

Title: Assessing the potential use of financial instruments in the low carbon economy in Malta in the 2014/2020 programming period.

Contractor: European Investment Bank

Executive Summary of Final Report:

In recent years Malta has experienced **positive dynamics** through several factors:

- **GDP** is growing faster than the EU average and is expected to continue in the coming years;
- the number of **enterprises** has increased by 25% between 2011 and 2016, however the size of the enterprises remains very small;
- **the population** has increased significantly in the last decade and at the same time the percentage of the employed population has increased;
- households' average **income** has increased, however 16% of population still lives under the poverty threshold.

Looking at the **energy sector**, Malta reports one of the **lowest energy consumption per capita in Europe** (about 4.87MWh per year), however, overall consumption increased in the last years (+13% between 2011 and 2015).

Although the energy consumption level is low, Malta is supporting measures to diversify its energy sources¹ (as Malta is heavily dependent on fuel imports), supporting **renewable energies (RE)** and promoting energy **efficiency (EE)** initiatives.

Public intervention is often needed, as the energy sector (EE and RE) is affected by **market failure** and suboptimal investment situations, therefore the private sector may not always undertake the desired level of EE/REs investments without some form of public support².

Renewable energies

The production of **renewable energies** has sharply increased in recent years, however it still represents a small share of energy production (about 6% at the end of 2016), which is smaller than the EU average and still far from the 10% 2020 target.

PV systems have emerged as the most efficient RE technology, mainly due to Malta climatic conditions and they are strongly supported by the public sector (grants and Feed in Tariffs).

Since 2010 the number of installed **PV systems** and **capacity has sharply increased**, reaching about **93.4MWp in 2016**, with the residential sector representing about 55% of the total installed capacity.

Based on the **2015 - 2020 national plan for renewable energies**, PV installations are expected to continue to grow in future years.

From the analysis of national strategic plans, interviews with relevant stakeholders and surveys, during **2018 – 2023** (the investment period of a financial instrument) the need of about **102MWp new PV**

¹ Among the most relevant recent initiatives, the **Malta-Sicily interconnector** started operating in 2015, contributing to a sharp reduction of CO₂ emissions (-38% between 2015 and 2016)

² This is particularly visible when considering, for instance, that the PV market started to develop in Malta only after public support schemes became available (increasing financial viability of PV installations) and that EE initiatives are perceived as a non-priority by Maltese corporates and households

installed capacity has been estimated, leading to a potential investment requirement of about **EUR 170m**.

The **largest part** of this investment (about 70MWp) is expected to be undertaken by the **corporate sector** and on the ground installations (e.g. landfills, parking spaces, etc.) are expected to play a more relevant role.

Energy efficiency

In Malta, **the uptake of EE initiatives is much lower than RE**. This is due to both the lower intensity of public support given to EE, compared with RE, and Malta's peculiar conditions (e.g. mild weather, absence of a district heating system, etc.).

Despite this, based on the analysis of national strategic plans, available energy audits, interviews with relevant stakeholders and surveys, a **potential investment demand in EE of EUR 100m** for the coming years (2018 – 2023) has been estimated.

The **corporate sector** is expected to be the main contributor to this demand, through the development of EE initiatives to both improve **buildings and machineries**.

The **residential sector** is also expected to contribute with EE initiatives in **residential buildings** (both renovation of **existing** dwellings and EE in **new** units).

Although there is only limited information available, demand is also anticipated from the **public sector**, to implement EE initiatives on buildings (energy audits are ongoing) and for public infrastructures (e.g. street lighting system).

Financing gap

Based on the analysis of potential demand and supply (including also the public support schemes in place and households/enterprises own resources) the potential **financing gap** in EE and RE has been estimated in **about EUR 98m in the 2018 – 2023 period** (about EUR 16m per year).

The **gap could be larger in EE initiatives** (about EUR 69m), in particular in the corporate sector (about EUR 35m), but **also in RE** important gaps (about EUR 29m) emerged.

Market gap (2018 – 2023)		
	Total (EUR m)	Annual (EUR m)
RE	29	5
EE	69	12
Total	98	16

Lessons learnt

In this context, solutions to maximise the impact of public supports should be implemented and **financial instruments** (FIs) could help to **fill the financing gap** by:

- supporting the **credit system** to provide resources to EE/RE initiatives (e.g. reducing the risk of these transactions);
- helping **households and enterprises** offering better conditions to access finance for EE/RE.
- complementing other public support schemes, **reducing grant dependency of EE/RE initiatives** and therefore maximise the grant impact.

