The European Investment Fund: Challenges and opportunities for Spain

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The rollout of the European Fund for Strategic Investments (EFSI), also known as the Juncker Plan, creates attractive investment opportunities for Spain. Taking advantage of these opportunities to support business projects, in collaboration with public authorities, can help boost growth and job creation.

In Europe, the crisis has had a significant, negative impact on investment, which over the medium-term could lead to decreased competitiveness and growth potential. Despite the region's economic recovery, investment remains well below pre-crisis levels, with some countries, such as Spain, particularly affected. Reduced public and private investment funding are hampering development of large-scale projects and growth and innovation efforts of SMEs. In response, the European Commission has launched the European Fund for Strategic Investments (EFSI), or the Juncker Plan, as a tool for reducing this output gap and increasing growth potential. The three pillar strategy is based upon: mobilisation of investment funding through the EFSI, creation of an investment-friendly environment; and, implementation of reforms to support investment in the real economy. The EFSI represents an important opportunity for European growth through allowing for the possibility to leverage private funds with contributions from national governments and European institutions, while allowing for project identification and ownership at the firm level. Spain should continue to take advantage of these facilities as part of its effort to change the economy's growth model and foster sustainable job creation.

The impact of the crisis on investment and loss of competitiveness in the medium-term

The economic crisis has led to job losses and has eroded income in the European Union, particularly along the periphery. Unquestionably, this has an impact on well-being in the short-term; however, it is also important to monitor the impact over a medium-term horizon. Indeed, the crisis has generated a significant investment gap, which undermines Europe's competitiveness and growth potential.

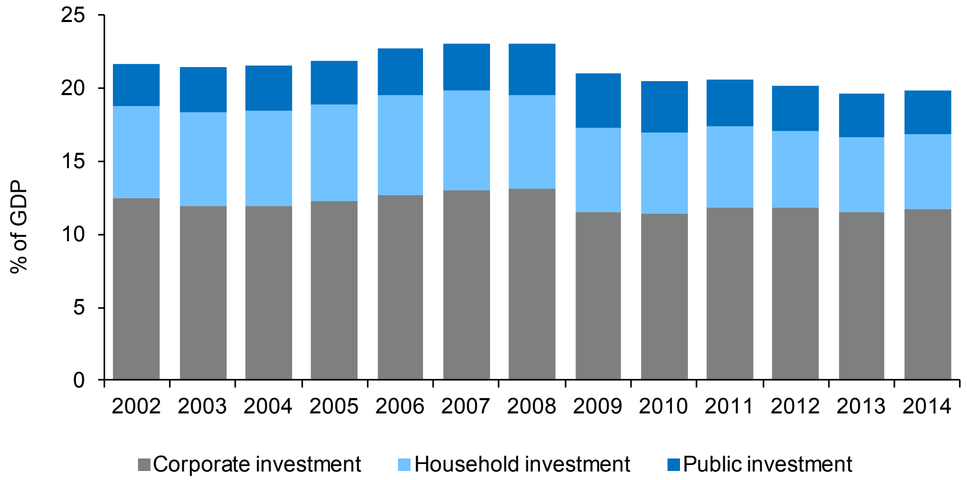
Despite the fact that the European economies are already staging a recovery, investment remains well below pre-crisis levels and the gap with respect to its potential remains very wide. Spain is the nation, in which investment has contracted the most relative to its closest peers (France and Germany). Between 2008 and 2014, investment has gone from representing 29% of gross domestic product to 20%. However, in Italy, the

[1] A.F.I. - Analistas Financieros Internacionales, S.A.

