European Commission

European Investment Bank

JESSICA Evaluation Study

The implementation of Financial Instruments to support urban development in the Ile-de-France region 2014-2020

English version

DISCLAIMER

This study was designed, commissioned and edited by the EIB, co-financed by DG REGIO and assigned to the consulting group Mazars LLP – Tower Bridge House - St Katharine's Way - London - E1W 1DD

Executive Summary

In accordance with the objectives of territorial cohesion policy, regional competitiveness and job creation, this study examines the possibility of using Financial Instruments deploying EU resources to support urban development within the next programming period (2014 – 2020) in the Île-de-France region.

Through a series of discussions with public and private sector stakeholders, a high-level analysis of 79 urban development projects, followed by a detailed analysis of nine of those projects, and the financial modelling of three case studies, the aim of the study was to identify and assess the following:

- market segments where the discrepancy between the supply of, and demand for, financial resources is adversely affecting project development, and;
- the financial and non-financial benefits of using Financial Instruments.

In this report, the strategic framework for deploying Financial Instruments is discussed, an organisational structure and investment strategy for each Urban Development Fund (UDFs) is proposed, the stages for designing and managing UDFs are described, and recommendations to the Managing Authority are outlined.

The recommendations concern the need to make provisions for the **inclusion of Financial Instruments in Operational Programmes for investments in urban areas**. To the extent that legislation allows, such revolving instruments could be considered under a multi-themed priority axis devoted solely to urban regeneration measures, or in a priority axis dedicated to Financial Instruments.

The strategic framework for Financial Instruments

Financial Instruments are established with Common Strategic Framework (CSF) Funds and must therefore fall within the objectives of the following policy documents:

- The European Union's "EU 2020" growth strategy and its five priorities in employment, R&D/Innovation, climate change/energy, education, and social exclusion;
- The Common Strategic Framework for future cohesion policy 2014-2020 and its 11 thematic objectives;
- The potential subject areas of CSF Funds (see glossary).

To effectively respond to the social and economic challenges in areas requiring investment in urban development and regeneration, projects should be aligned with, and form part of well-integrated urban programmes. This integration allows for more efficiency in delivery. Protecting the environment also forms a significant component in the aforementioned strategies and represents both a need and a financing issue for disadvantaged areas.

The "Grey zone" and market gaps

Projects are analysed in the study according to two main aspects: their positioning in the "Grey zone[1]" and their potential eligibility for CSF funding in accordance with the eight market segments which could be particularly relevant for the use of UDF-type Financial Instruments:

i. Transformation and restructuring of business parks and industrial estates
ii. Restructuring of retail spaces
iii. New buildings for SMEs / VSEs
iv. Energy-saving refurbishment of large buildings or residential areas
v. Promotion of renewable energy: geothermal district heating systems
vi. Building smart grids
vii. Development of eco-districts
viii. Creation of telework centres and co-working spaces

[1] The 'Grey Zone' is explained within the main body of the study'.

The financial and non-financial benefits from UDFs

The study shows that CSF Funds could be deployed via Financial Instruments that invest in the form of equity, loans, financial guarantees, or any other form of repayable and recyclable investment. In particular, the benefits of using Financial Instruments include:

a) They help to accelerate investments in urban development projects in the "grey zone" through low-cost financing;
b) They allow extended investment periods and a reduced need for short-term financial returns, and;
c) They provide reassurance to private investors to help encourage an amplified level of investment in urban development projects.

The use of Financial Instruments presents three main benefits, making them a viable and sustainable **investment mechanism** for a Managing Authority:

a) The repayable and recyclable nature of the mechanism and the actual and nominal investment capacity can increase over time;
b) Viability of projects and their chances of success are enhanced;
c) The leverage effect of Co-Investment which can amplify the support provided to strategically important urban projects (as well as prompting the private sector to participate in projects).

UDF organisational structure and investment strategy

The analysis conducted within this study suggests that market needs are found in the following sectors:

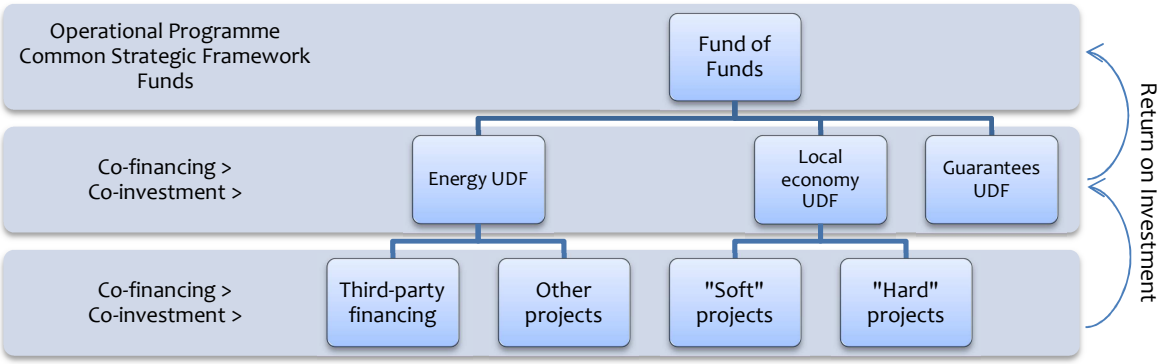
a) Support for the local economy, the development of VSE-SMEs and innovation
b) Energy saving and renewable energy

A UDF dedicated to issuing **financial guarantees** would be useful to trigger investments or loans in projects with financial risks which require mitigation.

A Holding Fund ("Fund of funds" or a special-purpose parent company) structure would **simplify the administration** procedures related to implementing and managing funds.

Legal research to confirm the proposed Financial Instrument architecture as well as State Aid issues will be necessary given the forthcoming changes to European regulations on Financial Instruments for the next programming period.

The proposed Financial Instrument structure is shown below:



According to the analysis, based on interviews conducted during this study, the Holding Fund (HF) could be allocated a **€100 million** contribution from CSF Funds (excluding the Guarantees UDF budget and formation and operating costs). This estimate can be seen as a maximum with regard to the potential CSF Fund contribution allocated to the region, and also as being realistic in relation to the market need and related capacity for absorption of the resources.

The above figure would need to be confirmed during a full ex-ante assessment to be conducted prior to the establishment of Financial Instruments.

Stages required to design and manage HF and UDF-type Financial Instruments

The key stages in designing and establishing the HF and UDF-type Financial Instruments to invest in urban development projects are outlined in section 3.4 of the study. These stages are all key to the success of Financial Instruments and projects receiving financing. Preliminary studies, including an ex-ante assessment as mentioned above as well as specific research into **state aid** issues to confirm the structure of the Financial Instruments to be established will be essential.

Project assessment and selection will be a key stage: the project assessment methodology will need to be developed (possibly with some technical assistance, as discussed in section 4.4 of the study) in a **uniform and transparent** way. The communication campaign to promote the fund to potential project managers will be equally important as well as the need for guidance notes to support project managers with the funding application process.

Furthermore, **performance measurement** will need to use monitoring tools to enable regular management reports to be produced: presenting the results from projects and UDFs using financial and non-financial indicators.

Recommendations to the Managing Authority

Recommendations have been devised based on the key findings within the Study:

- **Invest in identified "grey zone" market segments**

  This study demonstrates the need to invest in market segments identified as being in the "grey zone". It also outlines the feasibility of implementing Financial Instruments and the benefits of using Financial Instruments to support urban projects situated in the "grey zone".

- **Promote investment in partnership with the private sector**

  The involvement of the private sector is essential to the success of Financial Instruments in the identified sectors. Therefore, project managers and potential co-investors require the necessary information to ensure that the Financial Instruments to be established meet market demand.

- **Mention the use of UDF-type Financial Instruments in the Operational Programme within a specific Priority Axis**

  The main benefits of establishing Financial Instruments in order to help achieve objectives in urban policy through the use of CSF Funds include: streamlined administration processes, finance made available in shorter timeframes, and increased flexibility in investment criteria.

