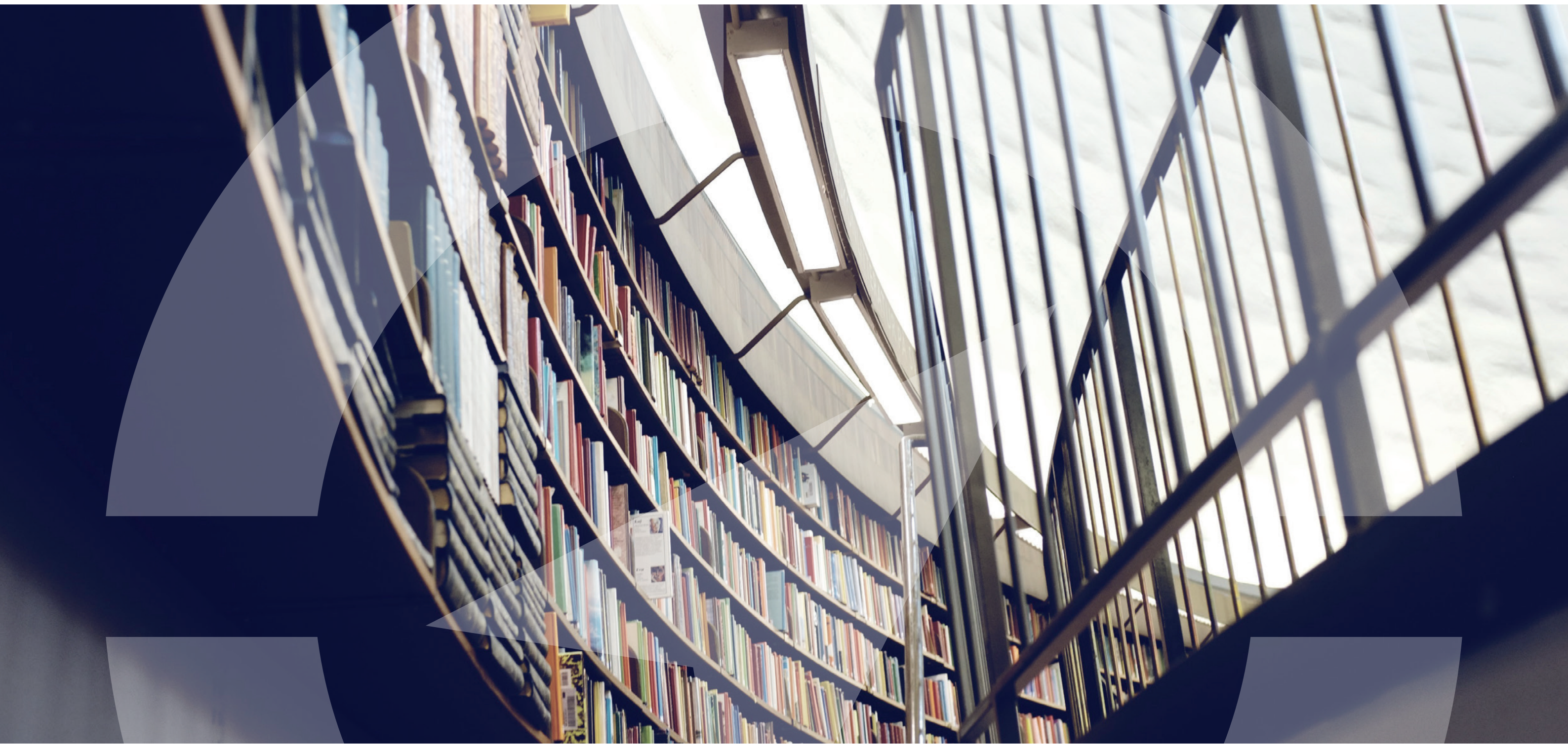

Ex-ante assessment methodology for financial instruments in the 2014-2020 programming period

Financial instruments for urban and territorial development

Volume V

European Commission

European Investment Bank The EU bank

Financial instruments for urban and territorial development

Please note that this version of the methodology reflects the current state of the Regulations as of April 2014.

The author reserves the right to update this document according to the evolution of the relevant regulatory framework.

Version 1.0 - May 2014

DISCLAIMER

This study was commissioned by the EIB, co-financed by DG REGIO and assigned to the consortium led by PwC."

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Glossary and definitions

ABER	Block exemption Regulation for Agriculture
CEB	Council of Europe Development Bank
CLLD	Community-led Local Development
Common Strategic Framework (CSF)	The framework which translates the objectives and targets of the EU strategy for smart, sustainable inclusive growth into key actions for the ESI Funds
CP	Cohesion Policy
CPR	Common Provisions Regulation
de minimis	See below under "State Aid"
DG REGIO	Directorate General for Regional and Urban Policy of the EC
EAFRD	European Agricultural Fund for Rural Development
EC	European Commission ('the Commission')
EE/RE	Energy Efficiency and Renewable Energy
EEEF	European Energy Efficiency Fund
EIB	European Investment Bank
EIF	European Investment Fund
EMFF	European Maritime and Fisheries Fund
ERDF	European Regional Development Fund
ESF	European Social Fund
ESI Funds	European Structural and Investment Funds for the programming period 2014-2020. This includes: European Regional Development Fund (ERDF), Cohesion Fund (CF), European Social Fund (ESF), European Agricultural Fund for Rural Development (EAFRD), and European Maritime and Fisheries Fund (EMFF)
ESIF Policies	Policies making use of the ESI Funds
EU	European Union
Ex-ante assessment	As in Article 37.2 of the CPR. MS/MA are required to conduct ex-ante assessments before supporting financial instruments, including: rationale/additionality against existing market gaps and demand/supply, potential private sector involvement, target final recipients, products and indicators
Ex-ante evaluation	Ex-ante evaluation required for Programmes in line with article 55 of the CPR
fi-compass	Platform for advisory services on ESIF financial instruments www.fi-compass.eu
Final Recipient	Legal or natural person that receives financial support from a financial instrument as described in Article 2 (12) of the CPR

Financial Instruments (FIs)	As in Article 2 (11) of the CPR, the definition on financial instruments as laid down in the Financial Regulation[1] shall apply mutatis mutandis to ESI Funds, except where otherwise provided in the CPR. In this context, Financial Instruments means Union measures of financial support provided on a complementary basis from the budget to address one or more specific policy objectives of the Union. Such instruments may take the form of equity or quasi-equity investments, loans or guarantees, or other risk-sharing instruments, and may, where appropriate, be combined with grants.
FRR	Fair rate of return for entrepreneurial activities in a certain sector in a certain country
Focus Area	EAFRD proposes 6 priorities with 18 focus areas, between 2 and 5 for each priority
Fund of funds (FoF)	Means a fund set up with the objective of contributing support from a Programme or Programmes to several financial instruments. Where financial instruments are implemented through a fund of funds, the body implementing the fund of funds shall be considered the only beneficiary in the meaning of Article 2 (27) of the CPR.
Funding agreement	Contract governing the terms and conditions for contribution from Programmes to financial instruments. This shall be established between a MA and the body that implements the FoF or the financial intermediary, between a FoF and the financial intermediary or between the MA and the financial instrument, as described in Article 38 (7) of the CPR.
GBER	General Block Exemption Regulation
GGE	Gross grant equivalent (NPV consideration for State aid purposes)
HA	Horizontal Assistance as foreseen in the proposed fi-compass
IFI	International Financial Institution
ITI	Integrated Territorial Investment
IRR	Internal Rate of Return
JEREMIE	Joint European Resources for Micro to Medium Enterprises
JESSICA	Joint European Support for Sustainable Investment in City Areas, EU technical assistance initiative in the 2007-2013 MFF to support financial instruments for urban development

1 *Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 (OJ L 298, 26.10.2012, p. 1).*

Leverage effect	According to Article 140 of the Financial Regulation and Article 223 of its Rules of Application "*Financial instruments shall aim at achieving a leverage effect of the Union contribution by mobilising a global investment exceeding the size of the Union contribution. The leverage effect of Union funds shall be equal to the amount of finance to eligible final recipients divided by the amount of the Union contribution*"
Managing Authority (MA)	Managing Authority, as defined in the Regulations regarding ESI Funds
MFF	Multi-annual Financial Framework of the EU (2007 - 2013, 2014-2020)
NPV	Net present value (of a cash flow)
Programme	Means 'Programme' as described in Article 2 (6) of the CPR
Other Revolving Instruments	Defined in the context of these ToR to refer to funds which are similar to the FEI/FIs, for the eligible sectors, but which are not established under Title IV of the CPR
SGEI	Service of General Economic Interest
SME	Small and medium-sized enterprises as per European Commission Recommendation 2003/361/EC
Specific Fund	A term used in the Summary Reports for 2011 and 2012. In the context of 'JESSICA type' of FEIs refers to an urban development fund (UDF); in the context of 'JEREMIE type' refers to loan, guarantee or equity/venture capital funds investing in enterprises.
State aid	'State Aid' means aid falling under Article 107 (1) of the Treaty, which shall be deemed for the purposes of this Regulation, to also include *de minimis* aid within the meaning of Commission Regulation (EC) No 1407/213 of 18 December 2013 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid[2], Commission Regulation (EC) No 1408/2013 of 18 December 2013 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid in the sector of agricultural production[3] and Commission Regulation (EC) No 875/2007 of 24 July 2007 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid in the fisheries sector and amending Regulation (EC) No 1860/2004[4].
Structural Funds (SFs)	EU Structural Funds for the programming periods 2007-2013 and 2014-2020 (ERDF and ESF)

2 OJ L 379, 28.12.2006, p. 5.

3 OJ L 337, 21.12.2007, p. 35.

4 OJ L 193, 25.7.2007, p. 6.

Sustaina-ble urban development	According to the article 7 of REGULATION (EU) No 1307/2013, the ERDF shall support, within operational programmes, sustainable urban development through strategies that set out integrated actions to tackle the economic, environmental, climate, demographic and social challenges affecting urban areas, while taking into account the need to promote urban-rural linkages.
Technical support	Grants for technical support, which are combined with a financial instrument (FI) in a single operation are provided for the preparation of the prospective investment (please refer to Article 37 (7), (9) of the CPR).
Thematic objectives	Objectives supported by each ESI Fund in accordance with its mission to contribute to the Union strategy for smart, sustainable and inclusive growth (see Article 9 of the CPR)
UDF	Urban Development Fund
Union priorities for rural development	For the EU rural development policy (EAFRD) 'Thematic Objectives' are translated into Union priorities for rural development as defined by Article 5 of Regulation EU (No) 1305/2013 (EAFRD). So, the term 'Thematic Objectives' will also cover the Union priorities for rural development.
Urban Regeneration / Development/ Transformation	A range of actions aimed at sustainable renewal, rehabilitation, redevelopment and/or development of city areas, which may include area-based and city-wide initiatives

Introduction

The *ex-ante* assessment methodology aims at providing guidance to Managing Authorities (MAs) in the preparation of the ex-ante assessment of financial instruments (FIs) foreseen in Programme(s), as required by Article 37.2 of the Common Provisions Regulation (CPR). The ex-ante assessment aims at ensuring that ESI Funds resources contributed to FIs are fully aligned with the objectives of ESI Funds and Programmes and are used in accordance with the principle of sound financial management, meaning in the most economic, efficient and effective way.

This document constitutes Volume V of the ex-ante assessment methodology dedicated to FIs for urban and territorial development. It also addresses specific aspects of place-based investment strategies that need to be taken into account in the ex-ante assessment.

This document should be used in conjunction with Volume I – Ex-ante assessment methodology[5]. Therefore the common descriptions and tools of the General Methodology are not repeated in full in this volume and for points where no particular specificities related to the territorial dimension arise, explanations are concise. In order to facilitate cross-referencing with Volume I, and possibly Volumes II-IV, where issues related to thematic objectives covered in those volumes may arise, this text follows the same structure as the other Volumes around the seven topics stated in Article 37.2 of the CPR, namely:

a) Analysis of market failures or suboptimal investment situations and the estimated level and scope of public investment needs;
b) Assessment of the value added of the FI, consistency with other forms of public intervention in the same market and possible State Aid implications;
c) Estimate of additional public and private resources to be potentially raised by the FI, including an assessment of the need for and extent of preferential remuneration;
d) Assessment of lessons learnt from similar instruments and ex ante assessments carried out in the past;
e) Proposed investment strategy, including an examination of combination with grant support as appropriate, options for implementation arrangements, financial products and target groups;
f) Specification of expected results including measurement of indicators;
g) Provisions allowing the ex-ante assessment to be reviewed and updated.

As a reminder, the MAs are not obliged to strictly follow the order described in Article 37.2. In addition, the ex-ante assessment is to be conceived as an iterative process rather than as a strictly sequential one. This means that MAs will often go back and forth in its elaboration and will have

5 *Ex-ante assessment methodology for Financial Instruments in the 2014 - 2020 programming period, Volume I*

to ensure the coherence of the whole assessment covering points (a) to (g) before it is finalised. It is also important to remember that the ex-ante assessment can be performed in stages, as foreseen by Article 37.2. For instance a first building block 'market assessment' covering topics (a) to (d) and a second building block 'implementation and delivery' from e. to g. could be performed in successive stages. Successive phases in the ex-ante assessment may also reflect developments of FIs after they are initially established – for instance MAs could consider starting with a mono-thematic approach to establishing a FI and at a later stage expand the ex-ante assessment to take into account a multi-thematic scope.

The methodological guidance encompasses five Volumes:

Volume I dedicated to the General Methodology covering all Thematic Objectives;
Volume II dedicated to Thematic Objective 1, namely: "Strengthening research, technological development and innovation";
Volume III dedicated to Thematic Objective 3, namely: "Enhancing the competitiveness of SME, including agriculture, microcredit and fisheries";
Volume IV dedicated to sectors related to Thematic Objective 4: "Supporting the shift to low-carbon economy";
Volume V dedicated to "Financial instruments for urban and territorial development".

1. Implementation arrangements for urban and territorial development

The urban dimension is a key part of the reformed Cohesion policy 2014-2020.[6] The target is to enhance the urban dimension of the policy by earmarking at least 5 % of resources under the ERDF for integrated actions in sustainable urban development, based on urban strategies. Sustainable urban development is defined in Article 7 of the ERDF Regulation, referring specifically to five urban challenges to be addressed through integrated actions. These are the "economic, environmental, climate, demographic and social challenges affecting urban areas, taking into account the need to promote urban-rural linkages".

Comprehensive and effective investment strategies in cities also include other spending. Thus, large scale projects and sector investment strategies – for instance in transport, energy, technology – should also be within the scope of territorial FIs. Successful strategies combine large scale projects such as infrastructure and urban regeneration, sector-focused schemes in industry and services, energy, water, human capital, information technology, as well as composite urban investment focused on specific areas within the city. [7]

Thus the path leading from the analysis of market failures and inadequate investment situations to the role of FIs in addressing these inadequacies and to the definition of the appropriate investment strategies for these instruments, must take into account the specific features of strategic investing in cities. In this context it is useful to preliminary clarify the notions of integrated investment, the appropriate spatial scale and the link with the 2014-2020 thematic objectives in Cohesion policy.

The "**integrated approach**" should not be seen as an end in itself or, even worse, a bureaucratic requirement, but an approach worth adopting in strategic urban planning and implementation. An integrated approach refers to "a system of interlinked actions which seeks to bring about a last-

6 *The Reform in 10 points, November 2013, see: http://europa.eu/rapid/press-release_MEMO-13-878_en.htm:*

Cohesion Policy will invest € 325 billion in Europe's regions and cities to deliver the EU-wide goals of growth and jobs, as well as tackling climate change and energy dependence. Taking into account the national contribution of member states, and the leverage effect of financial instruments, the overall impact is likely to be more than € 500 billion. The reform of Cohesion Policy will ensure maximum impact for the investments, adapted to individual needs of regions and cities.

