EUROPEAN UNION

EU MISSIONS

ADAPTATION TO CLIMATE CHANGE

December 2023

EU Mission Adaptation Community

Summary of the event: How to access private funds for adaptation projects.

Tuesday 12th December 2023

1. Introduction

This report summarises the discussions on 12 December 2023 as part of the EU Mission Adaptation Community Event: “How to access private funds for adaptation projects”. The recording of the event is available through this link.

A total of 45 registrations were submitted for the online event.

35 participants attended the event, including:

- 19 representatives of Charter Signatories (15 Charter Signatories)
- 5 Mission Secretariat representative
- 4 MIP4Adapt team members
- 6 presenters from banks and regions
- 1 Bank representative

The objectives of the event were to:

- Introduce the three-events series on funding and financing and explain the role loans play in funding adaptation projects within the Mission.
- Introduce the key high-level factors to be considered to access debt financing, focusing on loans.
- Identify the requirements and criteria to be considered to access financing with public and private financial institutions.
- Identify the steps and documentation required to apply for loans successfully.

The full agenda can be found in the Annex. Box 1 summarises the main findings from the event.

Box 1. Main findings from the 'Nature-based Solutions as an Adaptation Option' event.

- Financing a climate adaptation project will often require the use of a combination of different funding and financing sources. EU and national grants offer non-refundable resources to of Some forms of financing other than non-refundable sources are important to cover certain costs and complement, as total costs of adaptation projects may exceed the EU/national grants' availability and coverage.
- It is important to explore how a project can generate revenue streams. In adaptation projects, avoided costs are a key benefit, which should be captured and translated into financial terms.
- Different sources of finance and funding can be combined. Loans may be the primary funding for regions and local authorities' adaptation projects, as they are the largest available amount of funding and are the simplest instrument to access for debt financing.
- Before providing a loan, financial institutions will assess the project, the technical capacity to implement an investment project, the economics of the investment project, the borrower and the authority backing it, the borrower's creditworthiness and the authority supporting them.
- Any project financed by the European Investment Bank (EIB) typically goes through seven major stages: proposal, appraisal, approval, signature, disbursement, monitoring and reporting, and repayment.
- The EIB finances projects in most sectors. Financing can be provided up to 50% of project investment costs (PICs) with specific exceptions. Loans usually start at EUR 25 M - sometimes the EIB can lend lower amounts. No standardised documentation is required, but sufficient information is needed to assess alignment with EIB lending objectives.
- Public-private partnerships (PPPs) involve transferring design, building, finance, and maintenance activities from a government Contracting Authority to the private sector, shifting associated risks. The private sector benefits from PPs by avoiding direct impact on their corporate balance sheet in case of project issues, leading to lower interest levels and reduced financial risk.
- From regions' experience working with EIB, good practices are: 1. involve the operation department early before requesting an EIB loan; 2. select potentially eligible projects that will meet deadlines and assess technical and financial issues; 3. the EIB must be considered not only as a bank but also as a project partner.

2. Summary of the event

The event offered participants a deeper understanding of the different types of funding and financing available and the role of loans in financing climate adaptation projects. In the first session, speakers from the European Investment Bank and NWB Bank gave insights into how the assessment process for accepting projects is performed and what factors are evaluated for grant finance. In a second session, the event offered first-hand experiences and examples of funding for adaptation projects for the City of Warsaw (Poland) and Bordeaux Métropole (France).

Introduction to debt financing of adaptation

Reminder of key concepts: Funding and financing

- Funding is the allocation of money without the obligation of repayment. The resources are provided free of charge by public or private bodies for specific purposes. No repayment is required. Funding sources include **grants, awards, donations, internal capital, and taxes**.
- Financing involves providing money for a project, with the recipient bearing the liability to repay the money. Some refundable sources of finance are loans, green bonds, private-public partnerships, privatisation (elements of a local authority delivery service to secure capital investment), equity (i.e. Private Equity from Venture Capital firms), and crowdfunding.
  - **Debt financing:** Provision of capital for a project with the liability to repay later. In this case, interests usually apply. Typically offered by financial institutions in the form of **loans, bonds and other financial instruments.**
  - **Equity financing:** When a company or an individual sells a portion of their ownership to raise money. It does not have to be repaid but gives the investors some control and ownership. Typically, dividends are paid.