SEFO - Spanish Economic and Financial Outlook

Exhibit 1

Investment trends in the EU-28



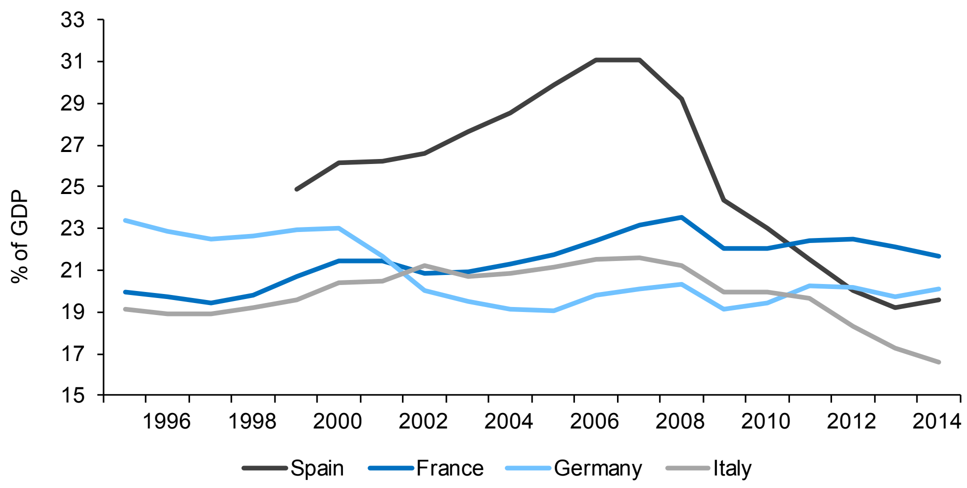
Source: Eurostat.

correction in gross capital formation has meant that investment as a percentage of GDP fell to an even lower 17% in 2014.

The drop in investment volumes has been driven by both the fiscal restrictions imposed, particularly in peripheral nations in an attempt to curb public deficits (public investment has corrected by over 20% in the EU-28 since 2009), as well as lower investment by households and companies due to weak demand, income stagnation and deleveraging.

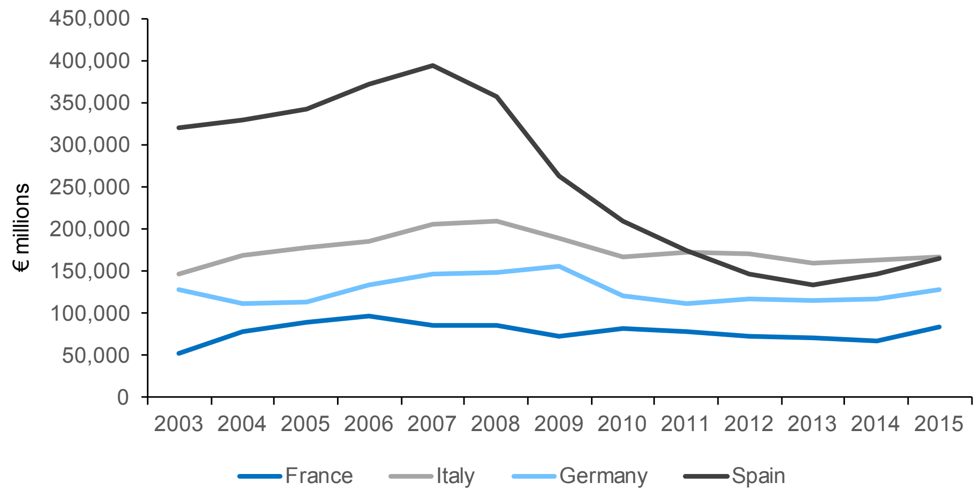
Exhibit 2

Investment trends in the main EU economies



Source: Eurostat.

Exhibit 3
New credit to SMEs



Source: ECB.

The lack of financing has hampered the development of large-scale projects (whether public or private) but has also eroded small and medium sized companies' ability to grow and innovate, given their dependence on bank financing. The European economy lacks alternative financing sources capable of channelling funds into higher-risk projects, in contrast to Anglo-Saxon markets where incentives for R&D, job creation and entrepreneurship are greater.

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Looking at the prospects for credit growth over a longer timeframe, we see that the volume of new loans granted to SMEs by banks, according to the data released by the European Central Bank (ECB), has been stagnant since 2010. Although this trend would appear to be reverting in recent months, marked by an increasingly-evident recovery in the granting of new loans, the burden borne by the banking sector by the provisioning effort and regulatory requirements is impeding more robust credit growth and therefore dragging down growth.

