EUROPEAN CLIMATE, INFRASTRUCTURE AND
ENVIRONMENT EXECUTIVE AGENCY (CINEA)

CINEA.C - Green research and innovation
C.4 - Innovation Fund

Innovation Fund
Knowledge Sharing Workshop

Main Challenges in Reaching Financial Close and Ways to Tackle Them

15 September 2022, Brussels

Introduction

The first Innovation Fund (IF) Knowledge-sharing workshop was held on 15 September with IF beneficiaries. It was a closed-door hybrid workshop focused on the experience and knowledge gained with reaching financial close amongst IF projects. All 37 IF projects joined, counting in total about 100 participants, of which half attended physically and the other half joined remotely. The event was organised and attended by the European Climate, Infrastructure and Environment Executive Agency (CINEA) and the European Commission's DG Climate Action.

Discussions focussed on first experiences with reaching financial close for IF projects targeting decarbonisation objectives under the European Green Deal. In the Innovation Fund the Financial Close (FC) is defined as the moment in the project development cycle where all the project and financing agreements have been signed and all the required conditions contained in them have been met. It is thus a critical step in the project implementation that enables the start of the construction phase. At the time of the event, 6 projects had reached Financial Close and 8 more projects were expected to achieve this milestone by the end of 2022.

Main challenges identified by IF projects included securing financing due to the risk involved in such projects and the project operation under regulatory frameworks under development with high market uncertainty. Based on presentations by the projects and the ensuing discussion, the main takeaways and lessons learned are the following:

Securing Financing

- As is often the case with innovative projects, uncertain returns make it challenging to secure financing and in particular to find external investors. The majority of Innovation Fund projects are expected to be funded mostly with equity in combination with IF grants, while some also plan to get additional state-aid support (e.g. through national recovery and resilience plan funds).
- To secure financing within the company, projects need to strategically rank high in priority amongst other projects competing internally. IF project coordinators address this by continuous dialogue with the company representatives and by promoting the strategic value of the projects.
- For innovative projects, it is often a challenge to raise debt due to uncertainty of cash flows and the difficulty of dealing with the level of risk associated with technologies not yet tested at large-scale. Some companies find it beneficial to seek legal advice during contract negotiation with project counterparties as a way to improve the bankability of their project.
- Many businesses would like to improve their knowledge on how to obtain state/regional funds and blend public and private funding. Having an early and transparent dialogue with the relevant authorities is a first step to access state aid support, however projects sometimes find it difficult to know where to apply for funding support. Furthermore, participants indicated that more could be done to encourage the implementation of certain types of technologies at the regional level, for example to support the development of European value chains for the manufacturing of components for renewable energy technologies.
- IF grant support was essential for projects to secure internal support within the company and reach final investment decision.

Regulatory Framework and Permitting Process

- Many projects implementing innovative technologies, including renewable energy, energy storage and carbon capture and storage (CCS), operate in a regulatory framework which is still under development. Some provisions regulating these markets are still unclear or missing. In certain cases, the supporting infrastructure necessary for the implementation and integration of these technologies presents a bottleneck (e.g. grid availability, or cross-border transport and logistics for a CCS chain). Firm measures such as legislative updates and financial incentives are needed to further promote investment in renewable energy and other innovative green technologies.
- Continuous and early engagement with regulatory authorities to provide input to legislation has been helpful in creating the necessary conditions for such investments in specific sectors. For example, such conditions can include lifting existing barriers in connection with the ability to sell certain products or securing specific treatment of a particular technology within its specific industry.
- Obtaining necessary construction permits from local, regional and national authorities in a timely manner presents a key obstacle for projects to timely reach financial close. One identified way to tackle this is to start the permitting process way ahead of time and maintain continuous dialogue with relevant authorities.

Market Uncertainty

- The Covid-19 pandemic caused significant supply chain disruptions globally with delayed deliveries and shortage of goods and labour. Today the war in Ukraine and increasing energy prices are causing turmoil on markets and cause impact on the investments.

- Rising prices of raw materials/components, energy and transport have led to changes in the initial budget of projects and may call into question the overall business rationale to invest in certain innovative projects. To address this, projects needed to increase their planned budgets, ask for additional contribution from their shareholders, and renegotiate contracts with customers. The ability to adapt and planning sufficient contingencies ahead have been key measures identified, but may not be entirely sufficient to fill an increased funding gap. Such issues need to be also tackled by a strong and experienced team, clear governance, well-defined planning, and close monitoring of progress. Altogether these measures will help to maintain shareholder confidence that now is the right time to invest.
- Supply chain disruptions and longer lead times for the delivery of raw materials and equipment continue to pose obstacles for realising projects. IF projects have responded by anticipating orders and coordinating with suppliers as well as diversifying their portfolio of suppliers. To account for longer delivery time, some have had to renegotiate delivery schedules with buyers.
- On the up site, for some projects, the current risk in energy prices and tight supply of imported fossil fuels created a business opportunity as they strengthen their business models and thereby reinforce the rationale for accelerating project development.
- For some IF projects the initial budget from the application increased due to cost increases. To address this, project shareholders injected more equity financing, which required close collaboration with both stakeholders and partners.
- Similarly the timing of some projects was delayed as a result of the pandemic or the current energy crisis. To avoid this, it is useful to establish reasonable timeline buffers from the start. Some projects have found it beneficial to have more lead time to deal with a backlog of project documentation, such as permits, Final Investment Decision, construction contracts, feedstock supply contracts, and others.
- For robust project implementation, some IF projects needed to reinforce their project teams. Some highlighted the need to have a clear project governance structure within the company and involve the right colleagues at the right time.

Conclusions

According to a poll with responses from IF projects, major factors affecting projects reaching financial close include, in descending order of importance: contracting challenges with suppliers and buyers, increase in CAPEX, delays in the delivery of equipment, raw material or feedstock, permitting and government approvals, and technical challenges. Volatility in prices of commodities and materials has had a significant impact on projects.

Overall, IF projects have tackled issues by anticipating potential challenges and putting in place mitigation measures as well as reacting fast when circumstances change. For example, IF projects have increased contribution from shareholders, built sufficient time and cost buffers, and renegotiated contracts with suppliers and buyers to adapt to a rapidly changing market environment.

Going forward CINEA and the Commission will hold knowledge-sharing events also in smaller and more focused groups, ideally addressing specific sectors or cross-sector value chains. Discussions at these events will also address regulatory issues and permitting hurdles faced by the projects and serve as a forum for knowledge-exchange among the projects.