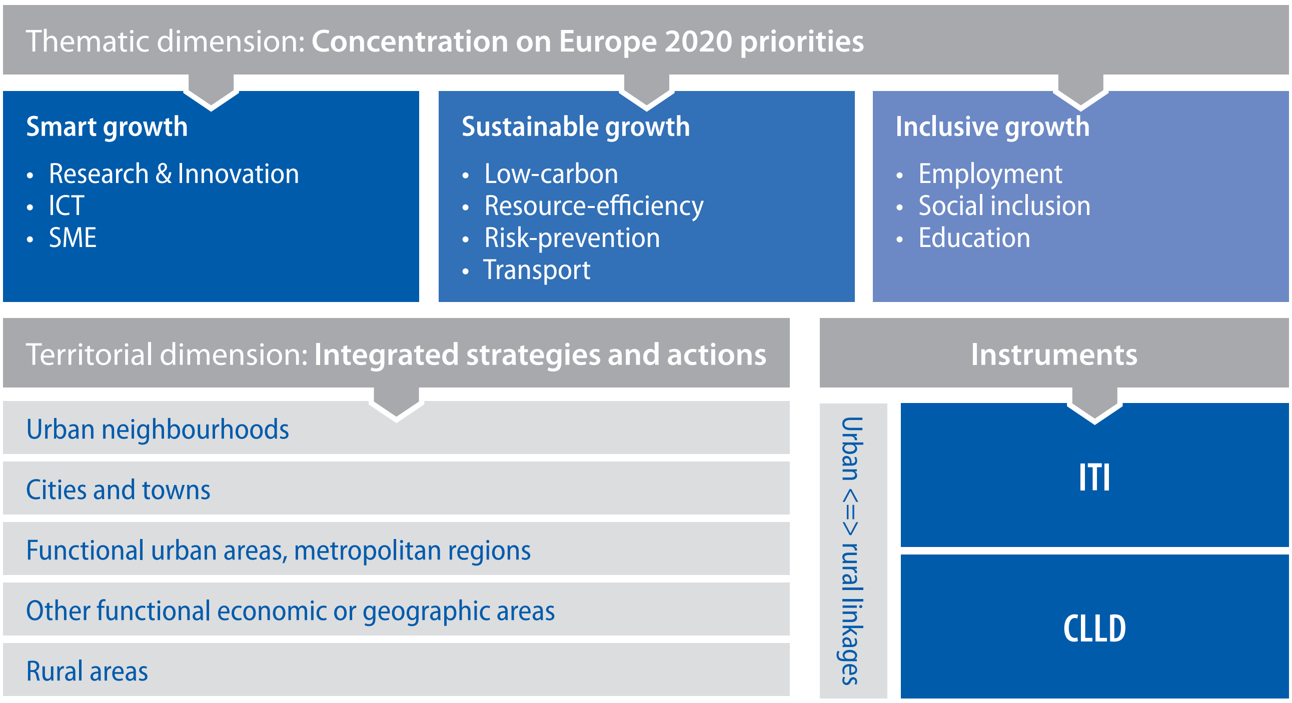
7 *See http://www.eib.org/infocentre/publications/all/shaping-sustainable-cities.htm.*

ing improvement in the economic, physical, social and environmental conditions of a city or an area within the city. The key to the process is "integration", meaning that all policies, projects and proposals are considered in relation to one another. In this regard, the synergies between the elements of the plan should be such that the impact of the plan as a whole adds up to more than would the sum of the individual parts if implemented in isolation."[8]

A second key concept related to the effectiveness of spatially focused instruments concerns the **appropriate spatial scale.** The definition of the spatial scale which is most appropriate for policy interventions, included those delivered through FIs, depends on specific territorial features of the jurisdiction under consideration, Cohesion policy objectives and the type of investment. Among the many examples, for investments related to the physical improvements of the urban fabric the appropriate scale can be localised, such as a district within a city (e.g. a deprived area) and its immediate vicinity, so the local positive externalities from physical improvements can be captured. For investment aimed at tackling unemployment, the relevant territorial scale may well be the travel-to-work area. Similarly, a strategy to reduce the carbon footprint of a city which can capture synergies between different measures is likely to be more effective at the scale of the entire urban area than an individual district.

Territorial strategies, including sustainable urban development, will have to **demonstrate their contribution to thematic objectives.** The diagram below provides an overall picture of the linkages between the thematic and the integrated territorial aspect in Cohesion policy 2014-2020:

Figure 1: Linkages between the thematic and the integrated territorial aspect in Cohesion policy 2014-2020



8 *Quoted from Jessica: A new way of using EU funding to promote sustainable investments and growth in urban areas. http://eib.europa.eu/attachments/thematic/jessica_2008_en.pdf.*

1.1.1 Sustainable Urban Development (Art. 7)

A specific article in the ERDF Regulation defines how ERDF shall support urban sustainable development, and links it to the requirement that at least 5% of ERDF resources under the investment and growth goal objective are dedicated to **sustainable urban development**. The Article states that strategies supporting sustainable urban development should "tackle the economic, environmental, climate, demographic and social challenges affecting urban areas". In this respect, some of the key features of sustainable urban development as envisaged in Article 7 concern the definition of target urban areas, the need to promote urban-rural linkages and the mechanisms to implement it. These are briefly illustrated below:

- **Definition of urban areas**. There is no definition determining which territories should be considered as "urban areas" either in the CPR or the ERDF Regulation. It is therefore up to Member States to define the appropriate level of territories to be considered as "urban areas" to fulfil the ERDF requirements. The urban areas selected need to have the critical mass required (in terms of population and organisational capacity) to design and implement integrated urban strategies in accordance with Article 7 ERDF; and the number of urban areas selected is proportionate to the amount allocated to sustainable urban development under Article 7 ERDF within the Member State.
- **Need to promote urban-rural linkages.** A truly integrated approach to urban development must go beyond intra-city policy coordination. As such, it should be clear in the urban strategies that integration with the surrounding areas of the urban authority, both urban and rural, has been considered. The benefits of stronger urban-rural cooperation include more efficient land use and planning, better provision of services (e.g. public transport, health) and better management of natural resources.
- **Selection of operations.** Cities, sub-regional or local bodies responsible for implementing sustainable urban strategies ("urban authorities") shall be responsible for tasks relating, at least, to the selection of operations in accordance with Article 123(6), or where appropriate, in accordance with Article 123(7) of the CPR.
- **Mechanisms.** Member States can choose between one or several ITIs, a specific priority axis or a specific operational programme in order to finance the integrated strategies required for Article 7. The choice may be influenced by the particular administrative set-up in the Member State or region. The existence of an integrated urban development strategy is a precondition for funding in any case.

It should be noted that the above requirements concern the programming by the managing authority, and do not have direct implications on the design of FIs. However, it is evident that FI for urban and territorial development while not necessarily bound by the same rules have to be designed so that they can operate effectively when supported by resources drawn from programmes which conform to the requirements of Article 7.

1.1.2 Integrated Territorial Investment (ITI)

Article 36 of the CPR introduces ITI as a territorial delivery mechanism that enables the implementation of a territorial strategy in an integrated manner for well-defined territorial areas[9]. According to the CPR, an ITI can be taken into consideration "where an urban development strategy or other territorial strategy … requires an integrated approach involving investments … under more than one priority axis of one or more operational programmes".

The key elements of an ITI are:

(i) a designated territory with an integrated (multi-sector) territorial development strategy constituting the basis for the implementation of the ITI; note that the strategy underpinning an ITI should be a single cohesive strategy;

(ii) an arrangement that draws on funds from at least two different priority axes or programmes and ensures that these funds are used in an integrated manner; and

(iii) specific opportunities for governance arrangements, notably the option for the Member State or the managing authority to designate intermediate bodies to manage and implement an ITI.

The CPR leaves flexible the territorial scale that can be addressed through an ITI.[10] This delivery tool may be used for sustainable urban development, but also beyond urban development to deliver TOs, the respective investment priorities or priority axis.

In any event when the use of an ITI is taken into consideration, the indicative financial amount of support has to be specified for each axis concerned in the description of the Programmes, except when used to implement ERDF Article 7 sustainable urban development.[11]

Delivery through an ITI is meant to address complex and interrelated challenges where a multi-sector development addressing several priorities and/or programmes is appropriate. The integrated combination of ESI Funds interventions, bringing together several funds and addressing several priorities, is possible[12].

The implementation of the instrument or some of the tasks of implementation and management (which may include the implementation and management of the FIs) can be delegated by the MA to intermediate (public) bodies, regional development bodies or Non-Government Organisations

9 *See Article 15.2(a) of CPR. ITI is an option for implementation. As explained in chapter 2, ITI is an arrangement for situations according to the CPR recital (33) the urban or territorial development strategy requires an integrated approach, if more than one priority axis of one or several Programmes are involved. Note however that an integrated strategy does not need to be implemented through an ITI.*

10 *See Article 152 (a) (i).*

11 *See Article 87 (3) (b) and (c)*

12 *See also Article 36 CPR*

(NGO). One example could be the upgrading of a housing area in a deprived district with a concentration of poverty and exclusion to a NGO where district developers of the municipality, the housing companies, local action groups and representatives of the civil society work and decide together. The physical and economic regeneration follows an integrated plan with flexible adaptations during the implementation, comprising e.g. classical investments in the social housing, upgrading of public space, improvement of public transport infrastructures and economic inclusion activities such as supporting local firms.

1.1.3 Community-led local development (CLLD)

A community-led local development approach[13] (CLLD) is a **bottom-up implementation** arrangement focused on targeted strategies for sub-regional areas.[14] A CLLD can also bring different sub-areas of two or more regions together developing a single target territory with a common purpose, for instance a biosphere reserve including marketing, visitors' centres, specific tourist facilities, adapted agriculture, development of the natural reserves and so on.

The CLLD is a delivery mechanism meant to bring about innovative solutions in respect to processes, decision making and participation, as well as identification of niches for economic activities.

CLLD is fundamentally a bottom-up approach. It is the local action group that determines the content of the local development strategy and the operations financed under it – including FIs such as microfinance schemes. By comparison, the ITI does not prejudge how decisions are taken on the investments – this process may be top-down, or bottom-up, or a combination of the two. As such, CLLD could, for example, be one component of a wider integrated urban strategy implemented through an ITI.

CLLD means a coherent set of operations to meet local objectives and needs, which contributes to meeting the Union strategy for smart, sustainable and inclusive growth, and which is designed and implemented by a local action group. It is based on the model of LEADER from EAFRD, but in 2014-2020 may be supported by all ESIF[15].

In case of multi-Fund strategies, there is the possibility to finance the running costs and organisation of the local development strategy through one single Fund (normally the Lead Fund).[16]

13 *The main features of a CLLD are similar to the LEADER principles and comprise the following five elements: (i) CLLD focus on sub-regional areas, (ii) CLLD are community led partnerships with a participatory approach, (iii) CLLD implement integrated multi-sectoral strategies, (iv) CLLD promote innovation with new ways of thinking and doing, (v) CLLD promote networking and cooperation. - See Common guidance of the EU Commission's directorates-general AGRI, EMPL, MARE and REGIO on community-led local development in ESIF (April 2013)*

14 *Criteria in respect to the area and the population will be laid down through a delegated act. For reference, the population coverage under LEADER aimed at a range from 10,000 to 150,000, URBAN II targeted districts with approximately 30,000 inhabitants.*

15 *See Article 32 CPR.*

16 *See Article 32 (4) of CPR. Further explanation in Common guidance of the EU Commission's directorates-general AGRI, EMPL, MARE and REGIO on community-led local development in ESIF (April 2013)*

Table 1: Example for a CLLD supported by different ESI Funds17

Programming of CLLD	Common Strategic Framework Thematic Objective	Fund specific priority
EAFRD	Promoting social inclusion and combating poverty	Focus Area 6b. Promoting local development in rural areas
ERDF	Promoting social inclusion and combating poverty	Investment priority 9d: Investments undertaken in the context of community-led local development strategies
ESF	Promoting social inclusion and combating poverty	Investment priority: community-led local development strategies
EMFF	Promoting employment and labour mobility	Union priority 4a: Increasing employment and territorial cohesion through the promotion of economic growth, social inclusion, creation of jobs and supporting labour mobility in coastal and inland communities depending on fishing and aquaculture. Also 4b: Diversification of fisheries activities into other sectors of the maritime economy and growth of the maritime economy including mitigation of climate change

To sum up, the following table provides a comparative summary of the key features of ITI and CLLD as implementation tools for territorial and local development strategies included in Programmes:

Table 2: Comparative summary of ITI and CLLD

ITI	CLLD
Urban development strategy or other **territorial strategy** or pact	**Bottom-up** integrated area-based strategy
Flexible – but generally top-down, public sector-led	Bottom-up, **community-led** (public, private, civil society)
Target areas of the principles by which strategies will be selected should be set out in Partnership Agreement	MS define selection criteria and target areas, selection of CLLD strategies through competitive procedure by responsible MA(s)
Any size as long as focused on a coherent functional geography	**Sub-regional** (10.000–150.000 inh.- except duly justified cases)
Single fund (ERDF, ESF or CF) or several funds (ERDF, ESF and/or CF complemented by EAFRD and/or EMFF)	Single fund or several funds (ERDF, ESF, EAFRD and/or EMFF)
Implementation by designated **intermediate body or MA**	Strategy & implementation by **local action group**
Optional	**Optional** (except for EAFRD)

17 See Common guidance of the EU Commission's directorates-general AGRI, EMPL, MARE and REGIO on community-led local development in ESIF (April 2013).

1.1.4 Consistency with Thematic Objectives and Programme strategy

The design and implementation of the FI needs to be fully consistent with the strategy of the applicable OPs. It can be anticipated that the areas where market outcomes are considered not aligned with policy objectives and where ESI Funds should have a role to play will have already been addressed in the Partnership Agreements and most likely in the OPs providing the resources to be allocated to the FI. This framework – which the ex-ante assessment will have to take as a starting point – will thus include a selection of TOs where OP resources will concentrate. The FI will have to operate within the constraints related to the thematic concentration, which means for instance that in the more developed regions the scope for basic infrastructure in their investment strategy will be more limited.[18]

As already mentioned, further specific aspects of the regulatory framework may be relevant for territorial FIs and their design and operation will need to be consistent with them. One refers to Article 7 of the ERDF Regulation and to this effect, the indicative allocation for integrated actions for sustainable urban development shall be set out in the Partnership Agreement and the indicative amount for ITI and specific priority axis or specific OP shall be set out in the respective OP.

By way of introduction on the logic of territorial investment strategies, the following conceptual steps should be borne in mind:

- The core concept is that the territorial investment strategy has to be aligned with the Programme from which the ESI Funds resources funding the FI will be drawn;
- The strategy – and, if known, the associated investment pipeline – needs to be mapped onto the 11 Thematic Objectives of ESIF policies for the 2014-2020 MFF. An important feature is that in 2014-2020 territorial investing is not a TO in itself, therefore it needs to be demonstrated that urban and territorial actions are an effective way to contribute to the achievement of the objectives;
- For each of the TOs relevant for the territorial strategy, market failures and inadequate investment situations that can be addressed effectively through a territorial strategy – for instance at city level – should be highlighted, as well as to what extent revenue-generating mechanisms capable of remunerating the FI can be put in place;
- Following the above analysis, the appropriate spatial scale[19] for operation and minimum critical size for the FI should be taken into consideration;

18 See Art. 18 of CPR and Art. 4 of ERDF Regulation

19 It is expected to see different levels of spatial orientation when FIs for urban and territorial development are set up. The narrower their territorial scope is, the more likely a multi-purpose approach should take place (e.g. upgrading of a deprived community with a housing component, a training strategy and better transport links). One reason for this is the design of multi-sectoral, multi-dimensional and integrated solutions to overcome societal challenges is by nature easier in smaller areas. On the other hand, rather specialised thematic FIs (e.g. low carbon or zero emissions bus fleets) are likely to be more effective if they are set up at a larger territorial scale. Thus the MA should consider implementation efficiency by choosing the spatial scale most appropriate to deliver the objective.

- The above conceptual steps should provide the background to go through the ex-ante assessment exercise as presented in Chapters 3 to 9 of this Volume and proceed in the most practical way with the design of the urban / territorial FI and its insertion into the structure of the relevant OPs.

It is important to make clear that there is a difference between the sectors or investment types that may be covered under the investment strategy of a FI for urban and territorial development and the Thematic Objectives covered in programming documents. Clearly both have to be closely coordinated, but the rules that apply to Member States and managing authorities in designing Programmes and investment priorities do not necessarily apply to the design of FIs, including those for urban and territorial development.

The CPR indicates that as a general rule it is expected that a programme priority ("priority axis") should cover one thematic objective, therefore a priority axis within a Programme should refer to a single TO. However the CPR also foresees that in specific, duly motivated circumstances a priority can be multi-thematic, as a derogation from the above principle. An urban or territorial axis would be such an example. Delivery mechanisms like ITI and CLLD are also designed to address multiple TOs.

There are no explicit conditions in CPR's Title IV on links between the scope of the FIs and TOs. Art. 37.1 reads "The ESI Funds may be used to support FIs under one or more programmes… in order to contribute to the achievement of specific objectives set out under a priority." Therefore, contributions from OPs to FIs can come from different priorities, provided that the FI keeps track of how the contributions from each priority are employed in order to achieve the priority's "specific objectives". What may change is the complexity of implementation and monitoring, in case this needs to be done for multiple priorities and TOs.

The ERDF Regulation contains further details which can assist in aligning the scope of FIs for urban and territorial development and "investment priorities" contained in programming documents. Art. 5 spells out investment priorities within the 11 Thematic Objectives set out in Art. 9 of the CPR. Some of the investment priorities indicated in Art. 5 and the corresponding TO are listed below:

- Supporting energy efficiency and renewable energy use in public infrastructures and in the housing sector (TO 4);
- Promoting low-carbon strategies for urban areas (TO 4);
- Promoting investment to ensure disaster resilience (TO 5);
- Supporting dedicated investment for adaptation to climate change (TO 5);
- Actions to improve the urban environment, including regeneration of brownfield sites and reduction of air pollution (TO 6);
- Promoting sustainable urban mobility (TO 7);
- Investment support for self-employment and business creation (TO 8);

- Investing in infrastructure for public employment services (TO 8);
- Investing in health and social infrastructure which contributes to local development and transition from institutional to community-based services (TO 9).

As an illustration, among the above listed investment priorities, those under TO6 include a wide range of investment types that cover a substantial number of projects funded by "urban regeneration" UDF in 2007-2013.[20]

In addition, a common key target for ESI Funds under the headlines 'social inclusion and combating poverty' is 'Supporting the physical and economic regeneration of deprived urban and rural communities (TO 9)'.