In order to properly implement a FI, lessons learnt in past initiatives have to be considered, including also the experience Malta has accumulated with other programmes (e.g. JEREMIE, InnovFin, SME Initiative, etc.).

Some **key lessons** have emerged, from the analysis of EE case studies undertaken as part of the ex-ante assessment:

- **activities to raise market and public awareness and proper communication**, are key;
- **coordination and cooperation** between the MA, Fund of Funds (if implemented), financial intermediaries and final recipients is crucial;
- **technical assistance** should be implemented, both in the preparatory phase and in the deployment phase;
- **grant and FI combination**, especially in EE initiatives, can increase the programme attractiveness, but at the same time it requires **strong cooperation between the MA and financial intermediaries**;
- previous and ongoing FI initiatives in Malta using **guarantee instruments** proved to be successful, in particular in increasing credit and improving its conditions to SMEs;
- as EE/RE operations tend to have a small size, **eligibility and monitoring procedures should be kept as simple as possible**, in order not to discourage financial intermediaries and final recipients to manage and apply for resources;
- the management of the **State aid** element is important, to promote EE initiatives in the corporate sector (that instead would concentrate investment and state aid only on RE).

Proposed FI strategy: sectors

There could be a **need to support EE/RE initiatives in all sectors**: residential, corporate and potentially also public sector, although there is currently only limited information available on the latter.

The majority of EE/RE initiatives are expected to be **small scale**, therefore the potential FI should offer **standardised and easy replicable products**.

In some cases the **combination of FI and grant** could improve the project financial viability, however a **careful co-ordination will be needed between the FI and grant providers**, to ensure that grant does not crowd out the FI.

In all sectors, public **mechanisms to support demand** should be implemented (besides FI and grant combination), these could be:

- **technical assistance** to increase public awareness (e.g. promotional activities, dedicated training courses for service providers, etc.);
- **technical support** for potential recipients (e.g. energy audits, business plans, etc.) to support the development of the project pipeline;
- introduction of **policy mechanisms** to require a certain level of EE/RE in new buildings or in renovations to be achieved.

Proposed FI strategy: products

Based on a comparative analysis of financial products, **portfolio guarantees** appear to be the most coherent option to support the EE/RE Maltese market, as they provide:

- risk mitigation;
- the possibility to have a standardized approach;

- no further liquidity (as this was reported not to be an issue by Maltese banks).

Portfolio guarantees are moreover, a well-known and appreciated product by Maltese banks.

From interviews with local banks, a preference for the **capped or uncapped** guarantee did not emerge.

This should be tested as part of the further soft **market testing** as part of the financial intermediary selection process.

Proposed FI strategy: set-up options

Several setup options are available (central instrument, off the shelf, tailor-made, combining ESIF and EFSI).

Some FI delivery mechanisms are already in place in Malta (e.g. SME Initiative, InnovFin) however, they are not recommended for this EE/RE FI.

The set up that appears to provide the most relevant advantages (e.g. 100% EU co-financing, crowd-in of third parties resources, etc.) is a **combination of ESIF with a contribution from EIB financial products under EFSI**.

It is moreover recommended to further explore the opportunity **to implement the EE/RE FI under the Smart Finance for Smart Buildings (SFSB) initiative**.

The “**Smart Finance for Smart Buildings**” initiative is part of the “Clean Energy for all Europeans” package announced by the European Commission on 30 November 2016. **Built upon existing EU financing strands**, the SFSB initiative aims at helping **unlock EUR 10bn of public and private funds by 2020** for energy efficiency (“EE”) in buildings for households and housing associations.

The SFSB financial instrument foresees a combination of (i) a **credit risk protection** mechanism with (ii) **technical assistance (TA)** and (iii) a **grant programme**.

This initiative is in line with the key recommendations for the setup of FI, however to meet the identified demand in Malta, it would be necessary to **expanding the scope of eligible initiatives for SFSB beyond residential EE** (e.g. EE/RE in commercial and public sector, communal solar PV, EE in machineries and production plants, etc.).

