

## A €120bn investment programme for the European Union's three-year Juncker Plan Massive financing of the energy transition in schools, hospitals and other public buildings

The SFTE<sup>1</sup> project aims to establish a broad partnership between public and private entities to stimulate the economy and deliver hundreds of billions of euros across Europe for the benefit of medium-sized projects (in the order of €1m) which are necessary for the energy transition. It will enable EU banks to finance the energy renovation of public buildings under excellent – cheap and long-term – conditions.

The SFTE project corresponds with the 2015 European 10-point agenda proposed by the Juncker Commission (12/11/14):

- "A new boost for jobs, growth and investment"
- "A resilient Energy Union with a forward-looking climate change policy"
- "A deeper and fairer internal market with a strengthened industrial base"
- "A deeper and fairer Economic and Monetary Union" (a globally unique green bond market)
- "A stronger global actor" (more energy independent; an exemplary shift project for COP21)

The SFTE project should serve to restore the confidence of European citizens in national and European institutions, all of them being users of public buildings. Regular dialogue between the European Parliament and the Commission about the SFTE project will be a catalyst for local decision-making by elected representatives.

The SFTE project is a strategic opportunity under the €300bn three-year investment programme announced by President Juncker. AFTER<sup>2</sup> has recently published proposals which, for the purpose of this note, have been adapted to the above investment programme, its constraints, and a direct economic stimulus by the EU<sup>3</sup>.

### I. Background and issues

#### 1. Prioritising the energy efficiency of public buildings as a quality investment

Since buildings represent 40% of energy consumption in Europe, they are a major segment of the energy transition, calling for hundreds of billions of euros of investment. Public buildings in particular (excluding social housing) are estimated to represent around 10% of the total surface area of the building stock. The SFTE project builds on the duty of European, national and local authorities to set an example and stimulate quality investment. In Europe, public buildings (schools, offices, hospitals and so on) are considered a largely untapped source of potential for financially sustainable renovation (entirely funded by energy savings as opposed to subsidies) of at least €120bn over the next three years, that is to say €100bn more than the current investment trend (BAU of €20bn or even less over the next three years). This untapped potential, which urgently needs to be more accurately assessed in the EU, is reason enough for action by public authorities, since:

- public finances are heavily constrained, and the situation is liable to deteriorate in most European countries, hindering public building retrofit projects and lowering the BAU trend;
- public accounting standards in the EU and member states (MSs) are a burden on these projects and their "conventional" financing mechanisms;
- existing project finance mechanisms remain ill-suited to these medium-sized operations;
- stimulating demand for renovation projects (currently in low demand and politically undervalued) calls for a clearly articulated long-term real estate strategy by MSs, and the key projects to realise that strategy;
- current financing capacities and regulations would be inadequate in the context of the proactive policy being proposed.

The SFTE's €120bn investment programme is based on financially long- or very long-term financially viable projects, with a 3% IRR objective.

#### 2. Support for EU objectives

Energy renovations in public buildings would help to attain several EU goals:

- exemplary reduction of CO2 emissions in the context of COP21, in accordance with European targets<sup>4</sup>;
- improvement of the EU's highly skewed energy trade balance;

<sup>1</sup> Société de Financement de la Transition Énergétique: Energy Shift Financing Agency (ESFA) in English.

<sup>2</sup> AFTER. Massive Financing of the Energy Transition. Feasibility Study: Summary Report. Energy Renovation of public buildings. November 2014. This feasibility study has been conducted by the AFTER non-profit association with an exemplary consortium of public and private stakeholders in France: local authorities, industry players, banks/financial institutions, NGOs, Plan Bâtiment Durable (Ministry of Ecology, Sustainable Development and Energy).

<sup>3</sup> The SFTE project aims to deliver between €180bn and €420bn of investment in Europe over 10 years.

<sup>4</sup> European Commission. [2020 climate and energy package](#) and [2030 framework for climate and energy policies](#).