The EAFRD may address the target with 'basic services and village renewal' actions and by promoting LEADER local development strategies. The ERDF may target integrated plans to reduce the spatial concentration of poverty, for instance where social housing is accompanied by interventions in education and health including local sport facilities. The ESF may focus on interventions for employment including marginalized communities such as the Roma. This multi-fund strategy is supported by Article 11 of the CPR stating that (i) the integrated use of the ESI Funds is promoted and (ii) the means by which the funds are to address the key territorial challenges for urban, rural, coastal and fisheries areas shall be provided. So ERDF support for investment priorities may be complemented by resources from EAFRD or EMFF.

Summing up, one can find a broad scope for FI for urban and territorial development **within a single, or a limited number of investment priorities and thematic objectives**.[21] On the other hand, there is a **specific emphasis on integrated approaches**. MAs have the option to elaborate a specific priority axis for urban development to strengthen the integrated approach. As already explained, other options include a specific OP or undertaking investments through ITI.[22] The pro-

20 *For instance, from the point of view of the investment areas under TO6 for an urban development FI, investment priority (6) "preserving and protecting the environment and promoting resource efficiency" as presented in Art. 5 of the ERDF Regulation includes:*
"(a) investing in the waste sector to meet the requirements of the Union's environmental acquis and to address needs, identified by the Member States, for investment that goes beyond those requirements;
(b) investing in the water sector to meet the requirements of the Union's environmental acquis and to address needs, identified by the Member States, for investment that goes beyond those requirements;
(c) conserving, protecting, promoting and developing natural and cultural heritage;
….
(e) taking action to improve the urban environment, to revitalise cities, regenerate and decontaminate brownfield sites (including conversion areas), reduce air pollution and promote noise-reduction measures;
(f) promoting innovative technologies to improve environmental protection and resource efficiency in the waste sector, water sector and with regard to soil, or to reduce air pollution;
(g) supporting industrial transition towards a resource-efficient economy, promoting green growth, eco-innovation and environmental performance management in the public and private sectors."

21 *According to Article 7 the ERDF Regulation sustainable urban development shall be undertaken through ITI or through a specific OP or a specific priority axis. The consideration in this chapter is mainly based on the level of the investment priorities as a part of a specific TO. The same consideration holds at the level of the TOs with the OPs as well, as a specific OP for urban development is an option.*

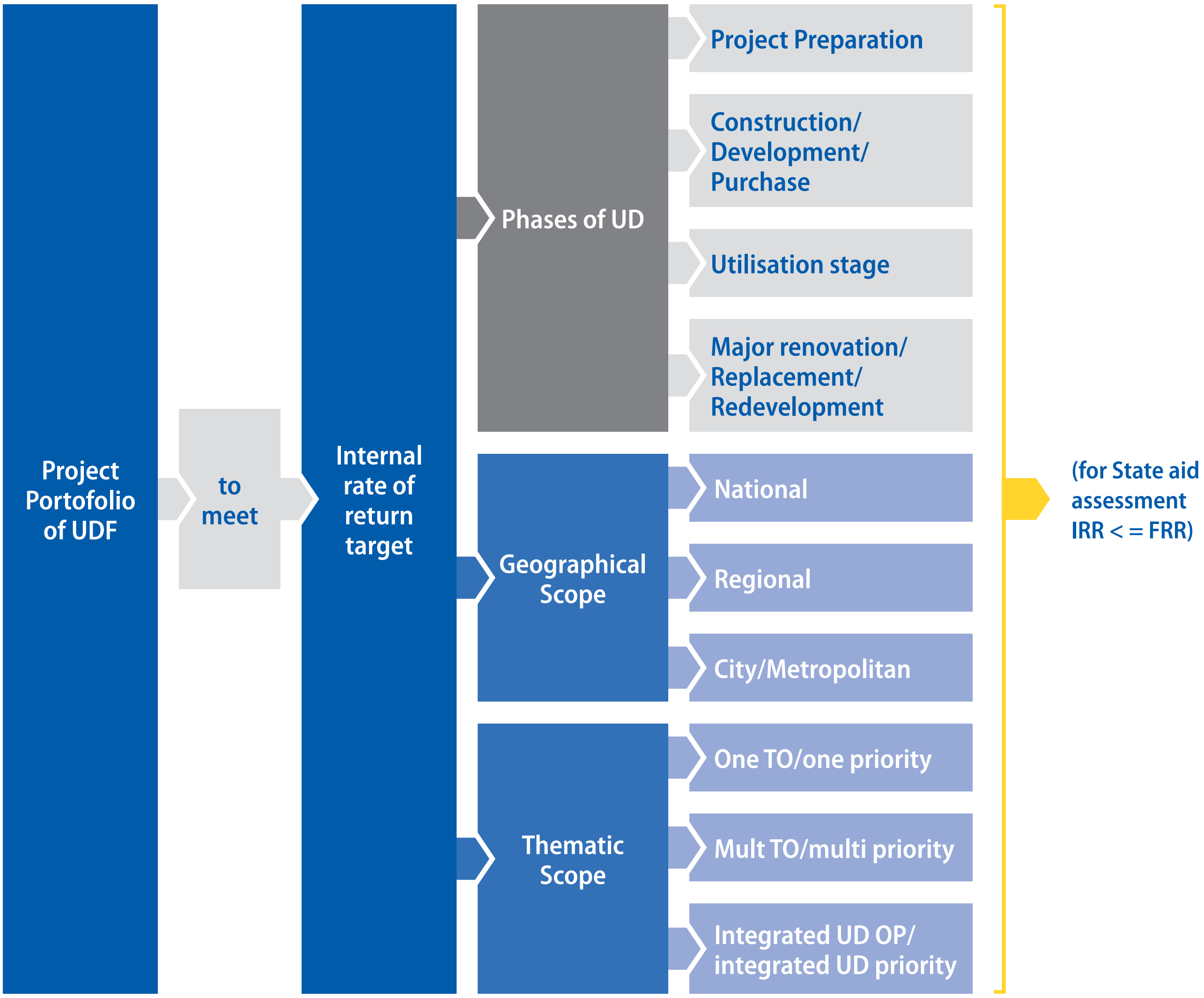
22 *In this respect an ITI could in practice operate like a small territorial OP, for instance at city level.*

vision under Article 7 of the ERDF Regulation that at least 5% of the resources are to be allocated at national level to integrated actions for sustainable urban development is another element to strengthen the integrated multi-thematic approach in programming documents.

As explained in more detail in Chapter 7, there is no mandatory requirement that FIs designed to promote urban and territorial development are supported by more than one thematic objective. However, it is likely that in order to address market failures prevailing in a spatial context in an integrated way, in many cases a FI will need to draw resources from a multi-thematic axis and multiple TOs.

Figure 12 below summarises the conceptual linkages between project phases, geographical scope and purpose / thematic scope of a FI for urban and territorial development.

Figure 2: Key Dimensions of a FI for urban and territorial development



Source: Adapted graph from EIB (2009), UDF Typologies and Governance Structures in the context of JESSICA implementation

See also Volume IV for a more detailed description of FIs supporting the shift towards a low-carbon economy.

2. Ex-ante assessment: preliminary considerations

2.1 Experience from 2007-2013

FIs for urban development have already been used in the 2007-2013 programming period together with those for energy efficiency in buildings and SMEs. However, the importance of the territorial approach goes beyond urban development and should be considered in every aspect of Cohesion policy implementation.

The JESSICA initiative,[23] supported by the Commission during the financial perspective 2007-2013, has been a major factor in fostering the development and use of FIs for urban development. As a result, several documents and publications contribute to a well-developed set of methods and instruments, which allow analysing the functioning of FIs for urban and territorial development.

Early general horizontal documents supported through the JESSICA initiative include:

- JESSICA – UDF Typologies and Governance Structures in the context of JESSICA implementation (November 2010)[24];
- JESSICA – Holding Fund Handbook (November 2010)[25];
- JESSICA – UDF Handbook (July 2012).[26]

These documents constitute useful general references for the development of the methodology presented in this Volume. They, however, are to be used with some caution since some of them do not incorporate lessons learnt from experience and interpretative notes approved after their publication and they reflect the requirements of the 2007-2013 programming period, which are in many ways different from those in 2014-2020.

23 *A non exhaustive list of the types of projects promoted through JESSICA under 2007-2013 MFF includes: (i) investment in education and healthcare facilities, (ii) renewable energy in urban areas, (iiii) investments in socially deprived areas, (iv) energy efficiency projects, (v) enhancement of competitiveness of urban areas, (vi) urban infrastructure and (vii) regeneration of brownfield sites.*

24 *See http://www.eib.europa.eu/attachments/documents/jessica_horizontal_evaluation_study_udf_en.pdf*

25 *See http://www.eib.org/attachments/documents/jessica_holding_fund_handbook_en.pdf*

26 *See http://ec.europa.eu/regional_policy/thefunds/instruments/doc/jessica/jessica_udf_handbook_final_report_120712_en.pdf*

Other sources have been used and can be more relevant than the ones above for practical purposes, namely:

- Further horizontal studies focusing on specific themes such as energy and housing in operations promoted by the JESSICA initiative;
- Documents prepared by the European Commission on State Aid;[27]
- Evaluation studies carried out under the JESSICA initiative, including the most recent ones focusing on the 2014-2020 period[28]. The latter are not ex-ante assessments, but do provide substantial analysis that can be used as part of the assessment in the regions concerned, and are a useful example for other MS and regions;
- Published calls[29] to select UDF managers under the 2007-2013 programming period, which could give useful indications on the criteria to select them and how investment strategies are to be linked to Programme objectives and priority axes.

Under the wider territorial dimension which can be addressed also through FIs, investment strategies may target a city, a district of a city or a small town, a village, as well as many cities, rural territories or specific territories or bands of territory. Therefore, this document does not make distinctions based on the legal status of the entities leading the territorial policy or the spatial scale associated to the strategy.

FIs for urban and territorial development can build on the existence and the experience of Urban Development Funds (UDFs) as developed in the 2007-2013 cycle. Urban development has been traditionally supported under Cohesion policy through multi-sector grant tools or direct public budget intervention addressing a broad variety of targets in a specific area, e.g. developing a new suburb in an integrated way including the development of the technical and social infrastructure and the public space. This approach was extended by foreseeing the establishment of financial engineering instruments for urban development promoted by the JESSICA initiative in 2007-2013 and further extended under the 2014-2020 regulatory framework. In 2014-2020 investment can cover all the types of investment that help to implement a successful urban development strategy in metropolitan areas such as human capital, technology/ smart cities, public transport systems and the like.

27 On State Aid see Competition Policy Newsletter: First JESSICA decisions - approach and implications, Number 3 / 2011 http://ec.europa.eu/competition/publications/cpn/2011_3_8_en.pdf

28 Over 50 JESSICA Evaluation Studies have been published – see http://www.eib.org/products/jessica/studies/evaluation.htm and http://ec.europa.eu/regional_policy/thefunds/instruments/jessica_evaluations_en.cfm

29 See http://www.eib.org/products/jessica/eoi/.

2.2 Rationale for FIs supporting urban and territorial development

The CPR emphasises the enriched scope for FIs with spatial orientation in 2014-2020 and allows for a broader use of FIs covering all TOs. Consequently, spatially oriented strategies and instruments may become one of the ways to pursue all TOs and, where appropriate, support schemes may be set up as FIs. UDFs[30] invest in urban projects by way of equity, quasi-equity, loans and guarantees structured in different forms and their investment strategies can be designed on the basis of both area-based and sector-driven approaches and use a combination of public and private investment. In 2014-2020 instruments of this type can be supported by ESI Funds resources, possibly in combination with grant funding[31] and in a more flexible way compared to the previous period. The main features for FIs for urban and territorial development in 2014-2020 can be described in a non-exhaustive list as follows:

- The projects can be structured in different forms, such as public-private partnerships, fully private and fully public investments, without specific stipulations concerning the legal status of final recipients;
- The CPR gives a particular emphasis to the integrated approach for the implementation of territorial strategies[32]. The group of actions targeted by the envisaged FI could be included in an integrated strategy compliant with Art. 7 of the ERDF Regulation, a suitable sector strategy for the targeted territory or a priority axis or an investment priority;
- The fund could operate with a specific territorial focus – city, urban area, or another defined territory – if such a FI is deemed to be more effective in delivering Cohesion policy objectives compared to instruments that are not spatially focused. Otherwise, investments may be addressed as a part of the investment priorities or priority axis within a Programme;
- The envisaged FI could be a fund, but other forms to deliver Programme objectives are possible as well, e.g. direct loans or guarantees by the MA;
- Irrespective of the structure of the FI and the financial product used (loan, guarantee, equity, quasi-equity finance) the FI aims at obtaining repayment. However, the level of envisaged revenues and repayment can be below commercial terms;

30 UDFs are defined in the GBER II (to enter into force on 1 July 2014) as a specialised investment vehicle set up for the purpose of investing in urban development projects under an urban development aid measure.

31 Which is explicitly mentioned in CPR (38) "It could be justified where certain parts of an investment do not generate sufficient direct financial returns, to combine financial instruments with grant support, to the extent allowed under the applicable State aid rules, in order for the projects to be economically sustainable. Specific conditions preventing double financing in such a case should be set out.." See also Article 37.2 (e) "The proposed investment strategy, including an examination of options for implementation arrangements within the meaning of Article 38, financial products to be offered, final recipients targeted, envisaged combination with grant support as appropriate."

32 The multi-sector approach and multi-purpose investment schemes could be considered particularly suitable for spatially focused financial instruments. However, single sector (single purpose) instruments are possible and may be effective e.g. a UDF to develop the public transport system in order to shift the modal split away from the private car.

- The fund concept includes a revolving approach, i.e. the prospect of reinvesting revenues and repayments in the future. In certain cases, the FI may be able to revolve only part of the original investment. Even in this case such a revolving scheme may exploit the opportunities offered by ESI Funds better than a grant scheme;
- One special feature is the potential use of contributions in kind to provide resources alternative to cash to capitalise FIs for urban and territorial development. Although contributions in kind are not normally eligible expenditure in respect of FIs, contributions of land or real estate for urban regeneration, urban development and rural development are allowed, where such contributions form part of the investment portfolio.[33]

The new territorial cohesion objective introduced by the Lisbon Treaty acknowledges that economic and social cohesion cannot be achieved at the European level without a stronger focus on the territorial dimension of EU policies. For this reason the CPR introduces several innovative provisions to support territorial strategies and sustainable urban development by community-led local development[34] (CLLD) and integrated territorial investment[35] (ITI). As already explained, ITI and CLLD are delivery mechanisms designed to facilitate the design and delivery of actions with a strong territorial and/or local development content.

In the context of urban and territorial development it may be useful to classify potential projects of the FI portfolio in phases, which may be characterised by different risk profiles. For instance, in the case of physical regeneration schemes the phases could concern:

- Project preparation;
- Construction, purchase, development;
- Utilisation Stage;
- Major renovation, replacement or redevelopment.

Under this classification, investment to support sustainable urban mobility could possibly be classified under 'utilisation stage', whereas 'regeneration of brownfield sites' could be considered as 'redevelopment'. The utilisation of geothermal energy for public buildings could start with 'preparation' in form of securing the access to the geothermal sources; or if an old an outdated system is replaced and modernised, 'replacement' would be the right phase.

As shown later in chapter 7, the investment in the different phases of the life-cycle of urban development projects correlates with different risk levels.

The general scope of FI covering all TOs is described in chapter 2 of the General Methodology.

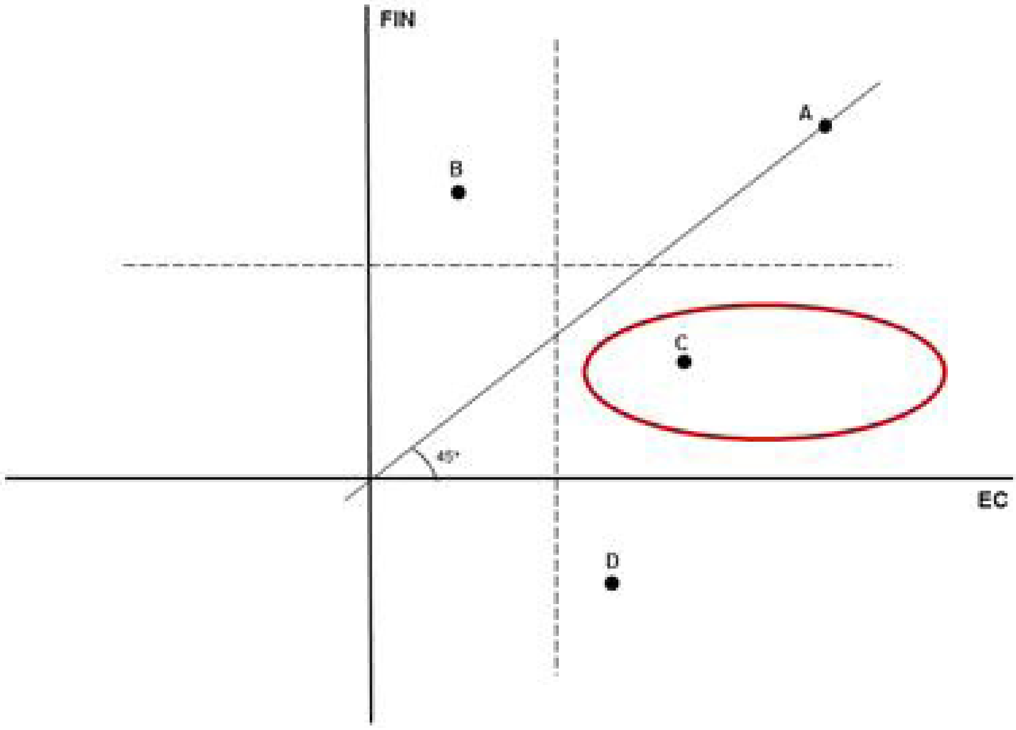
33 Article 37(10), 38(9) CPR. and Article 69 (1) of CPR. See also section 5.1.2 of the General Methodology (Volume 1).