- **Organise technical assistance**

  Technical assistance for the Managing Authority and project managers would enable better management of Financial Instruments through the various stages, and thus help deliver more successful implementation of UDF-type Financial Instruments and their investments into urban projects.

Contents

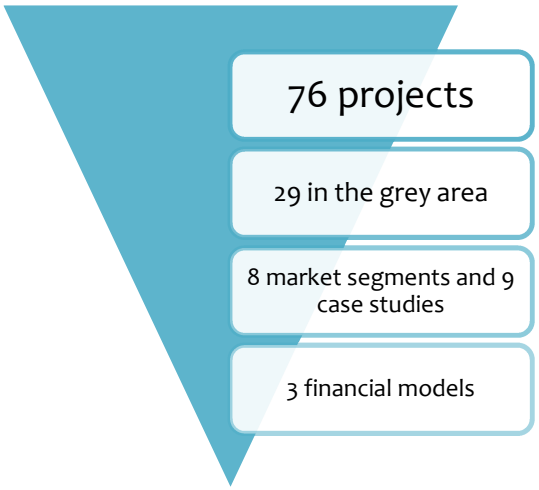
Glossary

CDC	*Caisse des Dépôts et Consignations* [French institution entrusted with managing public funds]
CDT	Regional Development Agreement (*Contrat de Développement Territorial*) [a French domestic policy measure]
Co-financing	Public- or private-sector domestic contribution made to the CSF Funds
Co-investment	Top-up investment from the private or public sectors in a given project or UDF
EC	European Commission
EIB	European Investment Bank
CSF Funds	The European Regional Development Fund (**ERDF**), European Social Fund (**ESF**), Cohesion Fund (**CF**), European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund are now collectively known as the CSF Funds.
Financial Instruments	Term used in the draft EU regulations for 2014-2020 to refer to various instruments delivering revolving forms of finance in the deployment of CSF Funds
Fund	Financial Instrument, usually a legal entity, which finances projects on the basis of a given investment policy.
Fund of funds	Holding Fund (HF)
Grey zone	The Grey zone refers to urban development projects, which in financial terms generate sufficient revenues to not be wholly financed from public funds, but where returns are too low to be financed solely by the private sector.
GSRA	General Secretary for Regional Affairs
Guarantee	Commitment to repay all or part of the capital and interest owed in the event of default on a loan granted by a banking institution
JESSICA	Joint European Support for Sustainable Investment in City Areas
Leverage	Total amount of funds invested in a project divided by the amount of these funds that comes from the public sector
Management fees	All the costs relating to the management of Financial Instruments
Managing Authority	Public-sector body in a member state which manages the CSF Funds (including ERDF). At the regional level, this is the GSRA.
Market gap	Discrepancy between the supply of and the demand for financial resources
Pari-passu	Describes two Financial Instruments that will be repaid with the same priority (as against preferential treatment)
PPP	Public-Private Partnership
Priority Axis	The name given to the different programme priorities within a European Operational Programme supported by CSF Funds
Revolving	Repayable and recyclable funding mechanism
SDRIF	*Schéma Directeur Régional d'Île-de-France*, the regional master plan for the Greater Paris region (Ile-de-France)
SEM	A French legal form (*Société d'Economie Mixte*), a public-private partnership with a majority public-sector interest
SMEs / VSEs	Small and Medium Sized Enterprises/Very Small Enterprises (Entrepreneurs)
UDF	Urban Development Fund
ZAC	Mixed Development Area
ZUS	Designated urban zone considered to be "sensitive"

Introduction

Mazars-Algoé consortium was selected by the European Commission and the European Investment Bank to produce an evaluation report regarding the use of JESSICA type Financial Instruments in the Ile-de-France region. In accordance with the objectives of **territorial cohesion policy, energy efficiency and economic development through innovation**, this study examines the possibilities of using Financial Instruments for urban development projects within the next programming period (2014 – 2020).

The European Commission is encouraging[2] Member States (MS) to make greater use of these Financial Instruments, possibly combining them with grants if need be, to support projects that cannot attract sufficient levels of private sector Co-Investment alone, and that offer **positive externalities** in line with EU development objectives. Such **revolving** investment mechanisms (i.e. **repayable and recyclable** funding) work to support economically viable urban development projects and make it possible to increase the financing capacity of Managing Authorities (MA) over time.



The objectives of this study are:

a) Knowledge-building about regional **development projects** in the Ile-de-France in view of the "*Grand Paris*" initiative and "eco-district" projects designated as new urban districts; determining those market segments showing investment deficiencies; identifying **market gaps;** and describing existing Financial Instruments. On the basis of this overview, the "“Grey zone”" was identified. This refers to those urban development projects, which in financial terms, generate sufficient revenues to not be wholly financed from public funds, but where returns are too low to be financed solely by the private sector.

b) Examining **implementing Financial Instruments** in the region (based on three case studies and indicative financial simulations) including:
    a. The potential for financial instruments to bridge the market gap,
    b. The leverage ratio that this type of Financial Instrument may yield through partnerships and Co-Investments.

c) Producing **recommendations** with a view to helping Managing Authorities with the negotiation process with the European Commission regarding the next programming period.

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By encouraging private capital to invest in market segments that are usually not sufficiently attractive to private sector investors, Financial Instruments could enable new forms of public-private partnerships, encouraging the blending of each side's expertise and contributions to projects that are in the public interest.

[2] Brussels, 9.11.2010 COM(2010) 642 final - {SEC(2010) 1348 final}

1. Key projects and CSF Funds

1.1 "*Le Grand Paris*", an urban, social and economic project of national interest[3]

Discussions about the "*Grand Paris,*" or the Greater Paris initiative, began in 2009 and led to the enactment of a law of 3 June 2010, which states that "*Grand Paris* is an urban, social and economic project of national interest (…) and promotes sustainable, socially responsible economic development that creates jobs in the Paris region". This aligns with the objectives of CSF Funds which support policies implemented by Member State Managing Authorities with regards to innovation, employment, training and education, and combating social exclusion.

With a population of 9 million and GDP of €382 billion in 2005[4], the Greater Paris area is **one of the largest city regions in the world**, and one of the main economic driving forces of the French and European economy. However, in the last few years, there has been a **slowdown in the Ile-de-France's economic competitiveness**, especially in comparison to cities in the emerging economies.

A project addressing three major challenges: inequality, climate change, and economic growth

The regional economy of Ile-de-France needs to be revived to reach its full potential by establishing optimal **conditions to allow for sustainable development and renewed competitiveness**.

The *Grand Paris* project involves two major components. The first are plans to build major extensions to the Paris underground system, known as the *Grand Paris Express* that aims to improve mobility within the region and to further support regional economic and urban development. The second component, related to local urban development, has been formalised by the setting up of Local Development Agreements (*CDTs: Contrats de Développement Territorial*).

The masterplan for the Ile-De-France region (or *SDRIF*), an urban planning document, promotes regional development. It discusses three major challenges: promotion of social and territorial equality; the anticipation of and responses to major changes and crises, particularly those connected to climate change and the rising cost of fossil fuels; and the development of a dynamic Ile-de-France region to maintain its place in the world economy. This document complements the *Grand Paris* initiative approach.

Since Autumn 2011, the Ile-de-France regional council has been conducting a review of the *SDRIF* master plan, in order to incorporate the *Grand Paris Express* transport network into the plan, and include more general provisions of the Grand Paris legislation from 2010. This review should be completed by 31 December 2013.

[3] See Appendix 2
[4] Source: INSEE (French national statistics office)

1.2 A historical view of integrated urban development

Over the period **2000-2006**, the objective of the Urban Community Initiative Programme (Urban CIP) was to support the economic and social regeneration of dilapidated towns, cities and neighbourhoods by encouraging the development of innovative and integrated urban development schemes. More than €51 million of ERDF funds (out of a total of €147 million allocated to the region) were at the time allotted to four areas targeted under the Urban CIP II (Clichy-sous-Bois/Montfermeil, Grigny-Viry-Châtillon, Le Mantois, and Le Val de Seine), with equal distributions of ERDF funding between the four areas.