- energy independence<sup>5</sup>: the EU28 imports more than 50% of the energy it consumes, and the Ukraine crisis is currently underlining Europe's vulnerability;
- investment which spurs the EU's competitiveness: fossil-fuel imports represent more than €1bn per day but energy savings would enable the EU to use these resources to generate more added value;

According to AFTER's economic estimates, investing €120bn over three years in public buildings would reduce their energy consumption by 10-15% and their CO2 emissions by the same percentage. AFTER's proposals respond to the need for the long-term financing of the European economy<sup>6</sup> and focus on the "real economy" without increasing the public debt, thus addressing today's market failures. They will improve the traceability of such financing to facilitate the safe and transparent monitoring of the scheme by public authorities.

### **3. Unrivalled socio-economic benefits**

Energy renovations bring key non-financial socio-economic benefits in addition to those previously mentioned:

- local job creation, in part through SMEs: with about 15 jobs per year per million euros invested (a €120bn programme of investment in public buildings would result in more than 600,000 additional jobs/1year over three years);
- the development of an industrial cluster of excellence which would boost EU exports to globally expanding energy efficiency markets, and which would also benefit strategic energy efficiency programmes geared towards residential buildings.

### **4. Three-year time frame**

It is estimated that €120bn of energy renovation work could potentially already be undertaken in a financially viable way in the EU<sup>7</sup>. While the level of readiness of member states may vary, operations could be launched in most EU MSs within a year. A dedicated task force will provide technical, legal and financial advice to some countries, so that operations could begin the following year.

### **5. Leverage potential**

The financial mechanisms proposed by AFTER are designed to maximise leverage potential, with private financial entities benefiting from the EU guarantee (see details below): (i) banks first; (ii) then institutional investors, following securitisation.

### **6. Scalability**

Between years 4 and 10, there will still be potential for around €60bn worth of additional BAU and financially viable projects. Moreover, according to the SFTE study, there should be an additional potential of €240bn of non-financially sustainable projects which could help to attain more ambitious energy consumption and CO2 emission reduction targets. Overall, for a €420bn investment over 10 years (i.e. €120bn over three years, and a further €60bn and €240bn in years 4 to 10), the energy consumption and CO2 emissions of public buildings would be reduced by 40%. In this case the minimum IRR would be slightly negative at -3%.

## **II. SFTE's technical proposal for an EU economic recovery plan**

### **1. Financial, industrial and political tools**

At the core of the scheme, the SFTE will provide a high-quality guarantee (counter-guaranteed by the European Union)<sup>8</sup> for dedicated loans by commercial banks. Given the intrinsic low-level risk of the SFTE project, the EU's guarantee will be a risk-sharing participation mechanism ("first-loss tranche" where the EU would bear 10% of the downside risks). The implementation of the scheme will be entrusted to the EIB by means of indirect management. The EU's guarantee (with the payment of a commission fee by banks) is necessary to improve the investment climate and enable the creation of a new market of green securitised assets. The level of the guarantee should decrease in the medium term, with the appraisal of the low-level intrinsic risk of operations by financial markets and rating agencies improving over time. Simple, transparent and safe securitisation will enable the refinancing of these very long-term loans – high-quality "green bond" infrastructure assets –, by the EIB and institutional investors.

### **2. Energy Performance Contracting (EPC) as a key public policy tool**

EPC is perfectly adapted to investment in the energy renovation of public buildings. It is based on a contractual commitment to achieve a given energy-efficiency target, subject to actual and systematic *ex post* monitoring. AFTER proposes several adaptations to EPC that will increase its integrity and serve to justify European and national investment through demanding impact assessments. Moreover, EPC benefits from strong European

<sup>5</sup> Energy consumption for heating in public buildings: 50% gas and 20% fuel oil (France).

<sup>6</sup> European Commission. [Communication on long term financing of the European economy](#). March 2014.

<sup>7</sup> Estimate based on France case study: €20bn of financially viable projects in 2014, for a €1bn BAU. Factor 6 multiplier for EU/France.