34 of CPR.

35

In addition to the 11 TOs, territorial investment has been added as a specific topic for the ex-ante assessment methodology, due both to the centrality of the territorial dimension in 2014-2020 and to the fact that specific Programmes or priority axes for urban and territorial development could be established.[36] However, it should be understood that FIs for urban and territorial development could be envisaged for all the TOs where a place-based strategy or investment in cities can contribute to the successful achievement of Programme objectives.

Figure 3: Simple conceptual illustration of the investment focus of FIs for urban and territorial development



The above diagram gives a simple conceptual illustration of the investment focus of FIs for urban and territorial development and shows where their privileged areas of application should be. This general formulation reflects the fact that potentially investments of all types could be part of strategic investing in a city or other territorial context. In the above diagram, the economic performance is measured on the horizontal axis and the financial performance on the vertical axis. For ease of interpretation, it can be assumed that the economic performance metric is the economic rate of return as measured through tools like Cost Benefit Analysis (CBA) and the financial performance metric the financial rate of return. The hurdle rates (minimum acceptable economic performance and minimum acceptable financial performance) are indicated by the dotted lines and the financial and economic performance of each investment is mapped in the diagram. The oval on the diagram shows the privileged target area for the FI – this is where the projects offer some financial return, but not enough to reach the minimum rate required by the market, and a strong economic return reflecting in principle their contribution to the objectives of the operational

36 *According to Article 7 of the ERDF Regulation sustainable urban development shall be undertaken through ITI or through a specific OP or a specific priority axis.*

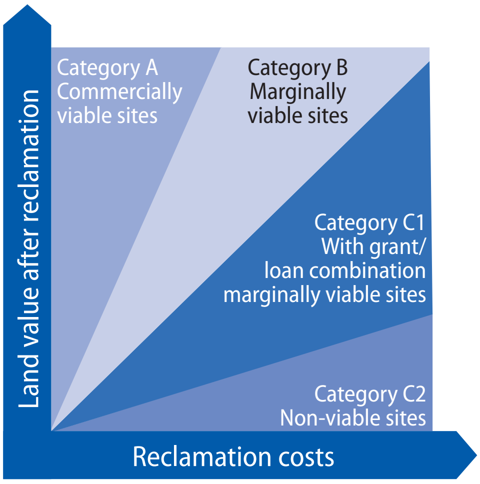
programme. In the above diagram, "A" represents an investment opportunity where market and economic return coincide (like in cases where no market failure applies) and whose financial and economic performances are both well beyond the hurdle rates – no need to interfere. The case of "B" illustrates a project with good financial return, which can be undertaken by market players, but with a poor economic return due for instance to strong negative externalities.

Projects of this type should not be undertaken. Investment "D" has a good economic performance but cannot generate a positive financial remuneration – projects of this type are candidates (unless they can be suitably reconfigured) for grant financing. Finally investment "C" has the features that make it suitable for FIs – low financial performance, but possibly sufficient to sustain a revolving mechanism, and good economic performance, possibly due to positive externalities associated to its implementation.

The above argument can be re-cast in more concrete terms taking land reclamation as a practical example which may be particularly relevant for territorial FIs. Three types of reclamation projects can be identified:[37]

- Project class A, where the reclamation costs are low and the land value after reclamation is high;
- Project class C, where the reclamation costs are high and the value of the land remains rather low even after the reclamation; and
- An intermediate class B, which will be in general the target of FIs for urban and territorial development. Class A would be considered as a target of private investments and class C could be addressed with grant schemes – assuming there is a public interest in implementing them, linked to a market failure or suboptimal investment situation.

Figure 4: Classification of land reclamation FI project types



Source: Adaptation of EIB (2009), UDF Typologies and Governance Structures in the context of JESSICA implementation

37 This is the CABERNET (Concerted Action on Brownfield and Economic Regeneration Network) classification, described in "JESSICA – UDF Typologies and Governance Structures in the context of JESSICA implementation", page 21.

It is now important to generalise this approach in order to show how it can be applied to assets other than land reclamation. To achieve this, we refer to the concept of the financial rate of return, or IRR as normally calculated. Conceptually, projects of all types in area-based investment strategies could be classified according to their expected rate of return. Projects of Category A would show a high IRR since the costs incurred are lower than the market value of the asset created. Category C shows significantly higher expected costs than the post-investment asset value.

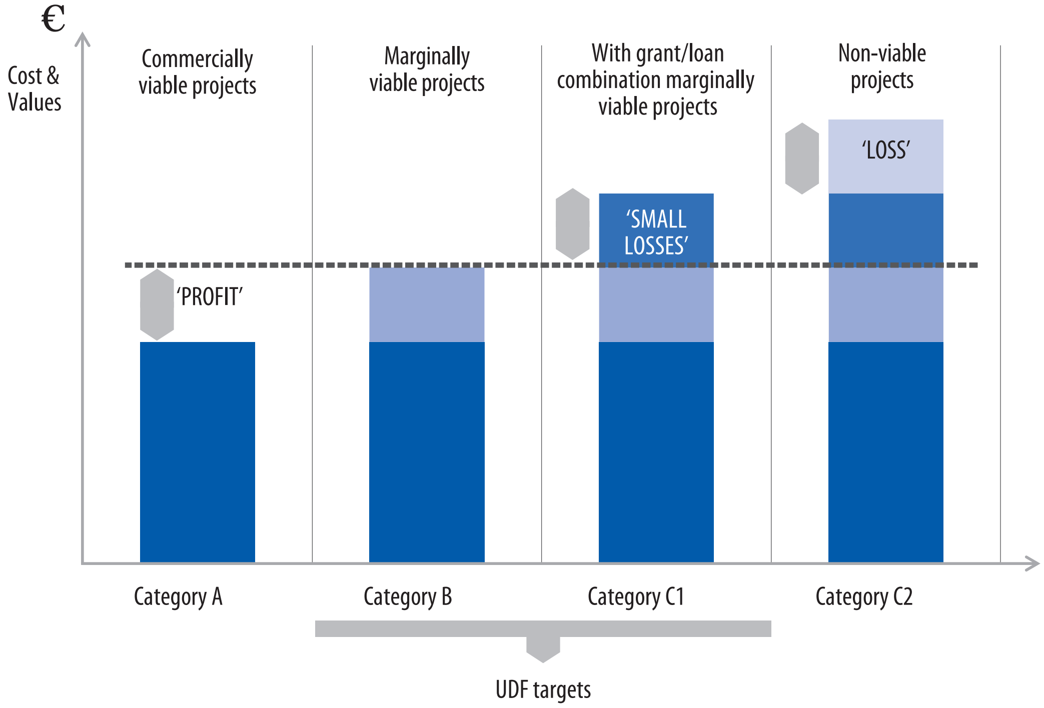
Taking into account the new set of instruments including the combination of a FI with a grant component, Category C "marginally viable projects" could be split in two sub-classes (i) C1 where the grant/FI combination makes the project break even or marginally viable and (ii) C2 where the project remains non-viable. A financially non-viable project is not suitable for a FI. If such a project (e.g. an investment in public space or in public infrastructure) is necessary, it could be supported through an appropriate grant scheme.

On the other side of the spectrum, Category A "commercially viable" could be considered attractive for private investors without further intervention.

As a further illustration, a regional or spatially focused microcredit scheme targeting disadvantaged groups of the population could be more effective in the long-term than a grant scheme in the context of a CLLD. Such a scheme could be supported by all ESI Funds (see Table 1 above). In this context, it is worth noting that although FIs jointly covering SME and infrastructure have not been developed and tested in 2007-2013, the new cycle allows flexibility so that spatially focused FI could invest in enterprises, human capital and infrastructure in order to maximize spatial synergies or to better address spatial market failures.

Indicators like the Net Present Value (NPV) or IRR can also be used to characterise the financial performance of individual projects. The comparison of NPV of costs and asset value after investment is shown in Figure 2 below, where the cost is represented by the dotted line and the asset value by the height of the columns. If the costs are lower than the asset value created by the investment, the projects are commercially viable (class A). The two further classifications B "marginally viable" and C1 "marginally viable with grant/loan combination" comprise projects where the costs are only slightly lower or slightly higher than the asset value (measured in market terms). The last class C2 "non-viable" is formed by projects where the costs are significantly higher than the revenues, including the effect of the potential support of the envisaged FI. This class should not be included in the FI portfolio.

Figure 5: Project financial viability



Source: adaptation of EIB (2009), UDF Typologies and Governance Structures in the context of JESSICA implementation

Another potentially useful component of an ex-ante assessment methodology would also be to look at the project's net impact on economic welfare using economic performance indicators like the economic rate of return (ERR) or the benefit-cost (B/C) ratio. However, these indicators are normally calculated for larger projects and it is not realistic to expect that such detailed calculations are carried out for all the projects that could constitute the portfolio of the FI.

Thus, the most appropriate mix of financial and economic performance indicators to be employed in the ex-ante analysis should be judged on the basis on the type of projects within the scope of the FI portfolio.

3. Analysis of market failures, suboptimal investment situations and assessment of the investment needs

3.1 Establishing evidence

As presented in the General Methodology[38], the presence of market failures, suboptimal investment situations and unmet investment needs is an essential component to justify a public intervention. The assessment of the extent to which additional investment is needed to reduce an identified investment gap related to the above needs should be the key rationale for the implementation of FIs.

For FIs focused on urban and territorial development, the market failure must be analysed mainly in a spatial context, which is embedded in the broader national or regional socio-economic context. Reasons for market failure are often unique to each region and market segment, therefore these specificities will play a central role in the establishment of evidence of inadequate market operation.

The Commission's common principles for an economic assessment of the compatibility of State aid with the operation of the single market[39] identify **the most common sources of market failure**. These are presented below, with illustrations that indicate how they can apply to the type of investment that may be targeted by FI for urban and territorial development:

- **Economic externalities** arise where market players do not internalise the whole benefit or cost of their actions, usually because of incomplete property rights. Typical examples are greenhouse gas emissions from a power plant or local negative externalities associated to nuisances from an industrial installation or a brownfield in the city centre, all obviously relevant for a FI for urban and territorial development.
- **Imperfect and asymmetric information** may lead to transaction costs, agency costs, moral

38 See: Ex-ante assessment methodology for Financial Instruments in the 2014 - 2020 programming period, Volume I.

39 http://ec.europa.eu/competition/state_aid/reform/economic_assessment_en.pdf hazard or adverse selection, which as a consequence lead to inefficient market outcomes. A relevant example could be the case of poorly known costs of environmental remediation in a former industrial site, which may lead to excessive risk premiums required by market investors.

- **Coordination problems** may also lead to market failures, where the costs of contracting, uncertainty about the collaborative outcome and network effects prevent the effective design or even the conclusion of contract agreements, thus leading to inefficiently low levels of coordination and output. Coordination problems in a spatial context may often be addressed by integrated approaches which bring together actions that are mutually reinforcing, or that can only function when implemented jointly. A typical example would be the need to coordinate the decisions of several independent property owners, in cases where successful inner city regeneration crucially depends on renovation being undertaken jointly.
- **Equity issues** which even if not related to economic efficiency may lead to situations considered suboptimal from a public interest point of view. Here a typical example could be the concentration of deprivation within specific territories.
- **Spillover signalling effects** may be generated when no sufficient financial support is provided, and conversely, public sector support can improve and stimulate private sector supply and also have an effect in terms of risk-sharing mechanisms. Spillovers of this type can be seen as a specific example of externality, where the positive effect can be triggered by signalling which would not take place without public sector involvement.
- **Lack of policy coordination** in the public sector may lead to duplication of efforts and a waste of financial resources, particularly in cases where public bodies do not act in synergy. This can exacerbate coordination problems between economic agents. The CLLD approach can be seen as a tool to address this type of failure in the territorial / local development context.

In addition, there are cases where market outcomes may turn out not be desirable from a European public interest point of view.

Geographical areas may suffer common as well as specific market failures, which may also be determined by geography, governance and other aspects. Insufficient access to finance for SMEs located in a declining city; the lack of seamless connectivity with regard to sustainable transport; the lack of nursery facilities to support early education and gender employment opportunities; inadequate skill and lifelong learning to prevent the concentration of exclusion and poverty; insufficient provision of energy-efficient housing – all these provide illustrations of the variety of market failure or suboptimal investment situations which may arise in practice in specific territories. In all these cases a strategic territorial approach can prove the most effective way to remove or mitigate the barriers to investment. In this context it is useful to recall the interlinked notions of "financing gap" and "viability gap" as referred to in chapter 3 of the General Methodology.

As a general principle, public intervention may be justified to address an **investment gap**, namely the fact that there are no sufficient resources to support investment which would be in the public interest. The likely main reason for such investment gap would be a "**viability gap**" of the investment, i.e. **the inability to achieve the financial performance required to attract the necessary funding at market terms**. In the urban context for instance this could apply to urban renewal and regeneration, urban development, area-based local development, implementation of sector plans and territorial investment needs, sometimes in the case of projects with significant sunk or unrecoverable costs like those linked to decontamination. The general approach is described in section 3.2 (establishing the evidence of market failure and suboptimal investment situation) of Volume I.

It should be emphasised that the viability gap must not be due to intrinsically uneconomic or poorly structured underlying investments,[40] but to market failures or other barriers, often related to the locational characteristics of the targeted territory. The viability gap may also occur at the project portfolio level, in cases where this is perceived as too risky and not generating sufficient returns to attract commercial funding.

The main other reason for an investment gap, which may well exacerbate the impact of the viability gap, is a **"financing gap"**, namely limited access to finance. The main methodological steps to be carried out in order to assess this financing gap are described in the General Methodology and involve the analysis of both the demand and the supply side, thereby allowing to estimate the unmet demand. For example, under TO9 'Promoting social inclusion and combating poverty' the physical and economic regeneration of deprived urban and rural areas may be addressed by providing programme resources to a FI to support micro-enterprises and self-employment.

The table below shows an illustrative list of urban development and other territorial investments facing certain investment gaps.

40 One typical example for a poor structure is an oversized project. It should not be considered as a viability gap if the revenues generated by the project do not generate a sufficient rate of return due to oversizing.

Table 3: Investment gaps addressed by FIS for urban and territorial development

(Main) type of gap	Examples	(Main) type of market failure
Viability gap	Under-used city space (non-excludability)	Public good
	Long amortisation time for sustainable investment (e.g. sustainable public transport)	Externalities
	Necessity of grant-loan combination for water-infrastructure	Externalities
	Non-excludability for climate adaptation investment (e.g. protection of river sides and sea sides)	Missing market / public good
	Shortage of investment in new industries (e.g. in areas with an industrial history)	Allocative inefficiency
	High sunk / non-recoverable costs in brownfield development (e.g. decontamination where the polluter pays principle is not enforceable)	Information failure
	High risk of catalytic investment to foster economic revival of a deprived area	Allocative inefficiency
	Energy efficiency / conservation of historical monuments	Public good
	Energy efficiency investment in apartment buildings with tenants	Allocative inefficiency, coordination failure
	Shortage of public investment due to budgetary constraints (e.g. modernisation of public lighting)	Government failure
	Turn (research) knowledge into products in districts where research institutions or universities play an important role	Property rights
	Merit goods such as education and cultural offer in neglected areas	Incomplete markets
	Introduction of new technologies for public infrastructure in areas with low purchasing power or sparse population	Informational asymmetry
Financing gap	No access to Tier I banks	Informational asymmetry
	No access to finance for certain social groups (e.g. development finance, microfinance)	Equity / Distribution
	No access to finance for the unemployed / under-employed (e.g. to facilitate transition to self-employment)	Equity / Distribution

As already mentioned, apart from the financing dimension, addressing investment barriers related to **coordination failures** is of specific importance for spatially focused FIs. In fact, coordination failure may turn out to be the most important dimension of market failure. The development of a new urban district might emerge as a market failure, if the housing investment (e.g. by private investors) is done, but the public infrastructure (e.g. childcare facilities and public transport) are delayed by a decade. If a comparable coordination problem occurs the other way around, an idle public investment will be costly and the asset itself may rapidly lose value. The coordination of private and public investment is therefore crucial. Similar arguments hold for the coordination of investments in public space and in physical assets (e.g. buildings) related to public space. Such failures cannot be solved by financial means alone, but FIs could be an instrument contributing to improve coordination and the ex-ante assessment should address the issue highlighting the potential role of the FI in bringing together parties proactively.