Over the period **2007-2013**, the CSF Funds total European budget is €308 billion, including €12.8 billion for France and €700 million for the Ile-de-France region, of which €151 million is allocated to the ERDF. As part of the ERDF regulations, ERDF needs to be co-financed at a rate of 50% from the state, local authorities (at the *département*, Regional Council, municipal and inter-municipal (*EPCI*) levels in France) or from private-sector organisations (non-profit associations, companies).

The 2007-2013 ERDF programme has enabled projects of varying size to be supported, including several major schemes showing potential for urban development. The 2007-2013 ERDF programming period is structured around several priority areas, including: (Priority I) sustainable development of urban areas in difficulty, (Priority II) innovation and competitiveness of the economic fabric, (Priority III) environment and sustainability, (Axis IV) risk prevention, management of usage and natural resources of the river Seine, (Priority VI) housing for marginalised communities. Priorities I, III and VI therefore relate to urban development.

The support mechanism under ERDF Priority I forms concerns the integration of social, economic and environmental issues within a specific geographical area covered by an association of local authorities or a publicly-funded development agency. Over the period 2007-2013, this priority axis has received €63 million, or 42% of the ERDF budget allocated over this period. A review of projects financed through this priority axis shows that they support refurbishment of dilapidated public-owned apartment buildings in Ile-de-France and energy efficiency retrofit in some private housing schemes. This confirms the importance of energy efficiency measures in the negotiations of the 2014-2020 programming period.

Importance of energy efficiency issues

Priority III received €17 million, or 11% of the ERDF budget allocated over this period, making it possible to finance energy-related refurbishment of social housing in economically deprived urban areas, as well as various environmental initiatives within integrated urban projects.

The Operational Programme evaluation reports stress the positive effects of an **integrated approach to urban development**, making it possible to respond to interconnected issues, whether economic or social in nature (for example, combating energy consumption, unhealthy living conditions, and support for the local economy might be the strategic objectives for a single project). This integrated approach appears to be more appropriate and more effective than a structural approach, especially in terms of positive impact on the geographical area in question.

1.3 The convergence of strategic objectives

In June 2010[5], the European Council adopted the Europe 2020 Strategy with the aim to stimulate smart, sustainable and inclusive growth. This strategy sets out the major objectives of the EU **up to 2020** regarding research and innovation, climate change and energy, employment, education and poverty reduction. As such, the ERDF should contribute to all objectives covering these matters by focusing on the areas of investment related to the business environment (infrastructure, business services, business support, innovation, ICT and research) and the delivery of services to populations in certain areas (energy, online services, healthcare, social and research infrastructure, accessibility and environmental quality).

The Lisbon Treaty added territorial policies to the principles of economic and social cohesion as it is evident that geographic or demographic aspects can exacerbate development problems. This comprehensive approach to promoting smart, sustainable and inclusive growth should therefore reflect the role of towns and cities and take into account of those urban areas facing specific demographic or geographic challenges.

The **Common Strategic Framework** (CSF) published by the European Commission on 14 March 2012[6] guides EU member states' actions and priorities until 2020. It also helps Managing Authorities in preparing for the next programming period and should improve the combined, sustainable use of the various CSF Funds, which will maximize the impact of the EU's long-term investments.

National and regional authorities will also need to refer to this framework to draw up "partnership agreements" with the European Commission, through which they will undertake to achieve Europe's growth and employment objectives for 2020. In addition, the Operational Programme for the 2014-2020 programming period will be the local mechanism used by Managing Authorities to implement these strategies.

Lastly, the *Grand Paris* initiative was produced in response to several fundamental problems, namely how to sustainably incorporate Paris into the international economic marketplace, whilst also building an environmentally sustainable city conforming to the Kyoto protocol. The strategic framework therefore has strong resonance with the new projects for Paris and the surrounding region.

[5] EUROPE 2020 A strategy for smart, sustainable and inclusive growth, European Commission
[6] Common Strategic Framework, European Commission

1.4 The strategic positioning of a Financial Instrument

This initial examination provides a brief overview of the public policy background to the potential establishment of Financial Instruments[7] during the next programming period. The following outlines the initial conclusions of this examination:

- The region is facing social and economic challenges which require large investments, especially in urban development and regeneration.
- The interconnectivity of projects with "integrated urban plans" is crucial to ensuring a coherent urban development policy.
- The subject of the environment represents both a need and a financing issue for disadvantaged areas.
- A "**sustainable**" Financial Instrument offers long investment cycles that needs to be available to support urban development projects meeting EU objectives adapted for the regional level.

The research during this part of the study also showed that the **active involvement of the private sector** is critical and removing certain cultural barriers that may currently prevent joint partnerships between the public and private sectors is necessary in order to accelerate investments into urban development projects in this geographical area. To mobilise private sector involvement, some administrative flexibility will be needed in regards to implementing and managing Financial Instruments, which would be considered as a major benefit.

The suitability of Financial Instruments will therefore depend not only on the policy strategy in urban development, but also and importantly on needs and demands expressed by the market. This financing need must be carefully identified to maximize the impact of a Financial Instrument designed to bridge the "market gaps", i.e. the discrepancy between the supply of and the demand for financial resources in particular economic sectors.

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Based on the main strategy areas described above, urban development projects in the Ile-de-France region are built on the complementary activities of the private sector and publicly-funded programmes.

[7] See Appendix 1

2. The urban projects market in Ile-de-France

The private and public sectors are traditionally involved in projects having different business models: the public sector provides grants to projects that are unprofitable by nature or by design, whereas the private sector only invests in projects that are economically viable and bankable. Between these two spectrums, there is a "Grey zone" that requires financing currently not covered by the market.

2.1 The ""Grey zone"" and the market gap

The "Grey zone" is found along the spectrum between the commercial private market and the grant financing public market. Grey zone projects might be single-component projects (e.g. a building accommodating a business incubator), or projects combining several components, typically mixed-use schemes (such as an area composed of some public infrastructure, support for private sector innovation, and landscaped open spaces). Such projects that on one hand are not profitable enough to attract private sector investment, but on the other, are revenue-generating and therefore not suitable for public sector grants, are said to be in this ""Grey zone"".

Projects that are insufficiently profitable for the private sector, but that generate revenue so are inappropriate for grant funding

Three main challenges facing projects in the "Grey zone" are:

i. A **technical** challenge when it comes to developing new technologies (for example smart power distribution grids), or measuring the benefits of change even where the technology is already developed (for example in building refurbishment aimed at cutting energy consumption).
ii. An **economic** challenge particularly in regards to investing in a category of projects for which the risk-return profile is not established (for example a new economic sector such as telework centres). If the commercial success of the activities is not recognized by the market, then the private sector may be reluctant to invest in projects, or may demand higher financial returns commensurate with the level of risk.
iii. A **legal and cultural** challenge regarding the projects to be financed through public-private partnerships or special purpose investment vehicles, as the projects must abide by the legal framework, and must meet several requirements including in relation to state aid.

Successful financing of such projects will depend directly on the ability of project managers to address these challenges.

As part of this study, 76 projects were identified from amongst areas where agreements with the French state under the *Grand Paris* initiative have been signed (11 framework agreements), and projects designated as "new urban districts 2011" (*NQU*), "eco-districts 2011" (*éco-quartiers*) and "eco-new towns" (*éco-cités*). Of these, 29 projects were categorised as being in the "Grey zone". These development projects were analysed in terms of the five priorities identified for the urban investment dimension by the European Commission's Europe 2020 Strategy[8], i.e. promotion of low-carbon strategies, economic revival of urban environments, promotion of sustainable mobility, reduction in social inequality between areas, and technological innovation.