<sup>8</sup> See the PF4EE (Private Financing for Energy Efficiency instrument) initiative.

support ("EPC Campaign" of DG Energy, Energy Efficiency Directive, IEE, JRC work on the ESCOs market, EESI 2020, etc.). In a nutshell, AFTER's proposal represents a shift from tailor-made to standardised, ready-made EPC projects, for wide-scale use with the help of the EU guarantee.

### **3. A massive impact without increasing the public debt**

The programme will benefit from: (1) an off-balance sheet EU guarantee and (2) the funding of projects under EPC partnerships (PPP-EPCs) that transfer a significant level of risk to private operators or semi-public companies. Like other institutions in Europe with which it is in contact, AFTER is calling for technically limited changes to the European accounting framework so as to better adapt it to energy-efficiency improvement projects: the accounting treatment of PPP-EPCs outside the scope of public debt is paramount to bringing about a change of scale in Europe. On the basis of a 10% "first-loss" guarantee, the capped guarantee for +€100bn projects would amount to €10bn. Given that the intrinsically low-level risk being guaranteed primarily consists of the default risk of governments and local authorities, risk weighted asset (RWA) calculations should imply a very low level of equity for the SFTE.<sup>9</sup>

## **III. The SFTE's proposed quality investment programme for an EU economic recovery plan**

We have seen broad interest in our innovative proposals through our European contacts: the EIB, the European Commission (DGs ENER, CLIMA, MARKT, ECFIN and others), KfW, NGOs and so on.

The SFTE project calls for the rallying of public authorities in the EU and Member States. Their commitment is essential to improve public project management capacity, pool operations, promote economies of scale, standardise projects, and ultimately to significantly increase the volume of operations. According to the G20, "Governments should build public sector institutional capability in project development and implementation, and foster greater knowledge sharing and transparency across levels of government, jurisdictions, the private sector and other stakeholders."<sup>10</sup> In addition, energy saving performance commitments will provide for reliable and demanding public policy assessments. The programme should be widely publicised to make it easier for local elected representatives to politically promote their energy efficiency projects.

## **IV. EU NEXT STEPS**

The SFTE project now calls for the rallying of all stakeholders, especially from European and MS public authorities.

### **1. European Union**

- Public buildings to be selected as a quality investment programme for the EU
- Creation of a dedicated task-force by the Commission; technical assistance programmes to MSs
- Creation of a European knowledge-sharing platform: observatory network on energy expenses, renovations, EPCs, costs/savings, RFPs, energy-efficiency techniques, etc.
- Fine-tuning of the Eurostat methodology to enable an accurate treatment of PPP-EPCs
- Specific business plan and creation of the SFTE: bylaws, analysis of existing national state-guarantee mechanisms, potential shareholders, governance, team, regulator approval, etc.
- EIB intervention and balance sheet optimisation: loans, equity (SFTE and/or SPVs), expertise, etc.
- Calibration and assessment of the intrinsic risk profile of operations: National Central Banks & ECB

### **2. National public authorities**

- National public building guidance and appraisal strategy, and strengthening of public project development capacity
- Massive pipeline of projects selected and budgeted by national and local authorities, based on consumption track-records
- Project implementation (PPP tenders); and evaluation and audit of projects (especially in EPCs)

### **3. Industry players, SMEs, banks and institutional investors**

- Ramp-up of operations, productivity gains and development of a European industry
- Securitisation Funds pooling medium-sized energy efficiency projects for investors

**Website:** [www.projet-sfte.fr](http://www.projet-sfte.fr)

**Contacts:** [michel.lepetit@global-warning.fr](mailto:michel.lepetit@global-warning.fr) - [guillaume.emin@after-asso.org](mailto:guillaume.emin@after-asso.org) - [alain.grandjean@carbone4.com](mailto:alain.grandjean@carbone4.com)

<sup>9</sup> Without taking into account the first-loss guarantee mechanism, or the state/local authority building shares, a [2%-20%] RWA on 8% for €100bn of guaranteed risks would give a [€0.16bn - €1.6bn] target. €400m of capital for the SFTE should be an accurate estimate.

<sup>10</sup> G20. [A set of Leading Practices on Promoting and Prioritising Quality Investment](#). September 2014.