3.2 Analysing investment needs

If the previous analysis shows evidence of market failure the next consideration is aiming to determine the **size** of the investment gap. An operational approach could have two steps - (i) quantifying the level of unmet demand and (ii) quantifying the potential size of an intervention with the support of ESI Funds to increase supply. In view of the nature of urban and territorial development strategies, which generally take place in a multi-purpose and multi-sector investment context with a diversity of project types and sizes and promoters, the approach should be flexible and adapted to specific circumstances. Therefore, the practical methodology to analyse investment needs will often need to be tailored through a combination of desk research, dedicated surveys, analysis of planning documents, soft-market testing and so on, as well as a mix of top-down and bottom-up methods.

Depending on the sector of the envisaged scheme, the level of unmet demand can be analysed from a market-led perspective or plan-led perspective. In the first case the demand for financing is expressed by market participants, e.g. for investments of enterprises in products and services for instance in cases where a real estate dimension is important in the analysis of investment needs. In cases where a planning-led perspective is dominant, the demand may be derived from the investment plans as described by a public authority or another competent body.[41]

Thus, a key source of information allowing to quantify the level of demand is the volume of investment needs as foreseen in the local urban development plan or strategy, although depending on circumstances and data availability also bottom-up soft market testing and/or survey methods could be employed to complement the information. The plan translates policy objectives - for instance as regards health and social infrastructure or local development strategies - into the necessary investment volumes. The required investment volumes have to be compared to the supply of financing already available, including market sources and any existing public or promotional support schemes. It may be helpful to calculate or estimate the trend and expected evolution of these investments in the future.

41 The market and plan-led perspectives on demand analysis are not mutually exclusive. If a large former military site is transformed into a housing area the major part of the investments will be defined by a plan and therefore governed by the plan perspective. But a significant part of the investment related to private housing is dependent on the market perspective. To make such former military site attractive for potential house owners a soft loan or another support scheme may be necessary to achieve marginally viable projects.

The distinctive feature for ITI is the integrated approach[42] in form of an integrated development strategy.[43] By nature, this is often defined through a (local) plan or similar planning instruments, because different investment streams in different sectors have to be brought together. Neither the volume of one contribution nor the timing could change without stopping or delaying the programme.[44] Such local documents describe the level of investment, sometimes including the presumed unmet demand. The ex-ante assessment in this phase could do a plausibility check. The main difference with respect to the approach set out in the General Methodology (Volume I) lies in the fact that the data have to be extracted from a **local plan**, from local trends and from the assessment of the prevailing investment levels in the targeted territory.

Box 1: Example of bottom-up approach to determine investment needs

A multi-region multi-purpose study of 2013[45] provides a good example of a bottom-up approach to determine the investment needs for specific areas:

- Step 1: four sectors of investment have been defined, namely (i) urban regeneration, (ii) social infrastructure, (iii) energy and (iv) business environment;
- Step 2: all potential projects are collected from local stakeholders or identified from national or regional actions, support schemes and plans;
- Step 3: all potential projects are mapped to the relevant Thematic Objective;
- Step 4: for each of the four sectors the probability for successful project development is assessed. Typical figures were found in the range from 15-60%. A 'bonus' for regions currently involved in FIs was established, mirroring the experience already matured;
- Step 5: for each of the four sectors the probability of using FI[46] is assessed. As it is a multi-region study the probabilities may be different in the different regions. Typical figures are 10% for urban regeneration and 50 - 75% for energy. These figures could be adjusted taking into account the readiness of the region in using FIs;
- Step 6: for each of the four sectors a breakdown in financial products (equity, loans, guarantees), grants and the private resources raised by the FI is assessed.

Typical ranges for the private resources are 40-50%, for guarantees 5-10%, for loans 20-27%, and for equity 12-15%.

Once this is done, the investment needs are assessed and the share of those needs to be covered by the envisaged FI will have been identified

42 *See Article 36 of CPR.*

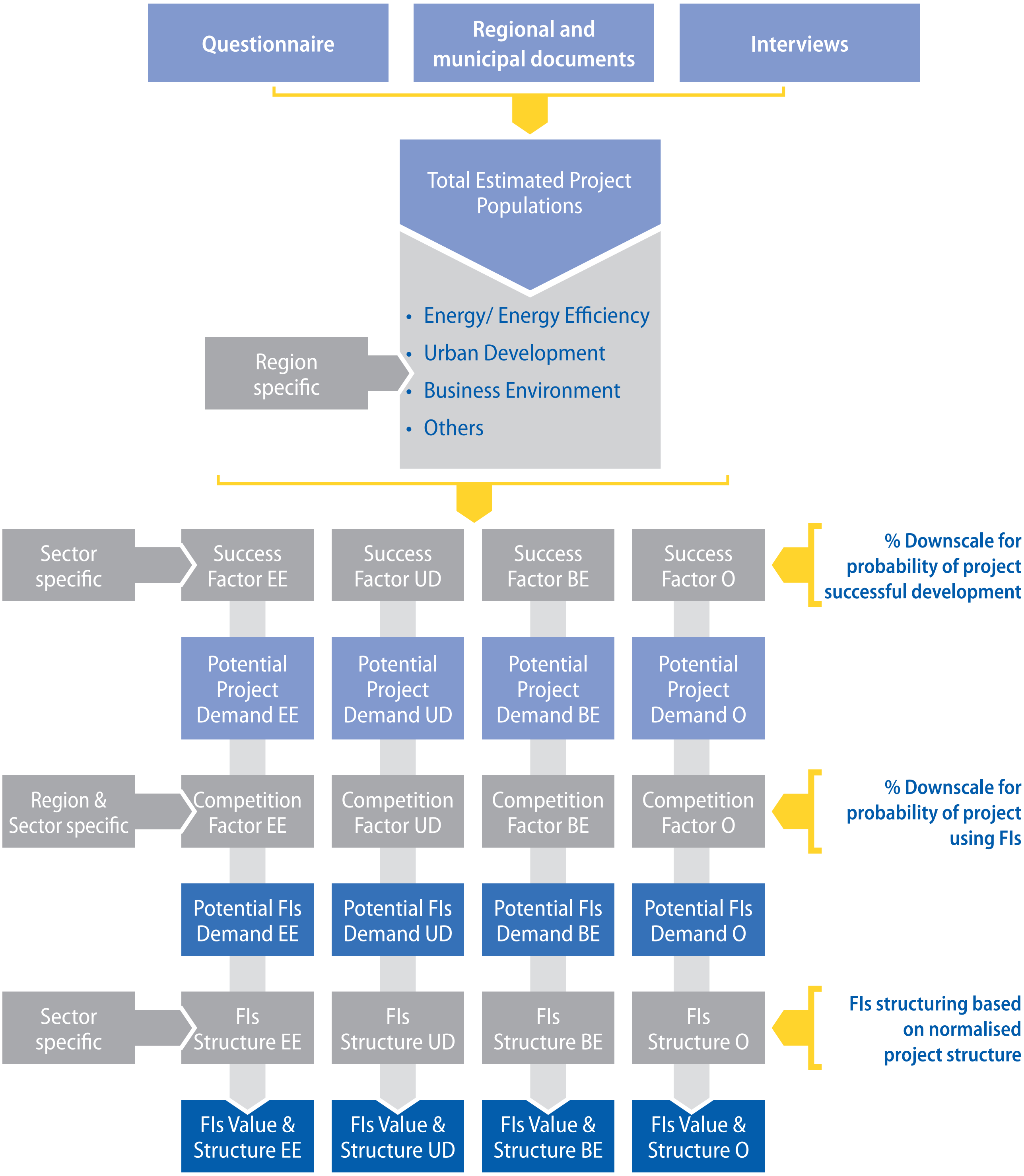
43 *See recital (33) of CPR.*

44 *See discussion on coordination problems in section 3.1.*

45 *This the 2014-2020 JESSICA Evaluation multi-regional study for Poland. For more details see http://www.eib.org/attachments/documents/jessica_evaluation_study_for_nine_regions_part1_en.pdf and http://www.eib.org/attachments/documents/jessica_evaluation_study_for_nine_regions_part2_en.pdf*

46 *Alternatives could be other promotional schemes, grant funding and pure market financing.*

Figure 6: Assessment of the investment needs and the size of the support scheme



As shown in the example, after the assessment of the investment need the indicative size and the financial structures of the support scheme are determined. This is closely connected with the indicative volume of the contribution from the OP and is a key step in the procedure affecting the later parts of the ex-ante assessment related to the design and structure of the FIs, as the achievement of a critical size is fundamental, *inter alia*, for the analysis of which implementation option is the most appropriate for each FI. The potential volume of intervention may be restricted by the maturity of the investment projectsƒ[47], by absorption capacities for the investment in the local area and by the scarcity of budgetary means of the EU contribution for a specific TO. As a key indicator for the supply side one could consider the project pipeline in the target sectors of the envisaged FI. In addition to the actual project pipeline an analysis of the capacity to bring each year new projects to the market should be done.

If the ex-ante assessment identifies a sufficient indicative pipeline of projects in line with the objectives to be delivered, this could justify (i) the creation of one or more FI for urban and territorial development and (ii) the indicative size of the FIs.

3.3 Operational tools

As mentioned before, the envisaged infrastructure investments should be addressed by municipal (or regional) plans. Integrated urban development can be used more effectively in the targeted geographical area if investment takes place within the framework of a multi-sector strategic plan adopting an integrated vision.

However, there may be other investments not connected to the plans and not identified in the plans, which can become part of the investment portfolio of the FI. Such further investment opportunities are expected particularly in the case of a multi-purpose FI for urban / territorial development. For example, under the CLLD implementation tool an important part of investments may be identified through a bottom-up-approach. Investments developed through a bottom-up approach could address issues such as social inclusion, entrepreneurial activities, upgrading of the public space or community development.

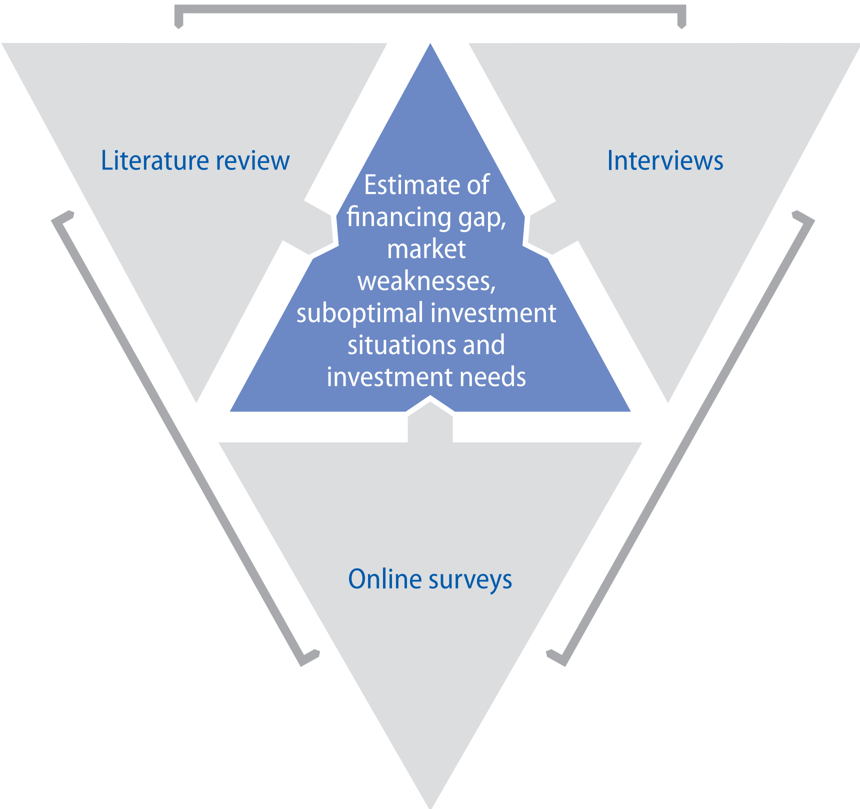
Where no suitable plans are in place, or in order to complement information available through existing planning and other strategic documents, a three-pronged method based on (i) literature review and desk research, (ii) interviews with stakeholders and experts and (iii) surveys of a sample of potential projects[48] could be used to determine the demand for financing. A more detailed analysis of the demand and the existing trends helps to identify and quantify the unmet demand for the envisaged time horizon of the FI. This unmet demand could serve to identify the investment gap in the relevant territory and if appropriate in the relevant sectors within the area.

47 Projects ready for implementation or ready to investment during the further years of the multiannual financial framework.

48 Not restricted to a certain method, it could comprise online surveys, questionnaire surveys, interviews with experts, etc.

Indicators and statistical data are identified, reviewed and analysed so as to provide ideally a quantitative analysis on both supply and demand and can be used to benchmark and compare the local territory being examined with other similar geographical areas.

Figure 7: Main tools to analyse investment gaps and market weaknesses



Quantitative indicators can be retrieved from official statistics and reports from EU institutions, Eurostat and national statistical offices, OECD and private sector organisations, as well as websites of financial institutions.

The literature review and identification of relevant indicators may also permit the **comparison of indicators between countries and/or regions** in similar situations.

The comparison of the structure and characteristics of targeted territories with similar areas may help to identify good practices in terms of use of financial products and the development of FIs. Such comparisons may also support the identification of financial intermediaries having previous experience with FIs in the same country, for instance where FI for urban development were established in 2007-2013[49]. Studies carried out by these stakeholders may provide further indicators and enable analysis of the evolution of FIs over time.

Besides the desk research another effective tool to analyse the investment gap is the use of surveys and interviews. For example, a pool of selected market players should be further addressed by sur-

49 See chapter 6, Table 5. In 2007-2013 UDFs were established only in 11 EU Member States.

veys or interviews to obtain more precise and up-to date information on the financing gap and ways to address it. On the supply side, stakeholder consultation can provide market intelligence, help assess the needs of potential beneficiaries for the new FI, and judge the adequacy of current FIs.

3.4 Identifying suboptimal investment situations

Suboptimal investment situations can be experienced also where significant investment volumes have taken place, but the level of investment and/or funding is considered insufficient to achieve public policy objectives. For example, despite continuous investments in the energy sector, the policy objectives in respect to energy efficiency and climate action of many Member States are not likely to be achieved if existing trends persist.

The gap can be assessed comparing the existing level of investment to the amount required to achieve a quantitative EU or national objective, thereby giving a measure of the investment needed to bridge the gap. Generally the reference case for comparison should be based on a continuation of the existing trend in investment volume.

In energy efficiency and renewable energy, an efficient mix across the different sectors with a well-defined spatial scope is likely to contribute effectively to achieving the EU and national objectives. A certain part of the investments could be supported by ESI Funds and part of the ESI Funds support could be delivered through FIs.

Box 2: Study on investment needs for energy efficiency in Poland

In 2013 a study was performed in Poland for the National Fund for Environmental Protection and Water Management (NFEPWM), which is the leading institution in Poland for energy efficiency support schemes and other promotional programmes with environmental impact. National targets in Poland were derived from the incorporation of the EU Directives into the Second National Action Plan (NAP) for energy efficiency. The objective of the study was to estimate investment needs breaking them down into different sectors. Estimates were carried out for five main sectors: (i) energy efficiency (EE) and renewable energy sources (RES) in buildings, (ii) EE und RES in companies, (iii) EE und RES in other projects including urban projects like city lighting, low-emission transport and revitalisation, (iv) generating energy from municipal solid waste and (v) generating energy from sludge. The requirements in sectors (i), (iii) and (iv) could be used to establish **urban investment needs** by **earmarking amounts** to be spent in cities to support comprehensive EE/RES investment strategies via urban FIs.

The study determined the investment needs to 2020 required in order to deliver the objectives of the NAP. The intensity of public support to make the investments happen was estimated in the different sectors in the range 15%-50%. As a result, the order of magnitude of the public support related to the investment needs was estimated at almost PLN 150 bn (around € 36 bn) as presented in the following table.

It should be mentioned that the intensity of state support was estimated for the purpose of assessing investments needs. More detailed measures for state support was quantified at a later stage in the design of the FI, based on the programme conditionality and more detailed analysis of the relevant segments.

Based on this ex-ante screening, a territorial FI targeted on EE/RES investment can be designed. The contribution to each of the sectors and to the overall target of the NAP should be quantified based on the specific objective of the investment priority. The amount to be spent in cities can be earmarked.