Analysis of the projects in the "Grey zone" outlines the market gap, where demand for financial resources for economically viable projects exists, but the current supply from the public and private sectors appears to be insufficient. Interviews conducted[9] with the main stakeholders (public- and private-sector financial backers and project managers) and an in-depth examination of selected projects made it possible to more accurately pinpoint this gap and the market segments concerned.

[8] Source: the urban dimension in the legislative proposals for the future cohesion policy / European Commission / Zsolt Szokolai / DG Regio C.2 Urban Development, territorial cohesion
[9] See Appendix 5

2.2 A cautious and reserved private sector

There are three main types of private-sector players in development and urban regeneration in the Île-de-France region (Paris and the surrounding area), namely property developers, investors and banks.

Property developers

Property developers play an integral role in carrying out development within urban projects. Property development companies carry out the bulk of activities, with the rest being managed by operating firms (property building/sale companies, property syndicates called *Sociétés Civiles Immobilières*). Property developers do not invest directly in long-term urban development projects because their operating periods are generally short, usually 3 to 4 years maximum. In addition, property developers bear the risk of construction, which is usually not the case with other market players.

Investors

Investors differ from property developers because they acquire property within development projects with a view to managing the property over the longer term. Investors' actions will be guided by their analysis of the risk-return profiles: the higher the risk, the higher the return required. The current state of the financial markets does not encourage risk-taking or investment in new types of projects such as projects within the "Grey zone". However, the low volume of opportunities on the market, the appeal of large-scale projects such as the *Grand Paris* initiative, and the benefits of receiving support from public funds could act as a catalyst for mobilising private investors to get involved in long-term urban development projects.

Banks

Property developers and investors rely upon private banks for providing the necessary liquidity to finance their projects. The analysis of the projects for potential financing made by the banks is similar to that used by investors, and therefore bank financing offers a somewhat reduced potential support for "“Grey zone”" projects. This is reinforced by the regulatory context (Basel III) and the macro-economic situation (credit crunch since 2007). In contrast, banks with a public interest remit and close ties with local authorities apply a different strategy: longer term investment, preferential rates, with expectations relating to the public interest of the project being funded. In these instances banks will therefore be the first to be asked to finance urban development.

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An initiative, involving CSF Funds and co-financing by regional funds from local authorities or other public bodies, could improve the risk-return profile offered by Financial Instruments. The private sector would then be encouraged to participate in investments through public-private partnerships which would then enable the region's objectives to be achieved.

2.3 Existing public-sector funding bodies

Funding for projects in the "Grey zone" have already been addressed by a small number of public-sector organisations at national and regional levels in France, including:

SEM Posit'if

SEM Posit'if is a public-private company (Société d'Economie Mixte) formed in November 2011, working solely in the renewable energy and energy efficiency sector[10]. It responds to the challenge of local energy production and energy conservation, mainly in housing - a major source of energy consumption in the Ile-de-France region, one of the most urbanised and densely populated area in France. Given the needs identified in terms of energy-efficiency retrofit of buildings in Ile-de-France, SEM Posit-if is well- positioned to serve as a third party investor. However, SEM's economic structure seems to need to be supported with inexpensive financing as a way to reduce the average cost of funds and encourage the inflow of private-sector capital.

The Caisse des Dépôts et Consignations

Since 1999, the *Caisse des Dépôts et Consignations* (CDC) has been developing a line of business aimed at supporting "productive" (tertiary sector) property investments in the field of urban regeneration and economic development in urban areas and on brownfield sites. This includes supporting economic development by encouraging property projects through public-private partnerships; encouraging business creation and growth; and bolstering the expansion of "digital" development (expansion of telecommunications infrastructure). CDC's involvement may take the form of favourable rates on loans for urban renewal; pre-financing of development schemes; acquisition by the CDC of land and property (for subsequent resale to the project owner); and Financial Instruments by taking an equity interest. Given that CDC has been investing in projects falling within the "Grey zone", CDC therefore could potentially be a major key player in the market.

French Agency for the Environment and Energy Management

The Agency for the Environment and Energy Management (*ADEME*) is a publicly-funded institution working in the areas of the environment, energy and sustainable development. Within their operating scope, ADEME assists in project funding, from research to implementation. ADEME works in similar fields as SEM Posit'if, specifically in energy efficiency, but at different levels. Whilst SEM Posit'if looks for a minimum level of profitability, ADEME concentrates on projects operating under more adverse economic circumstances which will not necessarily generate any returns on investment. ADEME could therefore be involved in supporting projects in the "Grey zone".

Other operators involved in the "Grey zone"

France's *SEMs* are hybrid organisations that are funded by both the public and private sectors. Similar to France's publicly-funded development corporations (*EPA*), the purpose of these bodies is to perform property and redevelopment transactions on behalf of the state, local authorities, or public institutions.

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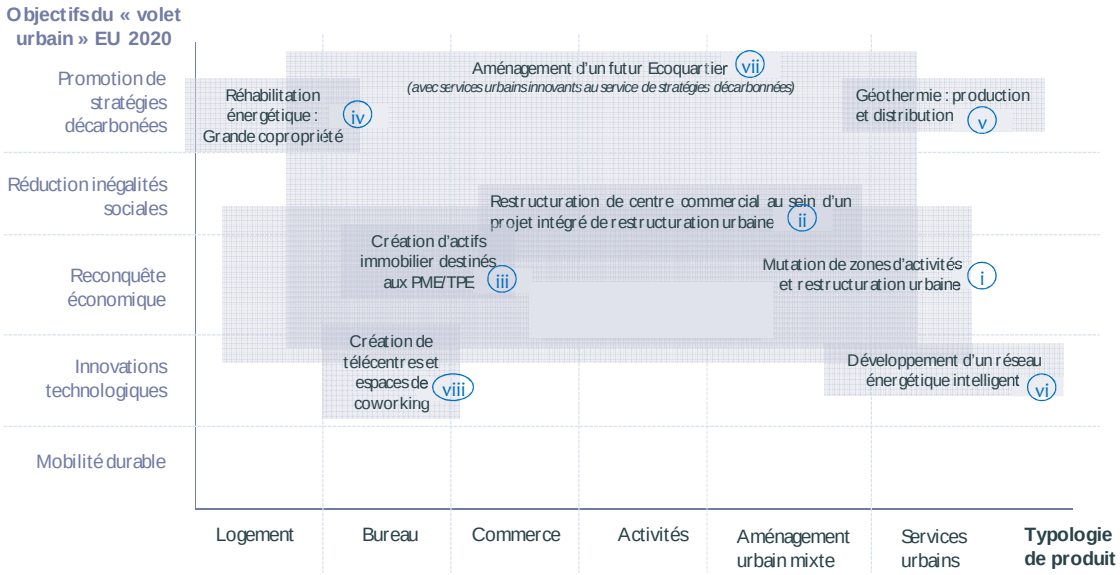
These bodies have proven their effectiveness in terms of working in partnership (with the exception of SEM Posit'if, which is still being formed), but are too small in scale to cover the aforementioned market gap. A **further contribution** of funding made to implement regional policies objectives would certainly be a useful addition.

[10] See Appendices 5.2 and 4.2

2.4 Market segments identified as in the ""“Grey zone”""

Analysis of the selected projects for this study based on their eligibility criteria and their position on the spectrum of this “Grey zone” revealed **eight market segments**[11] which could be particularly relevant in terms of the use of Financial Instruments. These segments are shown on the diagram below and then described beneath it:



i. Transformation and revitalisation of business parks and industrial estates

These are zones with a well-defined perimeter accommodating a number of companies in warehouses, business premises or logistics depots. Such zones are typically isolated from their immediate environment. “Grey zone” characteristic: the revitalisation of such zones often requires high spending on decontamination and carries substantial market risk (local demand for other types of economic activities is often unknown).

ii. Revitalisation of retail spaces

Mainstays of the local economy and community life for some areas in difficulty, local authorities manage such site conversion projects, which have a significant impact on their environment (employment, local economy, vitality of the area, etc.).