<u>The role of grants and loans</u>

While non-refundable sources will be primarily needed, other forms of financing will be important to cover certain costs and complement EU and national grants. For instance, the total costs of adaptation projects may exceed the EU/national grants available, and some EU/national grants may only cover specific activities (i.e., the design and development of the project but not a feasibility study or monitoring).

Refundable sources will be needed to fund at least some project components. Grants can be combined with refundable sources, and receiving grants is likely to help increase confidence in the reliability and creditworthiness of the venture (project) in the eyes of (debt) finance providers, decrease risks for them and enable a mix of funding to be mobilised for most projects.

However, exploring how a project can generate revenue streams is still important. It won't always be possible, but it is important to remember. In adaptation projects, avoided costs are a key benefit, which should be captured and translated into financial terms, i.e. by identifying costs that would be incurred if the adaptation measure was not taken and who they benefit.

How funds can be combined and in which ways will be explored further in the third event of this series of financing adaptation projects.

Loans may be the primary funding for regions and local authorities' adaptation projects, as they are the largest available amount of funding and are the simplest instrument to access for debt financing. A public or private bank typically issues loans that need to be paid back over a period of time with <u>interest</u> for the use of the money. A concessional loan is granted on terms substantially more generous than market loans, either through below-market interest rates, by grace periods, or a combination of both; a <u>secured loan</u> is a form of debt where the borrower <u>pledges</u> some assets as collateral (i.e. a piece of land, a building). The key actors offering loans for public authorities are national and supra-national public banks, such as the European Investment Bank and NWB bank in the Netherlands, and commercial banks.

Before identifying potential sources of finance, it is important to note that institutional and legal frameworks and fiscal relationships between national and local authorities and their financial autonomy imply different contexts for borrowing across Europe. In many countries, local authorities have statutory borrowing limits; prior approval from regional supervisory authorities may be needed. Also, special rules may apply to public-sector entities, e.g., utilities.

Regions should consider that public and commercial banks must meet their own commercial interests and financial objectives: (A) financial profit and returns and (B) acceptable level of risk of projects invested in. Hence, before providing a loan, financial institutions will assess the project, the technical capacity to implement an investment project, the economics of the investment project, the borrower and the authority backing it, the borrower's creditworthiness and the authority backing them.

Regions should present well-thought-through projects for financing, making the case that projects will lead to climate resilience without significant financial risks and demonstrating that, if any, the risks are effectively managed. They should also demonstrate that the borrower is financially robust and has a credible guarantor and that repayments will be made as agreed, either through revenue streams generated by the project itself or via the borrower’s sources. Further, as public banks and international banks require a minimum project size to be able to issue loans with acceptable transaction costs, regions should consider options to combine small projects into larger schemes or programmes. The governance structure needs care to ensure that it is clear who is liable for repaying the loan.

Guest speakers from banks: European Investment Bank

Should regions wish to work with the EIB, loan requests will go through a seven-step cycle. The first step is the submission of a project proposal to the bank. The proposal will be assigned to a loan officer who will do the assessment and be the counterpart of the region at the bank throughout the project's entire life, with the support of a team of EIB experts. If the project is assessed as eligible, the second step consists of an appraisal, a more comprehensive assessment of the different dimensions of the project. In parallel, the project is submitted to various internal governing bodies of the bank for approval, the highest one being the Board of the bank. Once the EIB board approves the project, it gets the green light to receive financing. The next phase will be a negotiation phase, after which a contract will be developed and signed between the region and the bank. Once specific conditions are met, the disbursement of the project can start. This sets the start of the project implementation phase, which will be monitored until the seventh and last step: the repayment.