This dynamic, to the extent long-lasting, would jeopardise delivery of the targets of the Europe 2020 strategy for smart, sustainable and inclusive growth, which is why it is crucial to break, by stimulating demand in true Keynesian style, the vicious circle which could trap the eurozone economy if these conditions were to prove to be protracted.

EFSI structure: Main characteristics

Faced with this situation, in 2014, the President of the European Commission (EC) presented the outline of the roadmap for setting up a fund for stimulating investment and job creation to the European Parliament. This gave rise to the European Fund for Strategic Investments (EFSI), alternatively known as the Juncker Plan, an attempt to redirect the growth model and conceived of as a tool for delivering a sustained reduction in the output gap as well as an increase in growth potential.

With the aim of achieving these objectives, the Plan was articulated around three pillars:

- Creation of an investment fund (namely, the EFSI).
- Generation of an investment-friendly environment via the European Investment Advisory Hub and the European Investment Project Portal (EIPP).
- Implementation of regulatory reforms in a bid to support investment in the real economy and eliminate non-financial regulatory barriers in key sectors.

Mobilisation of financing for investments via the EFSI

The European Fund for Strategic Investments has been set up in collaboration with the EC and the European Investment Bank (EIB), the Plan's financial arm. The onus is on companies and other organisations looking to raise funding to present their projects to the EIB.

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The hope is that this public support will facilitate financing in the amount of 315 billion euros (or 2% of EU-28 GDP) over a three-year period, with two-thirds of this sum earmarked to infrastructure and large-scale investment projects and the remainder to SME funding.

As a result, the beneficiaries will be public and private borrowers, in the broadest sense, the following qualifying to apply for funding:

- ✓ entities of all sizes, including SMEs and mid-cap companies;
- ✓ national promotional banks or institutions or banks acting as financial intermediaries;
- ✓ equity/fixed income funds and any other form of collective investment undertaking;
- ✓ investment platforms; and,
- ✓ public-sector entities.

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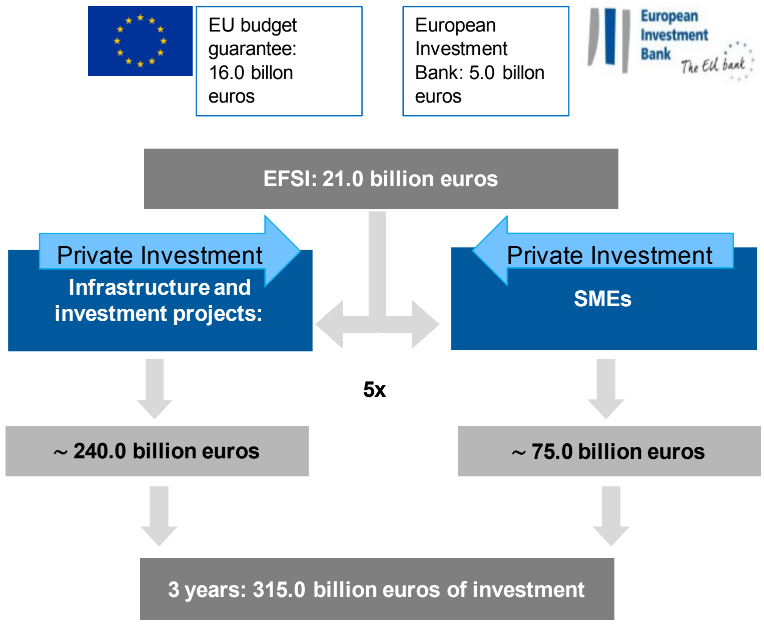
The idea is not, therefore, to have public investment substitute private market finance or products, but rather to act as a catalyst for collaborative projects that otherwise would not get funded by any private investor.

The funds will go to a large number of sectors, albeit emphasising those related to the Europe 2020 strategy: energy efficiency and independence; transport infrastructure; innovative transport equipment and technology, ICT-related projects and companies with fewer than 3,000 employees (particularly SMEs and small mid-cap companies).

Exhibit 4

EFSI financing scheme



Source: AFI, based on EC figures.