“Grey zone” characteristic: these retail spaces suffer from financial difficulties for reasons that are often technical in nature (entirely traffic-free design, for instance) or out of concerns over public safety.

iii. New buildings for SMEs / VSEs

Many areas see a continual need for property development to accommodate and promote the growth of businesses. The market segment identified in this area includes projects based on the creation of premises to support SMEs / VSEs which are intended to facilitate the long-term presence of small businesses in the territory.

“Grey zone” characteristic: in areas with little or no development, demand is difficult to assess. In addition, the businesses concerned (new businesses) present a substantial financial risk to investors.

[11] See Appendix 3.2

iv. Energy-saving refurbishment of large buildings or residential areas

This segment primarily includes assistance for housing organisations (co-owners' associations) to facilitate decision-making regarding energy efficiency improvements in insulation, heating systems' performance, and installing lightweight renewable energy sources (such as photovoltaic panels).

"Grey zone" characteristic: the requirement for long-term financing (the payback period of the capital works is long) is not compatible with the banking services currently on offer and the expected returns are slightly lower compared to the anticipated costs of financing.

v. Promotion of renewable energy: geothermal district heating systems[12]

The use of such systems enables users to maintain their thermal comfort while paying the same energy prices. All the territories studied show strong potential for rolling out of geothermal systems.

"Grey zone" characteristic: excessively long return on investment restricting private-sector involvement, and the price of fossil fuels is highly competitive.

vi. Building smart grids

These energy systems use computer technology to optimise power production, distribution and consumption, and to improve the match between supply and demand, i.e. between the generators and consumers of electricity.

"Grey zone" characteristic: a substantial risk relating to the innovative aspect of such projects, returns on investment being currently difficult to quantify.

vii. Development of eco-districts

This market segment has the distinctive feature of being very broad, both in terms of the asset types concerned (offices, housing, urban services, etc.) and the response it provides to the EU 2020 objectives and thereby the 11 subject areas covered by Cohesion Policy.

"Grey zone" characteristic: usually entails complex projects involving many stakeholders, (re)development costs are high owing to the additional costs related to environmental, energy and planning requirements, and for which the return on investment may prove to be long or unpredictable (risks taken with new districts, etc.).

viii. Creation of telework centres and co-working spaces

The purpose of such spaces, fitted out in tertiary premises, is to offer an alternative solution to the conventional workplace (telephone, internet, printer, video conferencing, basic catering service, etc.) but having an equivalent workspace located in close proximity to living places.

"Grey zone" characteristic: the business model is not yet determined, the market risk is high (little experience in this segment), and a large number of telework centres need to be developed in the first phase to deliver satisfactory geographical coverage.

*

Of the 76 projects analysed for this study, 29 were categorised as in the "Grey zone", of which nine projects matching the market segments identified above were selected for possible in-depth analysis[13]. A detailed financial analysis[14] of three projects selected from the nine projects as case studies was undertaken to assess the technical benefits of implementing Financial Instruments for the market segments identified. An investment strategy was also developed and is outlined below.

[12] Projects involving energy generation from biomass or biogas recovery may also be of interest, see p71
[13] See Appendix 3.3
[14] See Appendix 4

3. The involvement of Financial Instruments

Detailed analysis of case studies for this study made it possible to identify the benefits of using Financial Instruments deployed through either a Fund of funds or Urban Development Fund for the development of "Grey zone" projects. An investment strategy for UDFs in the Ile-de-France region has been proposed based on this, as well as arrangements for Financial Instruments and key stages in their implementation outlined.

3.1 Detailed analysis of case studies

Financial analysis intended to demonstrate the **impact of the potential use of Financial Instruments** was conducted for three selected case studies, namely SEM Posit'if telework and co-working spaces, and the Fort d'Aubervilliers eco-districts. The objective of this exercise was to illustrate the financial and non-financial benefits of using Financial Instruments through an UDF.

3.1.1 Summary presentation of the three case studies

These projects were selected purely for illustration purposes. As such, the analysis does not equate to an assessment of their eligibility for investment by a potential UDF.

Third-party financing of energy-saving refurbishment: SEM Posit'if

SEM Posit'if targets two areas:

i. Investment in energy efficiency projects
ii. Investment in renewable energy (wind on the outer fringes of the region, biogas recovery projects, biomass, deep geothermal resources)

The project examined the energy efficiency, and more specifically energy-saving refurbishment of co-owned housing in Ile-de-France, which is a priority area for the organisation. SEM Posit'if is responsible for refurbishment work, including coordinating technical advice, financing, and insurance. It also secures and provides guarantees on the financial resources generated by the additional future energy savings.

Secures and guarantees financial resources from energy savings

The financial mechanism is as follows: investment in refurbishment work reduces energy-related spending. A "rent" equating to the energy savings generated is charged by SEM Posit'if to the property owner for a period which varies depending on the project. The owner therefore pays the energy bill plus the "rent," in which the total is equivalent to the energy bill before the energy efficiency work was carried out. In this sense, the "rent" is used finance the initial investment made by SEM Posit'if. At the end of the agreement, the property owner pays only for their actual energy usage and therefore benefits from the energy savings as well as the potential added value of the work on their property.

Based on the business plan, SEM Posit'if anticipates applying this scheme to about 80 co-owned buildings over ten years, making an investment of €163 million.

Support the economic activity of VSE/SMEs by creating business premises without acquisition ("soft" scheme): telework centres and co-working spaces

Telework centres and co-working spaces are workspaces located close to where workers live. These types of projects help in terms of reducing the carbon footprint, and hence support the climate change agenda as well as supporting the local economy. They also meet a local need for reducing road congestion and easing the pressure on public transportation, which together make business mobility difficult and expensive.

A workplace 15 minutes from home

There is a growing interest in finding innovative solutions which allows employees to work closer to home. Similarly, companies would also like to expand upon this form of working, thereby reducing the square footage requirements per employee, as well as gaining extra availability of space. However, working exclusively from home does not provide an optimal solution as it often isolates employees, depriving them of the technical and collaborative working environment that boost productivity and form social relationships.

Convinced of the concept's potential, CDC intends to expand this model across France. An initial study has been carried out in the region, and a second report is planned for the Autumn of 2012 to identify market needs within the *Grand Paris* initiative. An initial project backed by the CDC includes private firms that are providing their technical expertise. Fifteen telework centres would be set up in Ile-de-France over the short term, and over 200 telework centres would be established in the region by 2020. This figure of fifteen initial projects would allow sufficient geographical coverage to attract the first large companies.

In order to model the benefits of using Financial Instruments to support these telework projects, a theoretical project combining a telework centre component and a co-working component was used for illustrative purposes.

Support the economic activity of VSE/SMEs by creating business premises with acquisition ("hard" scheme): the innovation cluster in the Fort d'Aubervilliers eco-district

Mixed-use development, focused on economic vigour and energy efficiency

The plan for the Fort d'Aubervilliers site is to remediate an old fortification of Paris into an eco-district project, covering an area of 35 ha. The project is targeting an integrated production process for the town through a cross-functional approach that showcases the architectural and landscape potential of the site: repairing the walls, remediating old buildings, and restoring parks and gardens.

The project is organised around the creation of an arts and cultural centre (artists' studios, exhibition spaces), building a business / housing / retail / amenity centre anchored by a future multimodal transport hub, and designing parkland and recreational areas with traffic-free routes on the site where two pedestrianised walkways are planned. The project will include local shops, nurseries, leisure facilities and a school.

To examine the UDF's potential to help in carrying out this project, which is particularly well-integrated in terms of the Managing Authority's strategic objectives of supporting SMEs, innovation, and energy savings, the financial analysis focused on the 40,000 m^2 devoted to accommodating SMEs and support for innovation which could possibly be backed by a special-purpose company.