Table 4: Investment needs and support envisaged for energy efficiency in Poland according to NFEPWM study[50]

<table>
<tr><td>(i) Buildings related Investment needs 2014-2020 (each year)

<table>
<tr><td>2014</td><td>5,5</td></tr>
<tr><td>2015</td><td>5,5</td></tr>
<tr><td>2016</td><td>9,7</td></tr>
<tr><td>2017</td><td>9,7</td></tr>
<tr><td>2018</td><td>9,7</td></tr>
<tr><td>2019</td><td>9,7</td></tr>
<tr><td>2020</td><td>9,7</td></tr>
<tr><td>Total</td><td>PLN 59,5 bn</td></tr>
</table>

Assumed planned intervention:

PLN 8,9 bn both in grants/loans
PLN 14,9 bn in grants

(average state intervention of 30% based on the JESSICA practice in EE)</td>
<td>(ii) municipal waste and
(iii) sludge to energy

Incineration of municipal waste

Required investment:
PLN 5,3 bn

Planned intervention:
PLN 4,6 bn
(average state intervention of 40% based on the Polish practice in the area)

BIOGAS
Investment requirement:
PLN 21,3 bn
(average state intervention of 50% based on the Polish practice in the area)

<u>Assumed planned intervention:</u>
In the form of grants and loans: PLN 10,65 bn</td></tr>
<tr><td colspan="2">Planned intervention for energy efficiency</td></tr>
<tr><td>Buildings: PLN 23,8 bn</td><td>Waste to Energy: PLN 15,25 bn</td></tr>
</table>

50 *On Polish investment needs, see also http://www.nfosigw.gov.pl/download/gfx/nfosigw/en/nfoopisy/20/3/5/action_strategy_abstract.pdf*

For certain TOs, most envisaged investments may be based on sectoral or integrated plans. In the case of energy efficiency (EE) and renewable energy sources (RES) investing, the plan should include for example where the investment should take place (e.g. location), the aims of the investment (e.g. district heating) and which part of the value chain will be affected (e.g. heating energy demand reduction, metering). In such cases, the investment gap should be derived from the analysis of the needs stated by the plan and a comparison with the investment trends without the envisaged support scheme.

The analysis of market failure and suboptimal investment situations should allow to quantify the investment need, and then move to the identification of the **support needed** to meet the investment need. The next step in the ex-ante assessment would be to identify what proportion of the overall support required to achieve the relevant policy objectives could be delivered through FIs.

Table 5 provides an indicative list of TOs and investment types where the approach proposed in this section could be applied to produce an estimate of investment needs and the potential contribution of a FI to cover these needs.

Table 5: TOs relevant for territorial strategies often addressed with detailed investment plans

TO2	Broadband	e.g. broadband in less developed regions and rural areas
TO4	Energy efficiency	e.g. energy efficiency in housing
TO6	Sustainable urban/ village development	e.g. brownfield regeneration
TO6	Sustainable public transport	e.g. tram system
TO6	Water (directive)	e.g. waste water system in line with EU directives
TO6	Waste (directive)	e.g. system for recycle and reuse
TO9	Combating poverty	e.g. access to high-quality services and healthcare
TO10	Education, skill	e.g. investment in education infrastructure

4. Assessment of the value added of the FI

4.1 Quantitative and qualitative dimensions for urban and territorial development

As described in the Chapter 4 of the General Methodology, the value added of a FI encompasses both **quantitative** and **qualitative** dimensions. The steps to carry out the assessment of the value added of a FI are described there and apply also to FIs for urban and territorial development. The rest of this chapter provides additional comments and illustrations that can be relevant for FI for urban and territorial development.

4.1.1 Quantitative dimension

As a first step, the ex-ante assessment should analyse the quantitative dimension of the value added of the envisaged FI. This analysis has to examine:[51]

- The intensity of subsidy. The lower the intensity of subsidy for a given investment, the higher the quantitative value added. FIs with a spatial orientation may operate in fields where the traditional predominant support scheme was grant-based with higher intensity of subsidy so there may be scope for an intensity of subsidy significantly lower than the alternative grant option;
- The leverage of additional contributions from the public and private sector to the investment at all levels down to the final recipient. The higher the leverage achieved by the FI, the higher the quantitative value added.
- The revolving scheme allows Managing Authorities to receive back the capital invested plus the gains generated by the investment activities of the FI. These financial resources could then be reinvested in funding additional investments consistent with the territorial development objectives pursued the FI. In the case of FI for urban and territorial development, this may prove particularly relevant to support development that tends to be a long-term process.

51 This is not to be understood as an exhaustive list.

4.1.2 Qualitative dimension

Once the quantitative dimension has been addressed, the ex-ante assessment should look to the qualitative value added of the envisaged FI. Examples of qualitative categories of the value added include:

- Supporting the establishment and consolidation of a strategic investing industry in the urban and territorial sector, strengthening its capacity, skills and structures, as shown by the emergence of an urban development fund sector following the promotional activity of the JESSICA initative;
- Supporting a more disciplined approach to investment with repayable instruments likely to incentivise more efficiently implemented projects, both in terms of project management and financial management, including a better financial due diligence in order to ascertain a minimum required financial viability of urban projects;
- Better fit with national/local strategies in terms of well-prepared projects in the sphere of urban and territorial development;
- Facilitating the establishment of a revolving support scheme financially self-sustaining in the long-term. This could be desirable for objectives such as energy efficiency in social housing, as typically only 2-3% per year of the housing stock can be improved and thus a support scheme working for decades could be very valuable;
- Developing through the FI new financial products not provided previously, such as equity support for urban and territorial infrastructure projects.

4.1.3 Value added in a Single-purpose territorial FI

A straightforward example is a single-purpose, single instrument FI for urban and territorial development. This could be the case for a fund addressing improvements in public transport. In this case, the FI strategy would be focused on projects envisaging investments in a new bus fleet or in new rolling stock for light rail and the like.

In order to carry out this component, the ex-ante assessment, the analysis could consider choosing one, or possibly a limited number of projects representative of the potential portfolio to assess in some detail the quantitative and qualitative dimensions of the value added. Based on this analysis, a comparison with other financial products can take place. In case different financial products are offered by the envisaged FI, it seems logical to look at each financial product separately. One would expect to find different performances in terms of value added and often different target groups.

In such a case, the respective parts of the general methodology apply.

4.1.4 Value added in a Multi-purpose territorial FI

A more complex approach may be needed in a situation where a **multi-sector, multi-purpose fund** is being considered. Two possible approaches are suggested:

- The first could be repeating the approach described above for each sector and for each financial product (loan, guarantee, mezzanine and equity) envisaged for the FI; the NPV method described in the General Methodology would allow adding the results in a comparable way, to assess the leverage for the fund as a whole, even if the different products have different tenors and risk profiles. This would be possible even in cases where grant grant/FI combinations were included in the fund;
- An alternative approach would be to calculate the expected IRR bottom-up project by project and calculating a (weighted) average of the IRR for the fund. As the IRR estimation is consistent with NPV based method, the framework remains consistent. The value added could be judged in this case by comparing the IRR with (i) a commercial rate of return for all the envisaged investments and (ii) a fair rate of return for the private investor (FRR), taking into account that the FI could provide funding at sub-commercial terms.

4.2 Assessing the consistency with other forms of public intervention addressing the same market

Please refer to the General Methodology for guidance on the consistency of the FI with other forms of public intervention addressing the same market.

4.3 Possible State Aid implications

While regional aid has been for a long time a central element in the EU state aid policy, there have been no specific urban and territorial development State aid policy instruments in the State aid guidelines and in the 2008 GBER. However, the Commission has built specific experience through the approval of notified aid schemes related to FIs for urban development in 2007-2013 that aimed at setting up urban development funds. These decisions were adopted directly under Article 107(3)(c) of the Treaty on the Functioning of the European Union.

Building on this experience, the revised GBER that enters into force on 1 July 2014, contains new provisions on urban development aid[52]. The new article on "Regional urban development aid" exempts an urban development FI from the notification requirement provided that it is "implemented via urban development funds in assisted areas", "co-financed by the European Structural and

52 See http://europa.eu/rapid/press-release_MEMO-14-369_en.htm and http://ec.europa.eu/competition/state_aid/legislation/block.html#gber

Investment Funds", and supports the "implementation of an integrated sustainable urban development strategy". Other conditions include provisions and parameters on maximum investment size (maximum €20 million per project), minimum leverage of private funds (minimum 30%), the form of aid (equity, quasi-equity, loans, guarantees), the selection of managers and investors, the remuneration of managers and investors, etc. The provisions cover only partially the potential scope of FIs for urban development as they do not cover measures targeted at non-assisted areas. Such measures will continue to be notified to the Commission for approval before implementation, similar to the practice in the 2007-2013 period. However, where applicable, GBER provisions are likely to facilitate the support, through sub-commercial FIs, of urban and territorial development investments in compliance with State aid rules.

In case the conditions indicated for block-exempted urban development aid do not apply, the approach indicated in section 4.3 of the General Methodology should be followed. Consequently, depending on the scope of the investment strategy and the nature of the investment portfolio (e.g. social housing, adaptation to climate change, regeneration of brownfield sites) appropriate sector-specific State aid rules may be applicable. Thus, depending on the specific portfolios of FI for urban and territorial development, investments could be covered – *in toto* or in part – by the *de minimis*, sector-specific GBER/ABER provisions or by the rules for Services of General Economic Interest SGEI (e.g. social housing).

Given the funding architecture of FIs for urban development, in the 2007-2013 period, some principles from the Risk Capital Guidelines were applicable with respect to State aid to the fund managers and the investors in urban development measures. The new block-exempted urban development aid article follows the same approach: it copies a series of conditions on commercial management, profit-oriented decision making and selection mechanisms from the block-exempted risk finance provisions.

FIs may be better-suited to overcome some market failures than traditional grant instruments because the portfolio may include a variety of project types and sizes. Consequently, they could minimise the overall level of state intervention, capitalising the portfolio effect of mixing investments with different risk and return profiles to achieve a financially acceptable return on the whole portfolio. Equally, the use of repayable instruments could help reducing the overall aid level necessary for the realisation of the urban development project. The Commission's State aid decisions stressed those features in a balancing test.[53]

The steps of such a balancing test are described in chapter 4.3 of the General Methodology.

53 See for instance case SA.32835/2011 Northwest Urban Investment Fund, case SA 32147/2011 Andalucia Jessica Holding Fund.

In the Commission decisions in respect of urban development funds in 2007-2013, the private investor contributes significantly (30% or 50% of the investment, depending on scope and region) and the remuneration for the private investor is limited to a "Fair Rate of Return", i.e. a market risk-adjusted rate of return that is aligned with comparable investment opportunities. This concept has also been taken over in the new provisions on block-exempted urban development aid.

Where the revised GBER article on regional urban development aid is not applicable, a notification procedure may be necessary if the funding is to be delivered at sub-commercial terms. This should be part of the ex-ante assessment because the legal basis directly affects the possible architecture of the FI.[54]

54 No notification requirement applies for measures that are market-conform, i.e. covered by GBER, de minimis or SGEI rules.

5. Additional public and private resources to be potentially raised by the FI

After analysing market failures, sub-optimal investment situations and financing gaps and assessing the added value of the envisaged FI, the ex-ante assessment shall concentrate on identifying the additional resources which could be raised by the FI. Chapter 5 of the General Methodology describes the steps to be followed to estimate the volume of resources and the need for preferential remuneration, as required by Article 37 (2) (c) of the CPR. The rest of this chapter provide additional comments and illustrations that can be relevant for FI for urban and territorial development.

5.1 Estimating additional public and private resources

The calculation of the leverage can be done as outlined in the General Methodology. Additional resources could be attracted from:

- Public investors (e.g. brownfield regeneration, where the contribution could be in-kind, e.g. the plot of land);
- Public banks (e.g. looking for efficient tools to deliver a given objective for the respective banks like rural development);
- Pension funds and other institutional investors (e.g. for long-term investments with a low or medium risk-profile);
- Private banks and private investors (see below section 5.2 and 5.3).

The ex-ante assessment could develop selection criteria and identify success factors for the envisaged partners. The application of such criteria can improve the quality of estimates regarding third party participation.

As part of this assessment, it is recommended to indicate the level at which the contribution should take place.[55] The contribution of final recipients would normally take place at the level of the project itself, while other potential partners could intervene at different levels.

Box 3: Example on social housing

The ex-ante assessment could simulate financial structures of envisaged projects. A JESSICA Horizontal Study from 2013[56] underlies that historically the subsidies and funding systems for social housing came directly from the State. There were three main approaches of support: (1) the provision of revenue subsidies, including in particular interest rate subsidies which reduce the annual cost of provision and therefore rents; (2) upfront capital grants, which reduce the need to borrow or otherwise fund the capital costs of investment – thus reducing outgoings and rents; and (3) the provision of subsidy in kind, normally in the form of free or cheap land which again reduces the need for funding and reduces costs.

Today the financing of social housing is integrated in the wider financial system and there is a significant scope for FIs. The market for large-scale borrowing by social landlords is well developed in the Netherlands and in England. In both countries, the risk premium has been reduced to minimal levels and there have been many providers of debt finance. Many times the support scheme is based on a **state-supported** soft loan with zero interest rate and a tenor aligned to the time frame required to serve the needs of low-income households. With an additional contribution of the **municipality,** the rent to be paid by the low-income households may be reduced further. The basic idea is that the rent to be paid by a tenant is fixed at a level that the project is **marginally viable**. The revenues have to service the loan(s), the maintenance costs and the capital costs of the project. A **reverse structuring** approach could also be used, starting from an affordable rent for the low-income household and deriving the combination of accommodation size, investment cost and loan terms compatible with the affordable rent.

55 See section 4.1 of Volume 1. Pursuant to the CPR additional resources can be contributed at the (optional) level of the FoF, at the level of an intermediary, at the level of the FI and at the level of the final recipient. The level of the final recipient is not possible for EADRF.

56 Horizontal Study Housing in JESSICA Operations, June 2013.http://www.eib.org/attachments/documents/jessica_housing_study_final_report_en.pdf

5.2 Estimating the leverage of the envisaged FI

As there are no specific issues related to urban and territorial FIs in terms of the concept of leverage, please refer to the General Methodology.

5.3 Attracting additional private resources

In addition to other public resources, the FI aims at attracting additional private resources, thus increasing the leverage effect. The General Methodology provides a detailed description of how to compute the leverage of the envisaged FI. Specific factors that may be relevant in a territorial context and worth addressing in assessing additional resources are coordination issues, the role of in-kind contributions and the position of the real estate industry. Each of these factors - mitigating coordination failures, the opportunity to provide contributions in-kind and the specific interest of property investors - may contribute to attract additional private resources.

5.3.1 Preferential remuneration for private investors

Preferential remuneration for private investors is a central issue for FI for urban and territorial development, as certain risks and perceived barriers are particularly relevant - for instance in urban regeneration - and could be addressed through preferential remuneration for the private investor. As preferential regimes are considered by the regulatory framework as exceptional, it is essential that preferential remuneration be duly justified. For spatially focused FI, a classification following the risk level (see chapter 7) is possible, whereas in high-risk investments preferential schemes could be more justified than in low-risk environments.

Where preferential remuneration schemes have been applied they comprise in most cases a preferential return on investment combined with some downside protections.

Box 5: Example of preferential remuneration for UDF

The preference scheme for private investors in a Spanish UDF comprises a first loss piece taken by the public funds to protect some of the private investment and allows private investors to take their return first (up to a level of a Fair Rate of Return).

Private investors must cover at least 30% of the eligible investment and the FRR is independently established by a competitive or appropriately independent assessment process. Each project has to demonstrate that it does not receive (sufficient) funds from the financial market (necessity test).

MAs have often capped the return for private investors in order to avoid selective State aid and to strengthen the revolving effect by limiting the risk of losses related to downside protection for the private sector. The following hierarchy under State aid considerations may be used:

- Preference is given to full downside participation of private investors;
- If negotiations show that this may not be acceptable, the downside protection should be restricted (no full downside protection);
- At the same time, a cap of the return level should be established.

6. Lessons learnt

Article 37.2(d) states that the ex-ante assessment shall include an assessment of lessons learnt from similar instruments and ex-ante assessments carried out in the past. The purpose of this section is to summarise some of the lessons learnt which may be relevant for FI for urban and territorial development. The main reference will thus be the experience gained in the establishment and operation of UDF in the 2007-2013 programming period.

In practice, building upon the approach detailed in the General Methodology, it is important as part of the ex-ante assessment to gather information on performance of public and private support schemes which may be relevant for urban and territorial FIs in the country or region in question. Additional lessons learnt can be gathered from other territories and EU-level.

6.1 Gathering relevant information

There are several EU-wide 'horizontal studies' which may provide relevant information and lessons at http://www.bei.org/products/jessica/studies/index.htm. For example, the UDF handbook[57] summarises the main areas where and for which FI experiences from other regions might be available.

6.1.1 Overview of progress in implementing JESSICA financial engineering instruments

At end of 2012, there were 56 JESSICA Financial Engineering Instruments (FEIs) in place and operational programme contributions paid into these funds amounted to EUR 1,64bn.

Loans are by far the most popular type of product offered by FEIs for urban development. But in terms of OP amounts disbursed by the end of 2012, equity support accounted for around two thirds of total disbursements.

57 European Invstment Bank (2012), UDF Handbook

Table 6: Number of financial products offered for urban development to final recipients and OP amounts disbursed (by the specific FEIs set up in the EU at the end of 2012 in € m) to final recipients[58].

Urban development	Number of products offered by FEIs	OP amounts disbursed
Number of Loans	618	16,47
Guarantees	0	0,00
Equity/ venture capital	3	37,48
Other products	0	0,00
TOTAL	621	53,95

By the end of 2012, across all 2007-2013 FEIs for urban development, the absorption rate at the level of final recipients was low, reaching only 3% of OP contributions paid to the FEIs. This low absorption rate may be related to a number of delaying factors, including the complexity and novelty of the FEI when it was introduced and the long process needed to set it up, as several items in the 2007-2013 regulatory framework needed clarification or changes. Given the experience gathered so far and the fact that the regulatory framework for FIs in 2014-2020 is more comprehensive, the need for clarifications is expected to play a less important role in the current programming period.