In terms of how the EFSI will invest in qualifying projects, the EC has sought to take a flexible approach, which can be tailored for the various projects' individual needs. The products for which support can be provided include:[2]

- EIB loans, guarantees, counter-guarantees, capital market instruments, any other form of funding or credit enhancement instrument, equity or quasi-equity participations, including in favour of national promotional banks or institutions, investment platforms or funds;
- EIB funding or guarantees to the EFSI enabling it to undertake loans, guarantees, counter-guarantees, any other form of credit enhancement instrument, capital market instruments and equity or quasi-equity participations, including in favour of national promotional banks or institutions, investment platforms or funds;
- EIB guarantees to national promotional banks or institutions, investment platforms or funds under a counter-guarantee of the EU guarantee.
- Lastly, the EFSI is also structured to contemplate the possibility of investing in European Long-Term Investment Funds[3] (ELTIFs).

Creation of an investment-friendly environment

For all the measures being championed under the scope of the current EC mandate to take effect,

[2] Instruments eligible for coverage by the EU guarantee in accordance with article 10 of EFSI Regulation (Regulation (EU) 2015/1017).

[3] Investment vehicles marketed to professional and retail investors in order to fund long-lived financial investments in unlisted European companies and long-term assets, such as real estate and infrastructure projects.

it is crucial to support Europe's companies and publicise the new financing channels put in place. To this end, the EC has created, again together with the EIB, the European Investment Advisory Hub, a platform managed by the EIB to provide access to a series of advisory and technical support programmes and initiatives.

In parallel, work is ongoing on the development of a portal – the European Investment Project Portal (EIPP) – which was slated to be up and running by the beginning of 2016. The portal will publish project details at the request of their developers with the aim of publicising them vis–à–vis potential investors.[4]

Support for investment in the real economy

The Commission has established the objectives of removing barriers to investment and creating a more favourable corporate financing environment. To overcome market failures, it is driving the creation of a Single Digital Market, Energy Union and Capital Markets Union.

All three projects constitute important initiatives for mitigating the fragmentation characterising the European market, which is often signalled by investors as one of the biggest obstacles to investing in the region. Against this backdrop, it is expected that the EFSI will be able to make progress on these aspects by financing cross-border projects and projects implemented by multiple countries in collaboration.

Potential impact for the Spanish economy

Although the cyclical upturn and the expansive monetary policy measures rolled out by the ECB have begun to fuel liquidity and credit supply, Spanish companies continue to call for institutional support to facilitate access to financing.

Since the EFSI has been set in motion, support totalling 5.7 billion euros for 42 projects has been unlocked for infrastructure & innovation, while backing for 84 transactions valued at 1.8 billion euros will be channelled towards SMEs. In both cases, the projects have attracted very significant sums of additional funds ('additionality') – these funds are expected to reach 50 billion euros in aggregate –, implying leverage ratios of 4x for the infrastructure and innovation arm and of 13x for SMEs.

Spain is filing an acceptable number of applications, ranking behind France, Italy and the UK.

Most of the support granted to infrastructure and innovation projects has gone to the energy sector and, to a lesser extent, to transport and RDI projects. In a nutshell, target sectors in terms of shaping a more productive growth model and boosting innovative sectors that strengthen European market union.

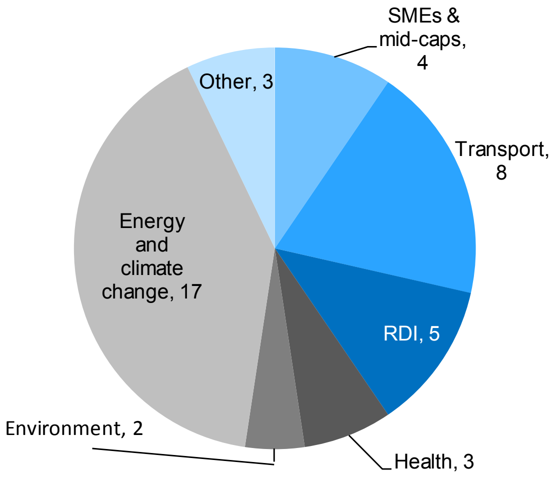
In Spain, the pace of applications is acceptable, albeit trailing that of France, Italy and the UK. Although the amount applied for in the infrastructure and innovation segment is similar to that requested by the above-listed countries, there is room for improvement in terms of applications by or on behalf of SMEs. Compared to funding deals for six infrastructure projects (for 515 million euros, expected to generate an aggregate investment volume of 1.6 billion euros), just three SME agreements have been entered into with financial intermediaries via the European Investment Fund (EIF) for 72 million euros (expected to generate ultimate investment of 731 million euros).