3.1.2 Financial analysis of the UDF's involvement

The table below illustrates for purely information purposes, the financial impact of UDFs investment by means of equity or debt in the selected case studies.[15]

Project type	Third-party financing of energy-saving refurbishment	"Soft" economic activity (Telework centres)	"Hard" economic activity (VSE/SMEs)
Total cost of the case study	€163m 80 co-owned housing buildings	€54m 200 telework centres or 200,000 m² fitted out	€86m 40,000 m² of business premises created
Investment period duration	9 years	9 years	9 years
Return for investors before FI *	2.6%	15%	9%
UDF** equity stake[16] (equity amount, share)	€2.4m or 15% of total equity	€3.2m or 20% of total equity	€5m or 20% of total equity
UDF** loan funding (amount, share of total debt, term, rate)	€41.7 m or 28% of total debt 26 years, 2.67%	-	€12 m or 20% of total debt 20 years, 3.87%
Return for investors after FI *	7.53%	15%†	9.6%
Leverage***	3.7	16.8	5
Financial benefit from the FI*	Low-cost long-term junior financing Capital contribution - "signal" effect	Capital contribution - "signal" effect	Capital contribution - "signal" effect Low-cost long-term junior financing

* Financial Instrument, here meaning investment by a UDF

** UDF involvement meaning after co-financing and before Co-Investment

*** Total amount of funds invested in a project divided by the amount of funds from the public sector

† Unlike the other cases, the involvement of a UDF here does not improve the IRR but does facilitate Co-Investment

The financial analyses conducted for this study helped to identify three types of projects that could be financed by a UDF:

a) **Third-party financing activities with low returns**

Owing to the high impact of debt on this type of activity and the low returns, the need for this type of project is the provision of **longer term debt at lower rates** than commercial borrowing. Furthermore, an equity stake could possibly promote and develop the investment capacity of the special-purpose company (for example, in the case of a *SEM* public-private partnership).

b) **Creation of business premises without acquisition ("soft" scheme)**

As with the example of telework centres and co-working spaces, this means projects whereby a business space will be leased and fitted out, as opposed to built and owned. The initial investment is therefore reduced. Owing to uncertainty as regards future income from innovative projects, the financing requirement is generally an **equity contribution** to encourage the private sector to invest alongside the project. In this sense, the equity stake could act as a '**signal effect,**' thereby helping to mobilise private sector involvement. In the case of premises owned by local

[15] These case studies do not represent projects actually financed by UDFs and the aim of this illustration is merely to demonstrate the financial benefits from a UDF investment.

[16] For equity finance in a French *SEM* type of PPP (see Glossary), legal research will need to confirm whether the funds from the UDF qualify as public or private

authorities, this contribution can also help alleviate the working capital requirement in the early years while the business becomes profitable, and therefore avoid the need for local authorities to have to reduce the rent charged to the special-purpose company.

c) **Creation of business premises with acquisition ("hard" scheme)**

As in the example of the Fort d'Aubervilliers innovation cluster, this means projects for which a business space will be acquired through the purchase of a building, or construction after purchasing land. The initial investment is therefore high. Since such operations are often complex in nature, involving decontamination or construction in disadvantaged areas, a **mixed contribution** from the UDF is required so as to encourage the private sector: a) to invest an equity contribution; and b) to reduce the cost of the borrowing needed to finance the building of the premises through offering cheaper borrowing rates over a longer term than commercial borrowing.

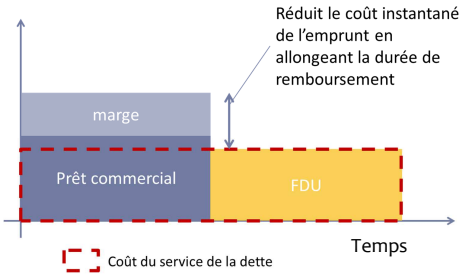
These latter two types of project could be financed through a single UDF because of their **similarities** (in terms of project type and shared objectives with reference to the CSF Funds), and **complementary nature** as regards to the returns generated.

UDF involvement method

Lastly, these financial analyses enable the method of UDF involvement to be considered. UDFs could invest in projects or through a special-purpose company by means of:

i. Equity stakes or taking a holding in the company's **capital**,

i. **Medium- or long-term loans or debt**, *pari passu* with commercial debt, or ranking lower (known as "junior debt" because it will be repaid after commercial borrowing including in the event of bankruptcy, and therefore carries both a higher risk for the lender and higher interest for the borrower). See diagram opposite,



ii. **Financial guarantee**, a guarantee to repay a loan in the event of default by the borrower or to pay a surcharge for exceeding a budget. Note that this financing method will not be given preference if the overall volume of UDF allotted to guarantees is not sufficiently large to offer a satisfactory dilution level[17].

The financial benefit of investment by the UDFs is therefore connected to its capacity to offer low-cost, long-term lending, and with the UDF's ability to send a positive signal to the market to encourage the public and private sectors to invest in "Grey zone" projects.

*

Beyond the financial advantage delivered by the involvement of the UDF, these three case studies have also demonstrated that the UDF helps to create positive non-financial externalities.

[17] Dilution of risk for a guarantee fund is the proportion represented by each guarantee issued relative to the overall size of the fund. The lower the proportion, the greater the dilution, and therefore the lower the risk of the fund failing.

3.1.3 Positive non-financial externalities from UDF involvement

As part of the study and in parallel with the financial analysis, the positive non-financial externalities of each market segment to assist the Managing Authority with its decision-making process were examined.

This additional analysis aimed to provide an assessment of the qualitative impact of projects. It should be noted that this information, which was not included in the financial analysis presented earlier, was examined given an understanding the market segments, and must also be taken into account in establishing and throughout the life of the UDFs. In fact, any projects developed will have an **influence on the environment** through, for example, reduced carbon dioxide emissions, on the economy by helping to retain local jobs, or indeed by strengthening the connections between the various stakeholders taking part in a project's development.

All these externalities are considered to be benefits of the policies implemented by the Managing Authority. They are compliant with the **EU 2020 strategy** and more specifically the Common Strategic Framework. All such externalities are described in the table below:

Typologie d'externalités non Financières / Segments de marché	Environnement		Social			Urbain		Réseau d'acteurs	
	Diminution d'émissions de CO_2	Recours aux énergies renouv.	Dév. de l'emploi	Qualité de vie	Education	Equilibre urbain de la zone	Image du quartier	Partage de connaissances public/privé	Consolidation des liens population / administration
Mutation et restructuration de zone d'activité économique									
Restructuration d'espaces commerciaux									
Création d'actifs immobiliers destinées aux PME/TPE									
Rénovation énergétique des grandes copropriétés									
Production et distribution d'un réseau géothermique									
Développement d'un réseau énergétique intelligent									
Aménagement d'un Ecoquartier									
Création de télé-centres et espaces de co-working									

Externalité non financière importante dans les projets du segment de marché

Externalité non financière possible dans les projets du segment de marché

Externalité non financière absente dans les projets du segment de marché

*

This detailed analysis, supplemented by the market analysis presented earlier, provides a comprehensive overview of the benefit gained by UDFs supporting urban development projects.

3.2 The benefit of Urban Development Funds

UDFs' contribution to the market and in particular those market segments identified as in the "“Grey zone”" should be distinguished from the benefits that the UDF provides directly to the Managing Authority.

3.2.1 Benefits of UDFs for the market and project development

The positive benefits of establishing an urban development fund to meet multiple criteria (including the availability of ERDF funds to allocate to this type of "revolving" tool) has been well-established. Stakeholders consulted responded favourably, and market analysis suggests that for more than one segment of the market, a public-private financial contribution of this kind would not only enable projects' profitability to be improved, but would also support their realisation, thereby bridging the market gap identified.