Proposed FI strategy: combination

Co-ordinated FI and grant combination in EE/RE initiatives is recommended.

Several types of grants can be used to combine FI, in particular: technical support, interest rate and guarantee fee subsidy, technical assistance and capital grants.

The combination can occur in **one operation** (at the level of FI) or in **two operations** (when FI is combined with capital grants).

To obtain the maximum from the FI and grant combination, a **coordination mechanism** between **public** (e.g. MA, REWS, Energy and Water Agency) **and private** stakeholders (e.g. financial intermediaries, potential recipients, etc.) is recommended.

Branding the FI, under **SFSB** could also allow for a **dedicated TA component** to potentially support both final recipients and financial intermediaries.

Proposed FI strategy: size

A portfolio guarantee is recommended (e.g. uncapped guarantee with an 80% guarantee rate – similar to the SME Initiative) with:

- an ESIF contribution between EUR 10m and 15m covering the FLP;
- an EFSI/EIB contribution covering the remaining part of the guarantee.

This instrument could generate a loan portfolio between EUR 40m and 60m with a leverage effect of 4X.



Proposed FI strategy: State aid

State aid will need to be addressed in the proposed implementation structure **at all levels** (i.e. Fund of Funds, financial intermediaries, private investor(s) and final recipients).

Based on information provided by Maltese authorities, **several aid regimes** and options are in place in Malta in the energy sector, in particular:

- De minimis (for the Feed-in Tariff and Renewable Energy in the Domestic Sector)
- GBER art.42 (for the Feed-in Tariff for PV smaller than 1MWp)
- GBER art. 40 (for investment Aid for High-Efficiency Cogeneration)
- GBER Art.38 (for investment Aid for Energy Efficiency Projects)

Although State aid is not an issue when final recipients are not undertakings (e.g. households – except for PV investments), based on interviews with local banks, Maltese enterprises are reported to potentially have an **aid cumulation problem**, as several grant measures are in place (in particular the FiT mechanism).

As an **ESIF and EFSI** combination is recommended, it should be noted that **EFSI is not considered State resources** and does not have to comply with State aid laws.

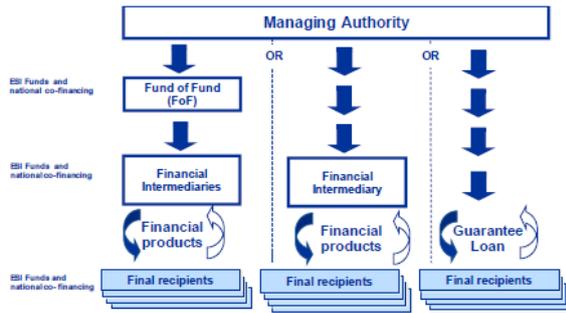
Proposed FI strategy: governance

Art.38 (1) of the CPR defines three options to implement a FI:

- FI created at EU level and managed directly or indirectly by the EC (while potential to contribute ESIF to central FIs is noted, its use is not recommend in the Maltese context for this FI);
- FI created and managed by the Managing Authority or under its responsibility;
- FI allowing for the combination of MA contribution with EIB financial products under EFSI (this opportunity is in the actual draft version of the Omnibus Regulation).

The MA has three options for managing FIs (as reported in the following figure):

- To invest in the capital of existing or newly created legal entities
- To assign execution tasks to mandated entities (e.g. a Fund-of-Funds)
- The MA to implement directly the FIs



Considering the **specific financial product** proposed (i.e. portfolio guarantee), it would seem desirable for the MA to **entrust tasks to a Fund of Funds** that can then offer the portfolio guarantee product to several financial intermediaries.

It is also recommended for the MA to mandate the **EIB Group to manage the FoF**, as this provides several opportunities:

- EIB Group is already mandated to manage the SME Initiative in Malta and it can generate **economies of scope and scale**;
- This management method can also allow for a **combination of ESIF and EIB resources backed by the EFSI guarantee** (as foreseen in Art.39a of the draft version of the Omnibus Regulation);
- It allows to rely on the **experience of the EIB Group and expertise** in the matter to facilitate the management of the FoF, in particular for the **Funding Agreement** and the underlying **Operating Agreements**;

The EIB group can **discuss with potential financial intermediaries** (candidates) to detail the FIs and determine their appetite to participate in calls for expressions of interest.