It is worth noting that there are no country quotas; this could lead to more competitive countries

[4] Publication of project details on this website does not guarantee receipt of EFSI funding.

Exhibit 5

Use of proceeds granted by the EFSI to February 2016



Source: EC.

taking up a disproportionate share of the financing, a development that would be counter-productive in term of fostering convergence across countries and regions. This should be taken into account in Spain, particularly with respect to the funding earmarked for SMEs given their small average size (53% of Spanish SME's have no employees and just 0.1% have more than 250).[5]

Lastly, recall that EFSI support can be complemented by other existing funds (whether or not derived from structural funds) devoted to stimulating corporate investment, particularly those targeted at small and medium-sized enterprises, such as:

- At the national level: The enterprise, entrepreneur and guarantee credit lines offered by Spain's public credit institution, ICO, (such as FOND-ICO Pyme, ICO Innovación Fondo Tecnológico and Línea JEREMIE) and the facilities granted by the Centre for the Development of Industrial Technology (CDTI) for research, development and innovation projects.
- At the community level: the SME Initiative (financing aimed at the provision of guarantees to financial intermediaries consisting of the provision of partial coverage of portfolios of loans extended to eligible SMEs), the InnovFin lines (with two tranches, depending on project size, which can take the form of loans or guarantees) and financing under the scope of the COSME programme for competitiveness of enterprises and SMEs.

Conclusions

There is a broad spectrum of facilities already on offer in the marketplace which complement the EFSI. Spain should take advantage of these facilities as part of its effort to change the economy's productive model and foster sustained job creation in the wake of the collapse of the real estate bubble. Although the scale of the so-called Juncker Plan is limited relative to the size of the European economy, it is probably the most ambitious initiative on the horizon in terms of breaking the pattern of sluggish growth. All the more so considering the fact that the budget restrictions imposed by the fiscal consolidation effort, still incomplete in most countries, will curb large-scale public investment.

Against this backdrop, the EFSI creates the chance to leverage private funding with contributions from national governments and European institutions, while allowing for project identification and ownership at the enterprise level. It is clear that this strategy marks a change in the role of public fund managers and calls for a welcome assessment, using impact and return criteria, of infrastructure projects so that they successfully draw investor interest.

The existing paradox, shaped by abundant liquidity in Europe coupled with investors' inability to identify sufficiently attractive projects (to justify reallocation of money held in risk-free assets

[5] The INE's *Central Company Directory* (DIRCE). Data as of January 1st, 2014.

carrying negative interest) must be reverted. In this context, the role of the public sector, in concert with the financial sector, should be redirected towards signalling priorities from an economic and social optic with a view to boosting productivity and social cohesion. From this perspective, it will be far more important for the authorities to facilitate project structuring in collaboration with the private sector by designing vehicles and platforms capable of channelling the interests of various investors as a function of the risk they are willing to assume than to devote funds directly to gross capital formation.

This is the chance to revitalise public-private partnerships by innovating, studying success stories and drawing lessons from the numerous experiences which have ultimately ended up frustrating private backers and government authorities alike. Particularly the latter, which have seen their debt burden increase (causing unanticipated imbalances) as a consequence of inaccurate demand estimates and/or ill-advised allocation of risks.The Plan is not targeted at member states' central governments, but rather at regional and local governments, together with enterprises, which must attract the interest of investors to fund projects with the capacity to stimulate the economy and creating stable, quality employment.