One key element for developing a project proposal is ensuring the adaptation project is eligible. There are a couple of activities that the Bank cannot finance, including illegal activities or activities like gambling or tobacco. This information is available on the Bank’s website. One key element is that the bank may not be able to finance the entire project, which means that regions should count on some internal funds or find co-financiers. The standard approach of the bank is to finance up to 50% of the project. Still, there is a specific rule derogating the 50% project investment cost for adaptation. So, if the project targets adaptation in more than 50% of the activities, then the bank's financing can go up to 75% of the project. There is one specific case under which the bank can finance 100% of the project, which is when the project is related to a post-disaster recovery operation.

Regarding ticket size, the EIB loan generally starts at 25 million Euros, but it can sometimes lend lower amounts to be assessed on a case-by-case basis. Note that if we are talking about the 50% rule, a loan of 25 million means that the project will have to be 50 million. There is no standardised documentation that is required. Still, the bank expects that sufficient information is provided to assess the merit of the operation: a comprehensive feasibility study, along with a detailed description of the capital investment, the prospective financing arrangement, as well as a detailed business plan.

Looking at the Second Step, the appraisal phase consists of comprehensive due diligence. Several dimensions will be assessed, starting with the financial profitability and the economic rate of return but also the environmental and social impact of the project (the project needs to be aligned with the Paris Agreement). This is also available on the Bank’s website. There will also be a technical assessment of the soundness of the project, alongside the procurement process, to check compliance with relevant legislation. Finally, the promoter's capacity is assessed to ensure it can implement the proposed project. In terms of duration, the appraisal process can last between six weeks and 18 months.

The Bank also provides regions with advisory services to develop and implement these projects, free of charge for public and private project promoters. The two Bank's mandates support those services.

The Bank usually lends senior unsecured framework loans, its main product for cities and regions. This is convenient as it only requires signing finance contracts and not signing security documents, except for Municipal utilities or public companies, where security is negotiated on a case-by-case basis. In recent years, there's been an increasing focus on climate change financing, with internal pressure to meet certain annual thresholds. EIB's business plan is tailored to deliver those targets.

Guest speakers from banks: NWB Bank

NWB Bank's clients from the public sector are increasingly focusing on sustainability and impact. Hence, the Bank is focusing on financing the public sector, trying to be a key player in financing the whole Dutch public sector. It is also focusing on responsibility and social return. The Bank acts as a commercial bank in many aspects, including the rating, the attraction of their funding on capital markets, and the clients. The main difference is that the Bank is a promotional Bank and is owned by the central and local government and focuses on the public sector, so it does not prioritise profit maximisation. The bank is trying to create an energy-positive loan portfolio by 2035, which means that from an asset perspective, it needs to finance many climate projects to achieve this target. The Bank is also closely linked to the Netherlands' government funding, which means that the interest it pays is relatively low compared to other commercial banks. Its mission is to provide funding to the Dutch public sector, with the side benefit of providing tailored financing at a very low cost, ultimately benefiting the taxpayer.

The Bank has different kinds of assets, one being the PPP (public-private partnership). A PPP involves a lot of entities, starting with a contracting authority. The Contracting Authority is the government; it can be local or central government, which transfers the design, building, finance and maintenance activities to the private sector. This means it typically transfers the risk on the balance sheets to another sector that is better equipped because it deals with this daily. Then, the Bank comes in to finance the project. There are different kinds of finance companies in this kind of contract because a lot of money is involved, such as commercial banks, EIB, and institutional investors like pension funds and insurance companies, all of which can provide long-term funding at quite a low-risk level. The main reason for transferring the risk from public to private is that governments get confident that the project will be primarily delivered on time and within budget. Cash flows can be unpredictable in these big projects, which the government compensates as a servicing fee to the project company, i.e. concession payments.

A final highlight is that within a project company and a PPP, cash flows will start at zero and, after 25 or 30 years, end up at zero, as they need to be financed both when they start and when they end. Why is this beneficial for all the entities mentioned? For the central government or the Contracting Authority, it is because they can hand over the risk to the private sector (e.g. construction companies), who are used to working with this type of project. This benefits construction companies because the project is outside their corporate balance sheet, and thus, it will not be impacted by any eventual failures. In addition, the greater capacity from both parts to leverage mitigation measures to cover for eventualities, reduces the risk of the investment, so interest levels of the cost of capital are lower than normal financing.