The market analyses and financial models produced for this study show the following advantages from Financial Instruments:

Bridge the gap identified and send a signal to the market

i. **An efficient project:** a "revolving" type of investment mechanism requires an economically viable and efficient project to support the economic and social development objectives sought.
ii. **A strong signal:** establishing Financial Instruments with a substantial public-sector component sends a signal to the private-sector market and allows delivery of the economic and social benefits by bridging the existing gap in the market segments identified. This signal encourages the private sector to invest in projects found in the “Grey zone”.
iii. **Optimum financial structuring:** financial support from UDFs in the form of either "junior" or *pari passu* debt would make it possible to improve projects' risk profile by reducing the overall cost of financing. This is particularly important where income is too low to meet the repayment of loan funds and meet the ROI expected by the private sector in particular.
iv. **Lasting investments:** a long-term and sustained contribution from the funds may help relieve the financial pressure on a project from private investors seeking some return on investment in the short and medium term.
v. **Additional security:** issuing financial guarantees could ensure that costs that are difficult to estimate in advance, for example decontamination, or bad debts, are covered. However, such an activity would require a significant amount of investment to diversify risk, and a specific study would be needed to assess the feasibility[18] of using financial guarantees in UDFs.

In conclusion, a UDF should make it possible to:

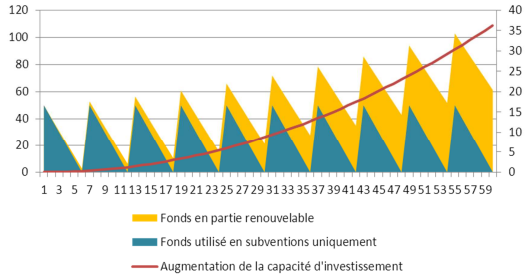
a) develop projects in the "“Grey zone”" through low-cost financing,
b) extend investment periods and reduce the need to generate immediate returns,
c) provide reassurance to private investors and encourage investment.

[18] In the next few months, the EC and EIB are to conduct a "horizontal" study (Europe-wide) on the potentialities offered by UDFs' use of the guarantee mechanism. Conclusions expected in early 2013.

3.2.2 Benefits of UDFs for the Managing Authority

For the Managing Authority and other public sector organisations in the broader sense, the significant advantage of a UDF is its **revolving nature**.

Every Euro invested in a project through a UDF will generate a return in the short term and be repaid in the medium-to-long term. The money collected, once UDF management fees are paid, can be reinvested in future projects. Through a 'snowball effect,' UDFs' investment capacity will naturally increase over time. Furthermore, monies collected during the ten years after the eligibility period will be reinvested in accordance with the same Operational Programme[19]. This mechanism is illustrated on the diagram opposite.



For every Euro invested in a UDF using CSF Funds, European regulations stipulate a national contribution, known as co-financing of 50% or 40% (see section 4.3 below), which can be sourced from the public or private sector, and invested in the UDF or in the project directly[20] (Current regulations stipulate that the co-financing of Structural Funds must be structured financially in the same way as the Common Strategic Framework Fund). This contribution can also be made in kind, by providing land, for example[21]. As a result, a **multiplier effect** can be created as the national co-financing increases investment capacity.

Through the strong signal sent by the implementation of such Financial Instruments to the market, and its corresponding ability to encourage private sector participation, UDFs can also trigger private investment at the project level. Such Co-Investment delivers substantial **leverage**, which is measured by the total amount of funds invested in a project divided by the amount of these funds that comes from the public sector.

According to the audit by the European Court of Auditors[22], leverage is highest with equity investments (1 to 2.2) and followed with loans (1 to 1.67). CSF Funds invested in UDFs will be placed in interest-bearing accounts pending investment in urban development projects; and co-financing will occur only when the project is selected and funded[23].

Sustainable financial instrument and recycled investment capacity

As such, these three advantages: the recycling effect of the UDF mechanism; the multiplier effect of co-financing; and the leverage effect from Co-Investment make the UDF a sustainable Financial Instrument.

Aside from the purely financial aspect, the UDF also has a social benefit, as it enables the pooling of expertise and procedural knowledge from the public and private sectors, each benefiting from the other's experiences. The Managing Authority and public-sector investors both actively participate in the UDF's governance, sitting on the Investment Committee alongside private-sector investors. In the mid-to-long term, the building up of an **institutional public-private investment sector** could expand to other sources of funding, enabling the development of a genuine capacity to finance urban development projects, supporting the regional economy and projects in the public interest, and delivering better use of public money.

[19] Article 39 – Proposal for a Regulation of the European Parliament and of the Council 2011/0276 (COD)
[20] Article 110 – Proposal for a Regulation of the European Parliament and of the Council 2011/0276 (COD) and Annex II – Set-up of financial instruments in 2007-2013, Financial Instruments in Cohesion Policy, SWD(2012) 36 final
[21] Article 32 of the Proposal for a Regulation of the European Parliament and of the Council 2011/0276 (COD)
[22] Special report no. 2/2012 - Financial instruments for SMEs co-financed by the European Regional Development Fund – European Court of Auditors
[23] The European Commission adopted legislative proposals for cohesion policy for 2014-2020 in 10/2011

3.2.3 Challenges to be met to make UDFs a success

Successful implementation of UDFs requires the Managing Authority (and indirectly the Fund of funds and UDFs themselves) to meet the following challenges:

i. Estimate the market's absorption capacity for segments chosen for the selection of projects and UDF investment,
ii. Ensure the availability of funds necessary for **co-financing** (the contribution required by European legislation) and **Co-Investment** (depending on the financing plan needed by the project),
iii. Overcome the issue of state aid (through appropriate legal research, see 3.3.2 below),
iv. Identify projects eligible for funding in order to build a project portfolio and so maintain a constant pace of investment, so as to commit the funds made available,
v. Continually reassess the market's need, the gap to be bridged and the interest of the public and private sectors in the preferred economic sectors,
vi. Closely monitor the performance of investments made, communicate about the experience and take appropriate decisions where there is underperformance.

*

These potential barriers to the creation and success of a UDF require an appropriate strategy and structure to be put in place.

3.3 UDF investment strategy

Following on from the financial analysis conducted on the case studies identified, and summarised in section 3.1.2, it is then possible to extrapolate the results obtained across the whole region for the relevant market segments and consider an investment strategy for the UDFs.

3.3.1 Identification and structure of UDFs

When financing several projects within a limited number of UDFs, so as to reduce formalities, streamline management, and cut operating costs, there are various options for grouping projects together:

- by geographic area
- by project type
- by private sector stakeholder(s) involved
- by expected return
- by associated risk

Taking into account the projects identified within each economic sector, and the interviews conducted with potential investors, grouping by **type** (meaning by type of activity on a given market segment) seems the most suitable. Moreover, by grouping projects by type, it is highly likely that by implication, the risks, returns and private-sector interest are going to be fairly uniform across these same projects.

Organisation by market segment and project type

The analysis conducted within this study suggests that market needs are mainly found in the following segments:

a) Energy saving and renewable energy
b) Support for the local economy, the development of VSE-SMEs and innovation.

These segments are consistent with, and support the EC's Europe 2020 strategy, as well as the regional policies, and help to support projects in the "“Grey zone”".

In conclusion, creating **one UDF dedicated to energy, and one UDF dedicated to supporting the local economy** appears to meet the market's needs.

A UDF dedicated to issuing **financial guarantees**[24] would be useful to trigger investments or loans in projects showing some areas of uncontrolled financial risk. Given the particular features of this type of financial product (similar to insurance), it is however recommended to offer them via a separate UDF rather than through the two aforementioned UDFs.

Fund of funds

A Fund of funds[25] (also known as a "Holding Fund", a special-purpose parent company) would make it possible to **simplify fund administration** and obtain **uniform quality** of performance monitoring and reporting for all UDFs.

The Managing Authority's workload would be reduced (as the Fund of funds collects and reports on the information that the Managing Authority has to submit to the Commission in respect of use of the CSF Funds in the form of Financial Instruments, see section 3.4.3 below).