The figure below clearly indicates that Poland, the UK and the Baltic states have extensive experience with UDFs and may be a suitable focus for lessons learnt.

Table 7: FEIs for urban development set up in the EU at the end of 2012[59]

1	2	3	4	5	6
N°	Member State	N° of FEIs	Out of which HF	Out of which specific funds with a HF	Out of which specific funds without a HF
1	BG	3	1	2	0
2	CZ	1	1	0	0
3	DE	3	0	0	3
4	EL	6	1	5	0
5	ES	4	2	2	0
6	IT	5	2	3	0
7	LT	5	1	4	0
8	NL	2	1	1	0
9	PL	12	5	7	0
10	PT	4	1	3	0
11	UK	11	3	5	3
Total		56	18	32	6

** including: holding funds and specific funds implemented with and without a holding fund*

58 Summary of data on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds (situation as at 31 December 2012), DG Regio, September 2013. FEI stands for Financial Engineering Instrument.

59 Summary of data on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds (situation as at 31 December 2012), DG Regio, September 2013

The topics to be studied for lessons learnt are:

- The governance rules and FIs' structure;
- The investment strategy and its effectiveness;
- The FI operations;
- The performance of the FI;
- The cost structure of the FI; and
- The monitoring of the results.

As urban and territorial FIs could always interact with sector-focused FIs operating in the same territory, a review of any positive or negative experience with such interactions is recommended in order to draw implications on the design of the investment strategy. If available, information on the financial performance of existing financial instruments could provide insights to assess the cost-effectiveness (e.g. management fees per euro disbursed) and the leverage effect achieved. Some general data on costs and fees based on the 2007-2013 programming period are reported in Table 8.

Table 8: Reported management costs and fees paid to FIs by the end of 2012 (in € m)[60]

Level	OP contribution paid to the funds	OP contributions paid to the funds in management costs and fees		FEIs for SMEs	FEIs for urban development	FEIs for energy efficiency/ renewable energies
HFs	5.957,16	137,20	2%	105,99	28,01	3,20
Specific funds set up with a HF	2.812,28	77,60	3%	62,30	13,76	1,54
Specific funds set up without a HF	6.601,07	165,79	3%	153,92	2,95	8,92
TOTAL	12.558,23*	380,59	3%	322,21	44,72	13,66

** TOTAL OP contributions paid to the funds = OP contributions paid to the HFs and specific funds set-up without a HF*

Lessons learnt can also be drawn on the effectiveness of the monitoring and control system and suitability of key performance indicators. These elements will feed the specification of expected results (section 8 of this methodology).

6.1.2 Gathering non-FEI information

Experience gained in constituencies where FEI were established will be an important potential source of lessons learnt. But work on lessons learnt should consider also other sources of information such as:

60 *Summary of data on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds (situation as at 31 December 2012), DG Regio, September 2013*

- Non-FEI but similarly structured revolving instruments in relevant themes – for example, social infrastructure or energy efficiency in buildings - in the constituency concerned and similar territories outside the scope of the ex-ante assessment; and
- Successful and unsuccessful traditional grant instruments that have leveraged resources/ met investment needs in themes relevant to the ex-ante assessment.

Such information may be obtained directly through desk research and/or may be signposted to by the MA or other bodies such as local and national economic development agencies.

6.2 Identifying success factors and pitfalls

MAs could study good practices, looking at experiences in:

- Policy shift from grant support to revolving support instruments;
- Policy shift from higher to lower intensity of subsidy and thus 'crowding in' additional private or public contribution;
- Identifying a market gap and addressing it with a FI;
- Delivering objectives of ESI Funds.

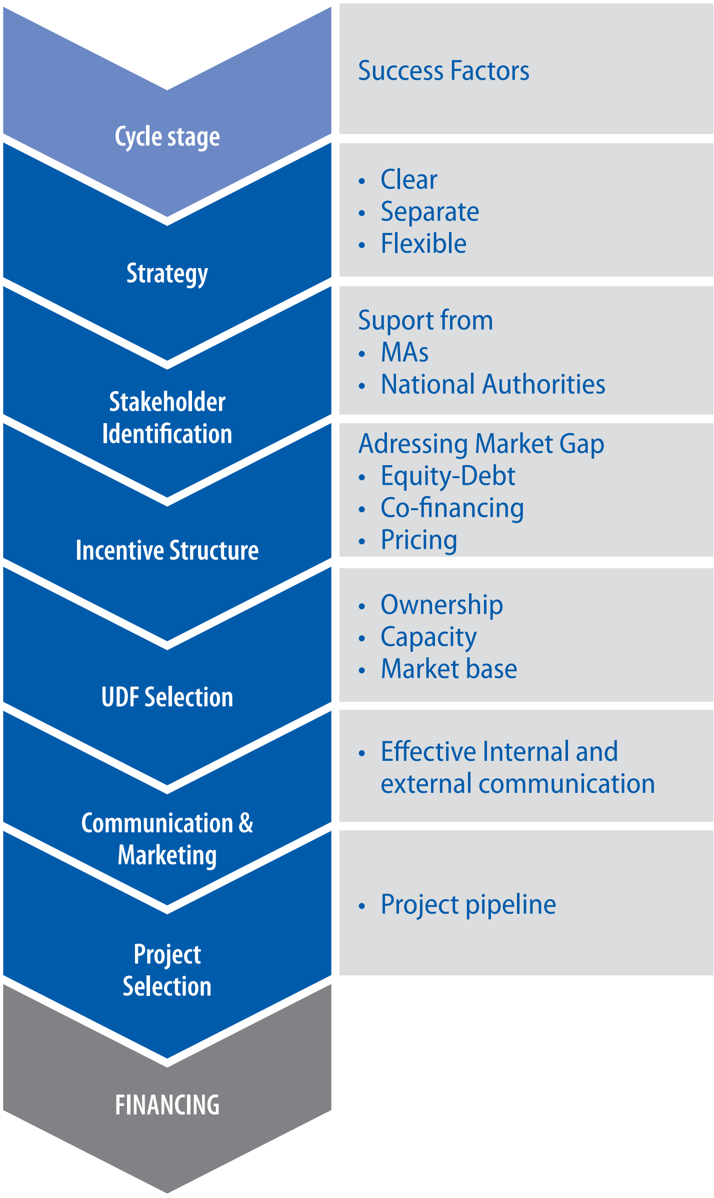
There are a number of potential risks and pitfalls that have emerged in implementing FIs promoted through the JESSICA initiative, including:

- Delays during the set-up of an FI;
- Slower than expected take-up of the investments;
- Less accuracy than expected in reaching the target groups;
- Deterioration in respect to the risk profile of the supported projects; and
- Higher complexity of the administration than expected.

While a formal ex-post evaluation of JESSICA Urban Development Funds is yet to be carried out, evidence to date suggests several success factors and lessons for consideration. Lessons can and should be learned at each stage of the implementation chain of FIs, from strategy setting to the operation of completed investment projects. It is probably too early to draw conclusions on UDF impacts that are likely to be realised in the later phases, namely when projects are implemented and operated - and legacy funds re-used. It should be noted also that, compared to assessing the impacts of a sector-based intervention, assessing the impacts of multi-faceted territorial investments supported by UDFs is likely to be more complex and resource intensive.

The above note of caution notwithstanding, experience so far allows highlighting a number of factors that have affected the speed and the effectiveness in the implementation of UDFs. These are illustrated in Figure 8.

Figure 8: Success factors at each stage of JESSICA implementation



Equally, experience gathered so far suggests that the following aspects were **crucial for a successful implementation of UDFs**:

Institutional capacity building is needed to support the switch from grants to FIs: Managing authorities need to consider factors such as the leverage, investment promotion, associated risks, how projects can be structured and implemented, and the selection of an appropriately skilled Fund Manager. They will also need to build up a solid understanding of matters like State aid requirements for FIs.

It is also worth noting that any good practice cases that may appear transferable between territories will almost certainly require substantial adaptation to local circumstances, and capacity building and organizational development will still be necessary.

Having a focused yet flexible strategy from the start is essential*:* Clearly identifying the investment type, financial product and target recipient from an early stage contributed to the success of UDFs in Estonia and Latvia. Elsewhere, there have been cases where the OP rules have designated private promoters as ineligible as final recipients, limiting eligibility to public sector entities or PPP vehicles. This led to delays and extensive administrative burden to amend the strategy to make the eligibility rules more flexible. Flexibility is important too as the nature of private competition means that certain investment opportunities may not be fully disclosed during an ex-ante assessment but only once the FI becomes established and is seen as a real financing prospect.

All players in the implementation chain from MA through fund managers to project implementing bodies need to be clear about the administrative process*:* This has been particularly the case concerning implementation stakeholders in London and Poland. Achieving this clarity requires a change of mind-set among MAs and an acceptance that the delegation of certain tasks to UDF managers is an important factor to ensure the effectiveness of FIs.

A Technical Assistance facility should be made available to increase the quality and quantity of the project pipeline*:* In certain cases where UDFs have been implemented, the quality of the project pipeline has been disappointing. Technical assistance available to bodies implementing FIs is a key tool to boost the quality and quantity of projects in the project pipeline.

At project level, there are several examples of projects funded by UDFs operating under the Holding Funds managed by the EIB. Some are reported in the table below:

Table 9: Examples of projects funded by UDFs

Country	Project	Market gap	Policy shift	Policy impact
Poland – Kozmin Wielkopolski	Old gasworks turned into a modern cultural space	Inadequate cultural premises	From grant to FI	Significant leverage for public intervention
Lithuania	Energy efficiency in housing	Lack of investors	From grant to FI	Significant enhancement of energy efficiency and living standards

Country	Project	Market gap	Policy shift	Policy impact
Portugal - Terreiro do Paço	Revitalization of some premises and conversion into cultural and commercial space	Neglected space in historic city centre	From grant to FI	Catalytic effect attracting enterprises, tourists and bringing new life to the area
United Kingdom	City labs for research in historical buildings	Lack of accommodation for research activity	Attraction of additional private money	Fostering economic regeneration
Italy - Trapani and Ribera	Energy efficiency for public lighting	No investor for projects generating significant savings	From grant to FI	Reduction in CO_2 emissions, introduction of new technology
United Kingdom - Dagenham	Organic waste facility brings clean tech industry to brownfield area	Shortage of clean-tech investment in the London area	Equity element acts as catalyst for loans from private investors	Part of one of the largest EU regeneration schemes

Once the research on lessons learnt has highlighted the key factors that allowed or hindered the full deployment of the potential value added of the instruments in the past, the ex-ante assessment should capitalise on these learning points and draw the implications for the preparation of a proposed investment strategy.

6.3 Applying lessons learnt to enhance the performance of the FI

Please refer to the General Methodology for guidance on applying lessons learnt to enhance the performance of the FI.

7. Proposed investment strategy

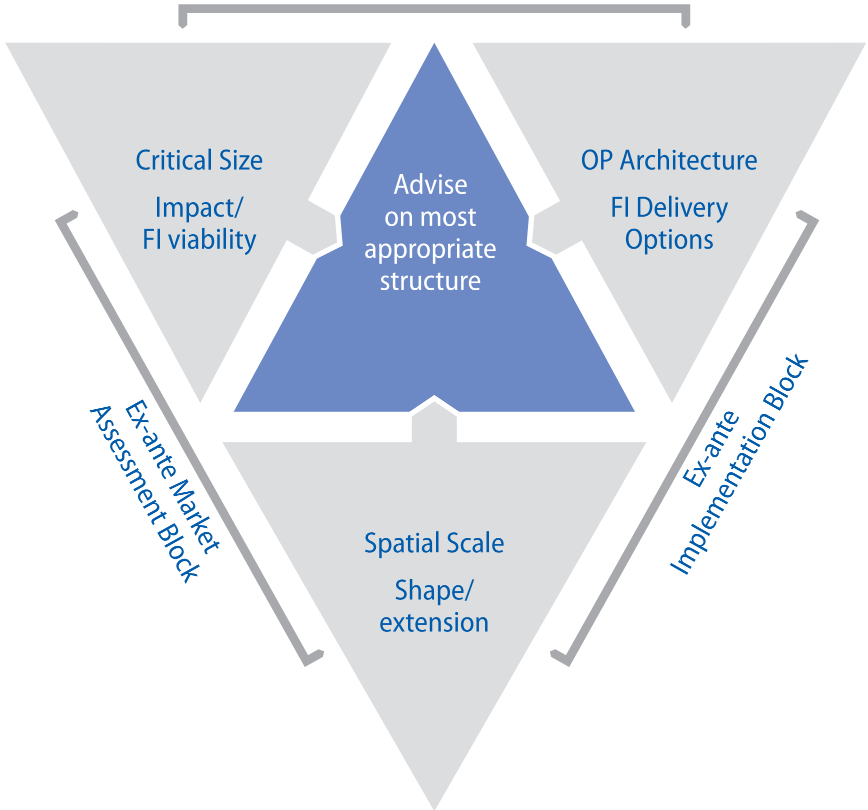
At this stage, the first building block of the ex-ante assessment has been completed, identifying market failures, suboptimal investment situations and financing gaps to be addressed by the envisaged FI; the value added of the possible solutions, the additional potential public and private resources; as well as, the lessons learnt from the implementation of similar instruments in the past. The analysis should have contributed to the characterisation of the overall investment orientation of the proposed FI, for instance with respect to its spatial scope, purpose and sector coverage, focus on thematic objectives.

The proposed investment strategy is the central component of the second building block in the ex-ante assessment. The (indicative) number of envisaged funds, their volume and the financial products to deliver will have to be determined in this block of tasks. In this context, it is useful to briefly discuss how some of the specific features of FI for urban and territorial development affect the architecture of the proposed FI and the investment strategy.

These guidelines should assist users to design the investment strategy of FIs so that synergies between FI operations and actions supported by ESI Funds to support urban and territorial development in 2014-2020 are captured and maximised. Thus, the architecture and strategy of the FI should be seen in a wider context, as the result of a process outlined in the diagram below:

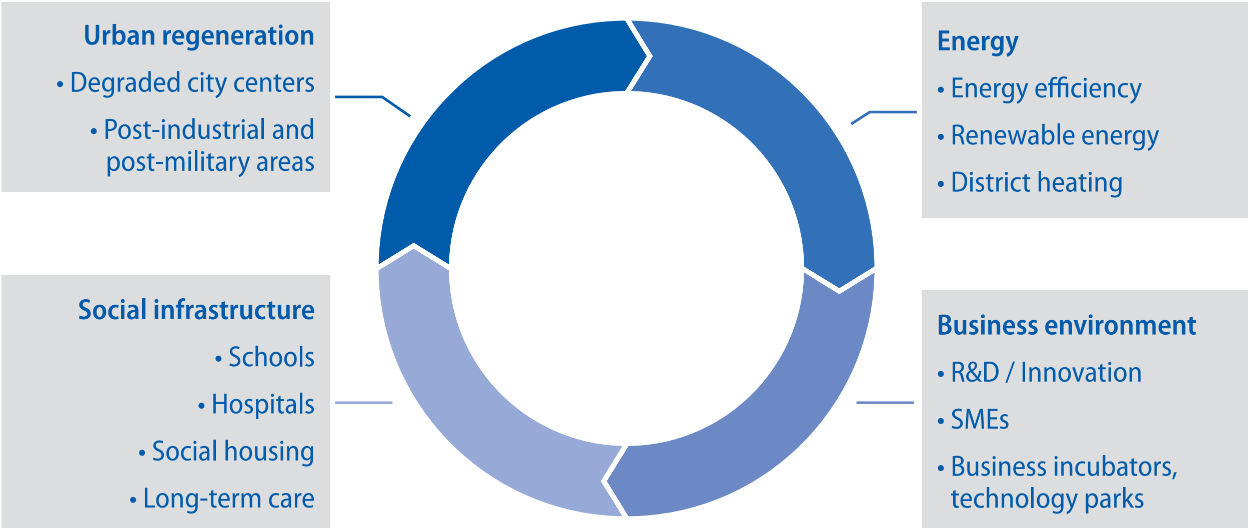
Figure 9: Wider context of the investment strategy definition