Guest speakers from regions: City of Warsaw

Warsaw has remarkable experience using loans from the European Investment Bank and European Union Grants. These two sources are complementary when financing investment projects in various areas. The European Investment Bank supports projects that promote priorities and objectives of the European Union where Warsaw is very active—sustainable cities and regions, development of transport infrastructure, investment in environmentally friendly projects, development of energy from natural resources, and projects with an impact on social cohesion, innovation, digital, and human capital. These areas are also in line with the Warsaw Strategy for Development, and that's why they started cooperation with the European Investment Bank a long time ago.

Since 1994, the City has signed 12 finance contracts with the European Investment Bank, totalling 8.6 billion PLN. Currently, Warsaw has two open credit lines. One is dedicated to financing Metro infrastructure; it will be active by 2025 with a volume of 1.9 billion PLN. The second is worth 200 million PLN, which will be dedicated to financing projects implemented in 2024. The municipal companies in the City of Warsaw's projects are the Metro company, a tram company, and a bus operating company: they draw the loans from EIB directly, and the total contract volume is around 3.5 billion PLN.
The City is very keen on drawing liabilities from the European Investment Bank. At the end of November, the total indebtedness in the European Investment Bank was at the level of 4.4 billion PLN, which is around 80% of the entire city's debt. The rest are loans from the Council of Europe Development Bank and funding from the local market.

The City of Warsaw highlights the key advantages of European Investment Bank (EIB) loans. These benefits include cost-effectiveness and alignment with the city's budget policy. The EIB offers long-term financing for up to 30 years with attractive rates, supported by its strong Triple-A rating. Flexibility is a key feature, allowing loans to be drawn in Euro or PLN, with the City securing favourable Euro financing during low-interest periods. Repayment terms are flexible, including one-off or instalment options, fixed or floating interest rates, and a 4 to 10-year revision period. The City values EIB's thorough evaluation of projects during feasibility studies, ensuring high quality and acceptance by reputable institutions. Additional advantages include the versatility to finance projects over multiple years, the option to draw loans in tranches, and the possibility to cover almost 100% of project costs, complementing grants from the European Union.

Guest speakers from regions: Bordeaux Métropole

Bordeaux Métropole is an administrative body in charge of a large territory experiencing rapid population growth. Because of this, it is adapting its skills to economic and ecological transition challenges and is also leading the necessary energy transition in its territory. Aware of these challenges, officials of Bordeaux Métropole have defined a framework and objectives included in a climate plan. The aim is to make Bordeaux an energy-positive and low-carbon territory by 2050. Bordeaux Métropole's climate plan, a multi-year investment plan, shows an amount of 1.5 billion Euros for the period 2023-2028, including nearly 750 million Euros for mobility projects.

The most important projects financed by the European Investment Bank include electric and zero-emission bus travel updates, express bicycle networks, tramway upgrades, pedestrian plans and electric river shutters. Bordeaux had to seek financing opportunities from the EIB because the traditional banking sector could not mobilise such an amount. Its programme matched very well with the conditions of the EIB financing. Moreover, the offers were attractive pricing, reflecting advantageous financing conditions; long financing terms adapted to the economic lifespan of each project, which sometimes exceeds 30 years. The last is the flexibility of financing methods, flexibility of drawing, amortisation, and indexation.

Bordeaux accessed financing from the EIB through the following process:

1. Inform the EIB management committee of the project financing opportunity and request approval.
2. The EIB technical team verified that the objectives of the Paris Agreement on climate change were considered. The EIB then sent Bordeaux a technical and economic questionnaire about the project to learn more, including the types of technology used, a legal analysis, and the side-economic and social impacts.
3. EIB evaluation of Bordeaux to discuss technical pending issues and financial queries.
4. Negotiations concluded with Bordeaux Métropole obtaining global funding estimated at EUR 220 million for EUR 486 million eligibility costs of mobility projects. Bordeaux Métropole's obligations towards EIB included transmitting financial ratios showing its solvency and submitting a project completion report showing the project contributed to the carbon neutrality objectives.
5. After approval of the project by the management committee and the board, the contract was signed.

The process took approximately one year to perform. Good practices to consider include involving the operation department early before requesting an EIB loan, selecting potentially eligible projects that will meet deadlines and assess technical and financial issues, and considering the EIB as a project partner, not just a bank.

3. Lessons learnt and outputs

During the Q&A session, participants were particularly interested in obtaining more information regarding funding sources, conditions of contracts and projects being financed for large projects, and repayment of loans, among other issues. A summary can be found in the Annex of this report.

A summary of lessons learnt is listed below:

- Regions should seek to identify the financial benefits and revenue streams from their adaptation projects to present good cases to access different sources of finance, like loans.
- When seeking finance, looking at the financial models and conditions required by each lender or funding institution is good practice. Assessing governance structures on a case-by-case basis and learning from successful models globally is essential.
- Collaboration with cities, regions, and public companies under a framework can effectively manage substantial financing needs.
- As a general consideration, the minimum loan amount from the EIB is 15 or 20 million Euros, with some exceptions.
- In Public-Private Partnerships (PPPs), cash flow predictability is achieved through fixed rates and predetermined contracts. Ensuring fixed cash flows over time is crucial in PPPs.
- Developing proposals for financing can vary in complexity and resource requirements. The preparation time and resource commitment depend on the project's scale, type, and the number of smaller projects bundled within a larger contract.

4. Next steps

During the event's closing remarks, participants were invited to join the following event: *Learning from each other: Identifying, assessing and selecting options"* (13 December). Moreover, the MIP4Adapt team invited participants to register on the Online Community of Practice, where they could still ask questions about the event through its forum.

For any queries from members of the Community of Practice on associated activities and events, specific concerns about your climate adaptation planning process, communications and press releases, and IT technical issues with the website, contact us via the Helpdesk form.

Annex

1. Agenda

Event Agenda
Welcome and opening remarks
Introduction to debt financing of adaptation
Q&A
Guest speakers from banks: European Investment Bank & NWB Bank
Q&A
Guest speakers from regions: City of Warsaw & Bordeaux Métropole
Q&A
Closing remarks (10 min)

2. Compilation of Q&A asked during the workshop

The answers to the questions compiled below were provided by the different speakers and EU Commission representatives.

Presentation by Guido Cocco

Have you considered or discussed the possibilities of providing private funding from banks, investment funds, and investors for carbon offset projects? Like afforestation, reforestation, and enhanced rock weathering to get carbon credits that could be sold on the voluntary carbon markets.

Everything is within scope, and the presentation aims to determine what works and doesn't. So, if something does work in terms of financing, then definitely. The idea is thinking about how it will work in practice. But we are talking about adaptation intervention, so if adaptation intervention involves planting trees and reforestation and if there is a way to identify financial benefits in terms of carbon offsetting, then absolutely.

On your point on bundling activities into larger investment programmes, are there models for more than one borrower? Projects like these are happening worldwide but without state or EU regulations.

There are certainly models. In most cases, this is done in a case-by-case manner. In this case, the best approach is to look at what has been done elsewhere. This has been done worldwide, and one must look at it on a case-by-case basis and assess how the governance structure was organised and how that worked in practice.

Do you know if the EU is considering establishing an EU body that could verify carbon offset projects?

There will be indeed a carbon removal certification scheme which will be recognised by the EC: Carbon Removal Certification - European Commission (europa.eu). However, the trilogue with the Parliament and the Council on the implementing modalities is still a work in progress. The related regulation is expected to enter into force in September but will typically require two years to become operational (i.e., by the end of 2026).

Presentation by the EIB and NWB Bank

The amounts EIB is financing in Poland are massive. Just to clarify, is the borrowing part solely for the individual region and city? Are they bundling programmes and projects together under large frameworks? Or are these simply individual projects above the 25m threshold?