Urban / territorial ex-ante as part of the wider implementation process



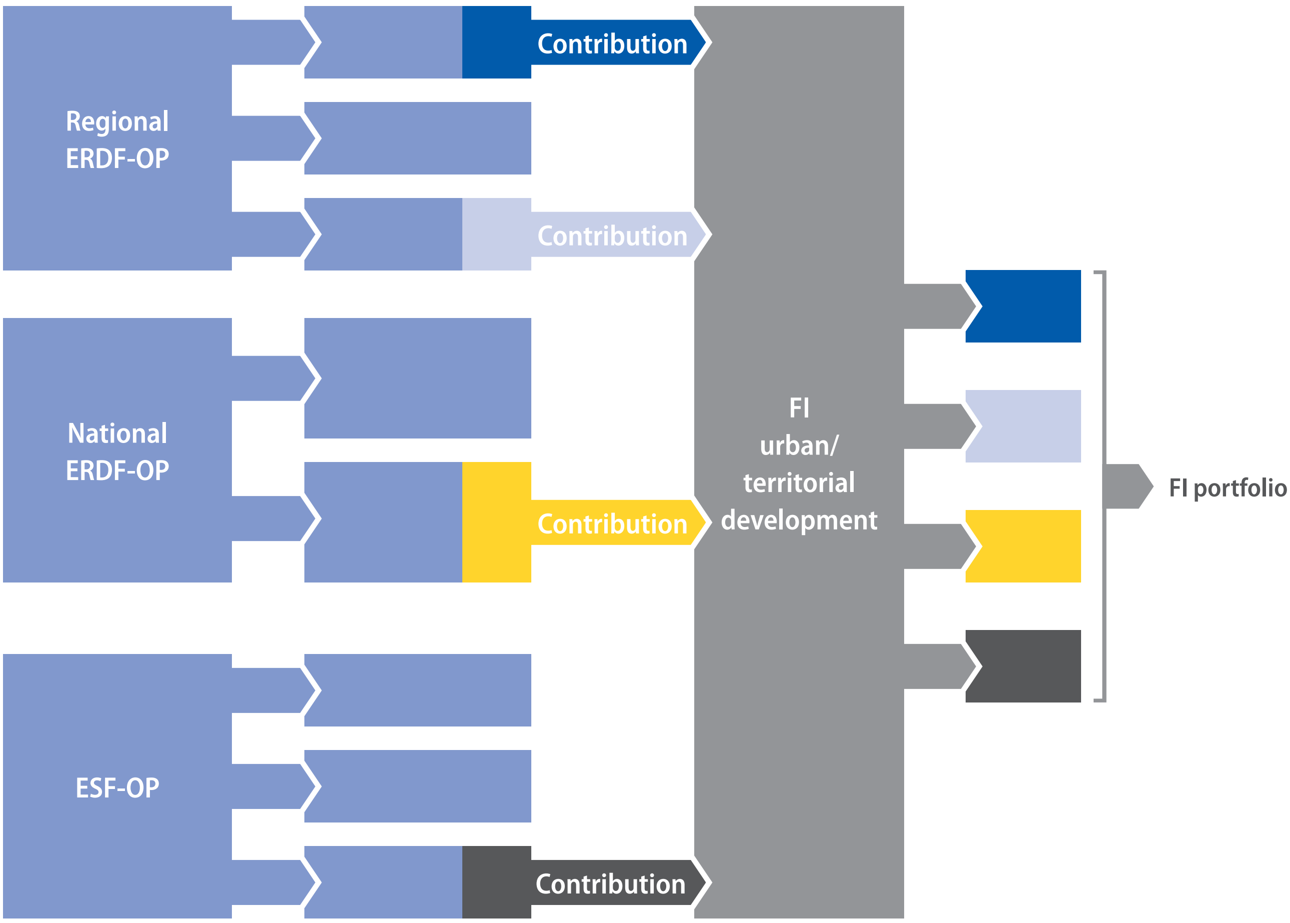
It is possible that the process of setting up a FI for urban and territorial development is more complex than for sector focused FIs given the multi-purpose/multi-sector nature of territorial development, and the need to adapt this feature to the structure of the Programmes (including the relationship with investment priorities and thematic objectives). To further explain, the potential investment portfolio identified in the ex-ante assessment block is typically constructed in line with a sectoral or planning-led classification, such as the one illustrated below:

Figure 10: Possible sectoral or planning-led classification



Thus, in order to smoothly transition from an investment portfolio of this type to a FI flexible enough to accommodate the requirements related to critical size and ability to deliver impact, while being compatible with the structure of the Programmes supporting it, it is useful to consider a FI for territorial development as an entity that can draw support – where appropriate to achieve its investment strategy – from several investment priorities and Programmes, in line with Art. 37 (1) of the CPR. This is illustrated in the diagram below:

Figure 11: FI for territorial development supporting several investment priorities and Programmes



One of the advantages of this approach is that the investment strategy and the associated portfolio would allow achieving scale – an essential component for the viability of a FI – through investment opportunities that are aligned with the strategy.

The rest of this chapter elaborates in more detail on steps needed to develop the investment strategies of FIs for urban and territorial development.

7.1 Level of detail of the investment strategy

The investment strategy will depend on the architecture of the proposed FI. If the envisaged territorial FI has a narrow sectoral focus – which may happen in cases where the ex-ante indicates that the minimum critical size for a viable FI can only be reached in a specific sector, for instance energy efficiency – it may be easier to develop the investment strategy in some detail, including the financial products and term sheet templates, and the conditions to be fulfilled in the FI business plan.

Alternatively, the envisaged instrument can be a multi-purpose / multi-sector FI for urban and territorial development with a large variety of challenges for investment support. In such a case, the investment strategy is likely to be more general and may have to allow for a more articulated process of definition and negotiation.

In both cases, narrow vs wide purpose/sector coverage, it is important to define:

- The territorial level envisaged for the instrument (national, regional, city, district);
- The investment priorities and/or programmes expected to support the FI, including the applicable thematic objectives;
- Relationship with the integrated approach to urban and territorial development, including if applicable requirements to be met in the selection and structuring of investment projects;
- The position in the investment life cycle of assets in the project pipeline (e.g. project preparation; construction, purchase or development; major renovation, replacement or redevelopment);
- The range of financial products offered to final recipients;
- The size of the FI and funding sources;
- A range for the intensity of subsidy in case the use of grants is envisaged as part of the strategy.

The MA should also consider at this stage of the ex-ante assessment which of the implementation options and structures described in chapter 1.2 of the General Methodology are more suitable.

If the FI is delivered via a fund of funds (FoF), two levels of funding agreements have to be prepared with details at two levels, the first between the MA and the FoF, and the second between the FoF and one or several FIs operating in the target territory. The requirements for the investment contracts of the FI with the final recipients or implementing bodies (e.g. local banks for micro-finance) have to be defined in the funding agreements at one of the higher levels.

7.1.1 Budgetary considerations

In setting up the FI, there are three main alternatives to attract other resources to complement the EU contribution, (i) national co-financing through the national or regional budget in the envisaged FI (or FoF) - the co-financed model, (ii) attracting private investors to contribute to the fund replacing budgetary co-financing partly or fully, which is the co-investor model, and (iii) providing the national co-financing at the project level. These three alternatives are not meant to be mutually exclusive. Given the features of urban and territorial FIs, contributions in kind in the form of publicly or privately owned assets (e.g. land, real estate) could take place at the level of the funds or at the level of the final recipient, if the respective project includes this type of assets.

The MA has to decide on the type of co-financing and the envisaged level where the national co-financing will be injected.

The General Methodology describes two main components of the investment strategy:

- The **scale and focus of the FI** which defines the structure of the fund; and
- The **governance structure of the FI** generally linked to the fund structure.

7.2 Defining the scale and focus of the FI

The definition of the scale and focus of a FI for urban and territorial development will in most cases need to be judged on the basis of specific circumstances and the needs of the target territory as they emerge from the market assessment block of the ex-ante assessment, as it is difficult to generalise. However, the 2010 Horizontal Study on UDF typologies provides a high-level conceptual framework linking the risk profile of investment strategies with the scope and structure of FI for urban development. Some of the insights it contains are summarised in this section and can be a useful general reference. However, a mechanical application of the indications of the study is not recommended, as other scale/focus combinations are possible and possibly more suitable to specific situations. Thus, the considerations presented in Chapter 1 of the present volume, the introduction to this Chapter and Section 7.2 of the General Methodology should be borne in mind when defining the scale and focus of a FI for urban and territorial development.

The low-risk approach illustrated in Table 10 and Figure 12 would fit situations that, in view of the position of the FI project portfolio in the urban and territorial development investment cycle, present a relatively low level of risk. Typically, this could be the case of energy efficiency in existing buildings, where the assets are currently in use, energy savings can be reasonably quantified and financial delivery models are relatively well-tested. In this case, it is possible that a single-purpose FI, fixed interest rate loans and a system to reach final recipients via retail or regional banks could provide a good 'package' to deliver effectively low-carbon economy impacts as part of a territorial strategy.

The high-risk end of the spectrum applies to cases where investments in the development / re-development phase constitute a higher share of the potential portfolio of the FI as emerged from the market assessment block in the ex-ante assessment. In this case, a multi-purpose fund may be a preferred option in order to address several sector-related challenges. It is also possible that a narrow spatial focus is necessary in order to address multiple needs and achieve a turnaround / regeneration impact. However, particularly if the focus of intervention is on deprived areas, this may make risk diversification more difficult and the narrow spatial focus may give rise to an additional geographical concentration risk. In order to better address the relatively high risk, FIs should employ risk-sharing financial products, including mezzanine finance and equity injections. Handling financial products like equity and mezzanine, however, normally requires fund managers with more experience and skills. Thus, a relatively higher administrative burden can be expected, both before the investment decision and during the whole lifetime of the support scheme.

Table 10: Risk related investment strategies for urban and territorial development funds

	Scope of FI	Form of FI	Scale of FI	Risk of FI
Low risk approach	Utilisation stage	Loan	- Single purpose, - scale to be defined (cap possible), - specific	Sector concentration (if any), no local concentration
Medium to high risk approach	Project preparation, construction, development and purchase included	Loan, guarantee[61]	- Single purpose, - large scale, - specific	More local concentration
High risk approach	Major renovation, replacement and redevelopment included	Loan, guarantee, mezzanine finance, equity participation	- Multi-purpose, - large scale, - narrow spatial focus	High local concentration

61 *The higher risk profile for unfunded products is described in Chapter 7.2.2 of the General Methodology.*

Figure 12: Paths with plausible combination of intervention stage, form of FI and risk profile of the intervention (adapted from UDF typology publication)

Managing Authority

	Path 1: Low risk	Path 2: Medium risk	Path 3: High risk
Trust Capital (of the UDF):	• Utilisation stage • National level • One TO (specific objective)	• Project preparation construction, development included • National level • One TO (specific objective)	• Deep renovation, replacement and redevelopment included • City, district or sub-district level • Multi-purpose
Financial Instruments:	• Long-term loans	• Long-term loans and guarantees	• All types, including equity and equity mezzanine
Governance structure:	• Only public actors • Direct implementation or Fund of Fund with retail banks as distribution channel	• Only public actors • UDF as part of existing (promotional) bank	• Public actors, later also private actors • UDF as independent newly founded investment fund with independent fund management
Costs/time/risk:	Low	Low	High
Impact:	Moderate	Medium to high	High
Necessary first implementation steps (for Managing Authority):	• Decide about structure Fund of Funds/ without Fund of Funds • Prepare agreements of UDF	• Select promotional bank • Completion of UDF funding agreement	• Selection of private investment fund manager (e.g. competitive tendering) • Completion of limited partnership contract (company formation) • Completion of UDF (e.g. funding agreement)

Source: Adapted graph from EIB (2009), UDF Typologies and Governance Structures in the context of JESSICA implementation

If not already done at an earlier stage, in the assessment procedure the MAs will have to decide on:

- The risk appetite of the envisaged FI;
- The supply of financial products (loans, guarantees, mezzanine, equity);
- Where applicable, the stages of intervention in the urban development life cycle; and
- The requirements for the fund architecture.

7.3 Defining the governance structure of the FI

The governance rules and procedures should be defined, as follows:

- Providing clarity around the decision making process (e.g. fund selection and investment decisions[62]);
- Establishing investment policies and approval processes (as a part of a wider set of principles for the envisaged FIs);
- Outlining control procedures (e.g. risk management, conflict resolution);[63] and
- Where applicable, setting the parameters for the FI to coordinate with ITI and CLLD operations.

Box 7: Example for the governance structure for CLLD

A governance principle for a CLLD could be to delegate its management to an intermediate body for the CLLD as a whole, in order to facilitate coordination tasks. The local action group (LAG) would have a single interlocutor and the reporting for the LAG would be much simplified. Even better links to the LAG could be expected by selecting an intermediary based in the area of the LAG. Local development agencies have played similar roles within LEADER in the past. If FIs are involved, the option for the single intermediary could be even more useful, as the implementation (e.g. with local retail banks) is much easier with a one stop approach. A further governance related decision where the CLLD is funded by several ESI Funds would be to designate a lead fund. According to the bottom-up principle of CLLD such a decision should involve the LAG as well.

The decision making in respect to governance structure is explained in Chapter 1.2 of the General Methodology.

7.4 Envisaged combination with grant support

As mentioned in Chapter 1, the combination with grant support may be an important support element to set up FIs for urban and territorial development, including where they have to operate in conjunction with delivery mechanisms like ITI and CLLD.

For urban and territorial development, political considerations in many circumstances may recommend a gradual transition from a former grant regime towards a loan or guarantee driven approach. The reduction in the volume of subsidies might create frictions, which could be partly

62 E.g. Investment Board rules.

63 See examples in publications on the UDF typologies and the HF handbook.

compensated by combining FIs with grant instruments. The main advantages in the long-term come from the revolving character of the instrument and the scope of 'crowding in' additional public and private finance.

The analysis should follow the principles spelled out in Section 7.3.2 of the General Methodology.

8. Specification of expected results consistent with the relevant Programme

8.1 Establishing and quantifying the expected results of the FI

Once the proposed investment strategy has been developed based on the elements described in the previous chapter, the ex-ante assessment has to provide an indication of the expected results, how and to what extent the FI is expected to contribute to the achievement of the specific objectives and results of the relevant priority or measure under which it has been established (i.e. its effectiveness).

The steps for defining the expected results of any FI are detailed in Chapter 8 of the General Methodology. There are 48 specific output indicators for the Investment for Growth and Jobs goal[64], some which may be relevant for FIs for urban and territorial development and are presented in Table 11.

Table 11: Examples of output indicators

Sector	Unit (examples)	Name
Productive investment	Full time equivalents	Employment increase in supported enterprises
Sustainable tourism	Visits/year	Increase in expected number of visits to supported sites of cultural and natural heritage and attractions
ICT Infrastructure	Households	Additional households with broadband access of at least 30 Mbps
Urban transport	Km	Total length of new or improved tram and metro lines
Solid waste	Tonnes/year	Additional waste recycling capacity

64 *Article 90 and 92 of CPR and Annex to the ERDF Regulation.*

Sector	Unit (examples)	Name
Water supply	Persons	Additional population served by improved waste water treatment
Wastewater treatment	Population equivalent	Additional population served by improved wastewater treatment
Risk prevention and management	Persons	Population benefiting from flood protection measures
Land rehabilitation	Hectares	Total surface area of rehabilitated land
Research, Innovation	Enterprises	Number of enterprises supported to introduce new to the market/new to the firm products
Renewables	MW	Additional capacity of renewable energy production
GHG reduction	Tonnes of CO_2eq	Estimated annual decrease of GHG
Urban development	Square meters	Public or commercial buildings built or renovated in urban areas
	Square meters	Rehabilitated housing in urban areas
Labour market and training	Persons	Number of participants in joint local employment initiatives and joint training

It is important to develop spatially meaningful output indicators for FIs for urban and territorial development, as well as indicators related to 'lowest cost solutions' to capture complementarities often present in territorial investment. For example, the retrofitting of a district heating system should include demand management measures and indicators. Sustainable lower demand will allow reducing the production capacity when the system is modernised and reduce the risk that the improved capacity will be unnecessarily oversized.

Output indicators are related to milestones needed to establish the performance framework for each priority.[65] Some of these milestones include:

- Financial indicators;
- Output indicators;
- Result indicators[66] (where appropriate).

The financial indicators for FIs could comprise expected credit defaults, management cost, share of non-performing assets, expected losses given default, etc. Such indicators are likely to be specific to each FI (and each financial product) and not applicable to grants. In contrast, output and

65 See Annex II CPR.

66 See chapter 8.1 of Volume 1.

result indicators for the different support schemes, including grants, should be the same within a given investment priority.

8.2 Specification of how the FI will contribute to the strategic objective

Please refer for further considerations to the General Methodology for guidance on the specification of how the FI will contribute to the strategic objectives.

8.3 Monitoring and reporting

Please refer to the General Methodology for guidance on monitoring and reporting.

9. Provisions for the update and review of the ex-ante assessment methodology

The ex-ante assessment should be updated and reviewed every time it no longer represents the initial market conditions. This may happen throughout any phase of the FI life cycle.

No specific variations of the general approach are foreseen for FI for urban and territorial development and the process described in Chapter 9 of the General Methodology should be applied.

10. Article 37 completeness checklist

For the completeness checklist the recommendations in Chapter 10 of the General Methodology should be applied.

Appendices

Appendix A
List of useful documents

- Alföldi Gy., Kovács Z. (2008), 'The future of our cities - joint responsibility and joint green action, Urban Green Book
- Alliance to Save Energy (2007), 'Regional Synthesis Paper: Addressing Affordability of Utility Services in Urban Housing: Energy Efficiency Solutions', Municipal Network for Energy Efficiency, A Program of USAID, Washington, D.C.
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- European Court of Auditors (2012a): Opinion No 7/2011. On the proposal for a Regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1083/2006. Official Journal of the European Union.
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- European Investment Bank (2010) JESSICA – Holding Fund Handbook, Nov 2010 (EIB publication);
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- Competition Policy Newsletter (2011): First JESSICA decisions - approach and implications, Number 3 / 2011;
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www.fi-compass.eu
contact@fi-compass.eu

European Commission
Directorate-General
Regional and Urban Policy
Unit B.3 "Financial Instruments and IFIs' Relations"
B-1049 Brussels

European Investment Bank
Advisory Services
fi-compass
98-100, boulevard Konrad Adenauer
L-2950 Luxembourg