Witold Szpak (EIB): To give you an impression, we are usually signing five to six large framework loans with Polish cities and regions, each of which can be 100-150 million euros. I recently signed a framework loan with a city of around 150 million euros, and we are also signing one or two loans with public companies, like wastewater, water utilities, or transport companies. So, on average, this is around eight loans to several entities. This, indeed, given the needs and the numbers, adds up to about 1 billion Euros. We can go below 25 million because we appraised several municipalities at once, simplifying the project. But the minimum loan amount is 15 or 20 million Euros, so in terms of volume, those are smaller amounts.

Could Leon repeat how the cash flow is made equal over time?

Leon Knoester (NWB Bank): That is basically because during, for example, the operational phase, you have to meet amortisation, so you have to pay the debt back, you have to pay interest, which is usually at a fixed rate, and you have to pay the cost for paying contracting companies. These are all set from the start. So, for example, there is a contract between a project and a construction company that pays these kinds of cash flows for a period of, let's say, 25-30 years. The construction company is at risk if there's any deviation, but the project does not pay for the deviation, so that's why it is so predictable and predetermined and at a fixed stream of cash flows.

Presentation by the City of Warsaw and Bordeaux Métropole

Did the regions need many resources to develop a suitable proposal to the banks? Resources and staff available sometimes are an obstacle.

Bogdan Klimaszewski (City of Warsaw): It depends on the volume and type of contract. If we take, for example, the contract for the extension of the metro line, it was not difficult because it was one project covered by the loan, and this project was established not only for financing from EIB but also for financing from European Union grants. But if the contract consists of many small projects, like this project for the sustainable development of Warsaw, there are around 540 projects to be evaluated by the European Investment Bank. Depending on the preparation of this project, there is availability depending on the volume to finance it, and it takes quite a long time and involves a lot of Human Resources to prepare it properly.

Jacques Fraval (Bordeaux Métropole): We have to make the link with the EIB and the project manager, and it takes quite a lot of time for the project manager to work and respond to the EIB, as well as patience. We worked with the EIB for one year. Perhaps other regions need less time, but in Bordeaux Metropole, we had to finance many projects with many managers and respond with answers to many technical questions.

Bogdan Klimaszewski (City of Warsaw): To add a few words on these sustainability projects because they are very largely diversified: these are projects in culture, in the health sector, in social affairs, in the construction of buildings, and so on. So, they require participation from the European funds departments and cooperation with the various bureau offices within the Warsaw office structure (municipality). This is time-consuming and requires a lot of staff.

These are large sums of funding, especially in the case of Warsaw; how do you plan to repay these loans? Maybe taxes, own funds or another type of revenue, etc.

Bogdan Klimaszewski (City of Warsaw): There are some legal restrictions because we have to fulfil the special requirements written in the Public Finance Act, that the loans should be extended to a longer period and the repayments should be quite equal and not negatively impact the budget. The other element is that a multi-year financial plan requires a forecast until 2050. In this forecast, the plan to finance our investment from debt is scheduled for only 2027. After that, there is a repayment. Of course, the plan will be moving and probably in the next year, there will be a plan to extend the investment plan to 2028/2029. But repayment is done mainly from the surpluses from other loans. Currently, we do not have the surpluses, but in an extended period, starting from 2010 to 2020, Warsaw will also have had significant surpluses: on the one hand, finance as part of the investment from the loan, and on the other hand, these loans were repaid from these surpluses.

Guido mentioned that the local institutional and legal framework needs to be considered. What did you take into account in Poland and France?

Jacques Fraval (Bordeaux Métropole): In France, we must make an ecological plan to respond to the Paris Agreement objectives for 2050 and be carbon neutral in 2050. All the projects are designed to reach those objectives.

Have you done any assessment of the impact of the funding received?

City of Warsaw: Assessment of the Warsaw Climate Adaptation Strategy (including financial and climate adaptation impact) is a subject of public procurement, which is about to be announced by the Air Protection and Climate Policy Department at the turn of the 1st and 2nd quarter of 2024, so at the moment we are not able to provide detailed and reliable data on this matter.

Luxembourg: Publications Office of the European Union, 2021

Publications Office of the European Union