Another advantage of the Fund of funds lies in the flexibility offered by a Fund of funds . By defining UDFs' investment strategies, the Fund of funds would enable the UDFs' capacities to be adjusted as and when

[24] See 3.2.1 above
[25] See Article 44, second paragraph in (EC) Regulation No. 1083/2006

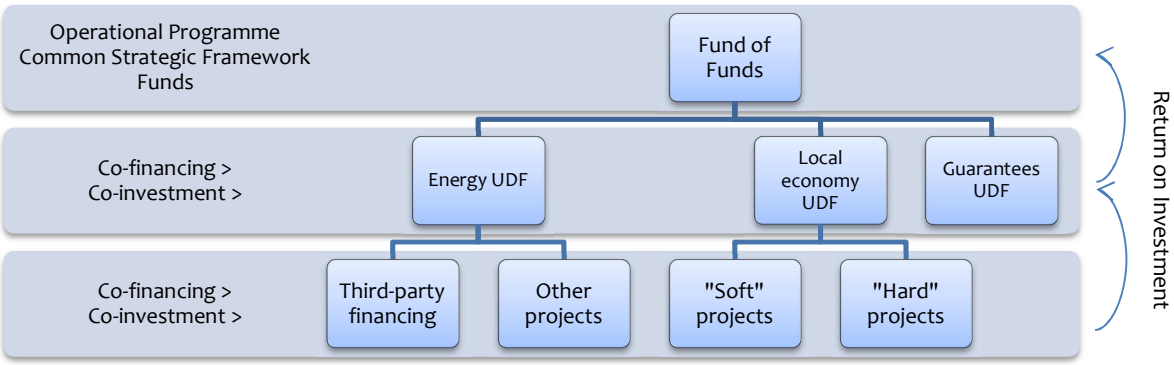
needed, as well as the potential for establishing new UDFs if necessary, on the basis of market developments, project types, the assessed risk and partnerships with the private sector.

At the project level

A special-purpose structure (project company) within which private partners would invest (equity or debt) is needed to hold and manage each project. These special-purpose companies are used to isolate the risks and benefits of a project within a broader portfolio. As such each project can thus have its own investors, financial structure, bank loans and guarantees, without affecting other projects run by the same managers.

Organisational chart

The structure of the UDF group would be as follows:



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If the Managing Authority wishes to create a first UDF within a relatively short lead time, SEM Posit'if could potentially be a UDF, if investments are made solely in the energy sector in the next programming period. Otherwise, as suggested above, the establishment of an energy-specific UDF which would then invest in SEM Posit'if, is recommended.

3.3.2 Legal form, manager and state aid

According to the legal analysis conducted in the study of the evaluation and implementation of JESSICA instruments in the Nord-Pas-de-Calais region for the 2007-2013 programming period, European Community law offers a great deal of freedom to member states and regional authorities in establishing Financial Instruments. French law does not provide any specific legal framework or set of provisions governing the structuring of Financial Instruments in France. Any project financed through the UDFs should simply fall within the existing legal and administrative framework at national and regional level:

- As regards the possible setting up of a Fund of funds, management of this may be under either **the EIB or the CDC** in particular without going through a public procurement or competitive tendering, or indeed be undertaken by any private financial institution; [...] The [CDC] solution must however only be considered warily, insofar as [the CDC's] remit entails its involvement also, and probably mainly, as a direct investor in one or more UDFs;
- Any public or private structure[26] is able to participate in Financial Instruments in the capacity of UDF Fund Manager. As regards public or semi-public structures, the CDC [or other local stakeholders] appear qualified to apply to establish and manage an UDF [same comment as previously about the CDC and its investor role];
- A **number of legal forms** can be identified for projects receiving JESSICA backing: commissioning of public works, partnership agreement, public works concession, development concession, Co-Investment in a public-private partnership, with a majority public-sector interest, known as a *SEM* in France), local public company usually formed by two or more local authorities to carry out public services, known as an *SPL (Société Publique Locale)* in France, or an equity interest and Co-Investment in a special-purpose company such as property holding company (a *SCI* in France) or simplified joint stock company (*SAS – Société par Actions Simplifiée* - in France).

The Nord-Pas-de-Calais report also states that "The risk is that JESSICA's contribution distorts competition to the extent that it creates a distinction between companies or projects that receive support and those who do not". In particular, "When contributions from the Operational Programmes to financial engineering instruments are invested, loaned or committed as guarantees in enterprises (mainly SMEs) or urban projects, then this may effectively amount to state aid. Member states and Managing Authorities then have to comply with the rules on state aid, with the help of holding funds if necessary."

Updated legal opinion needed

An update to the conclusions drawn by this study will be necessary given the changes to European regulations on future Financial Instruments for the next programming period. A legal examination, specific to the Ile-de-France region, will therefore be needed to confirm the arrangements proposed in this report, the legal form of the UDFs and Fund of funds, the procedure for awarding management contracts, and **confirmation of the financial arrangements' compliance with the rules on state aid**. The opportunity to take an equity interest in *SEM*-style PPPs and the categorisation (as public or private) of such investments will also need be investigated.

It is nonetheless worth noting that the legal framework for Financial Instruments as outlined in the draft European regulation offers **increased flexibility** in using CSF Funds (e.g. if a funded project ceases trading, the funding is not repayable, unlike traditional use in the form of a grant) and **simpler procedures** (for example, Financial Instruments are outside the scope of legislation applying to financing major projects)[27].

[26] Guidance Note On Financial Engineering, COCOF 08/0002/03-EN
[27] Articles 61 and 90 of the Proposal for a Regulation of the European Parliament and of the Council 2011/0276 (COD)

3.3.3 Detailed features of UDFs

Market expectations about "Grey zone" projects make it possible to determine the size of the fund to be built for each economic sector or type of investment.

Absorption capacity of the market

Within the identified sectors, for example energy saving and renewable energy; and support for the local economy and the development of VSE-SMEs and innovation; different types of projects were identified earlier in this study, including third-party financing activities, and support for economic activities by establishing business premises, as either "hard" or "soft" schemes. Based on these projects, market requirements for investment over the next programming period can be estimated[28] and are thoughts to be as follows for the two sectors:

a) Energy saving and renewable energy
   - Third-party financing of energy-saving refurbishment work: approximately €150 million.
   - Development of geothermal sources: several hundred million euros. These funds could also be partly allocated to projects for energy production from biomass or biogas.
   - Smart grids: between €50 million and €200 million.

b) Support for the local economy, the development of VSE-SMEs and innovation.
   - Refurbishment or construction of business premises: €40 million to €100 million per project.
   - Investment in new services such as telework centres: €50 million to €100 million.
   - Enhancing sites (integrated projects such as eco-districts): €100 million to €200 million per site.

These investment requirements for projects falling within the "Grey zone" could be partly financed by the UDF. The financial analysis conducted as part of the study allow for a **theoretical potential** of **investment** (allocation of resources) to be estimated for each UDF. Details of this estimate are found below.

Formation and management costs

UDFs and Fund of funds have a start-up cost in connection with the activities and studies required (see 3.4.2 below) plus operating costs (management fees) running from 1% to 3% of the size of the funds managed. The eligibility criteria for the funding of such expenditure noted by a European guidance note[29], states that costs related to the preparation of investment decisions, monitoring performance, technical and legal research, audits, valuations, etc. are all eligible expenditures. Expenditure directly related to the implementation of individual projects by the final recipient, such as the preparation of building permits/planning permission, a technical feasibility study for a project, and so forth are not eligible.

Creating UDFs and Fund of funds therefore requires a minimum level of investment to recoup the preparatory activities and management costs, estimated at €10 million for a UDF and €30 million for the Holding Fund, if applicable.

[28] These estimates are made on the basis of discussions with market stakeholders and not documented. Estimates to be taken to mean after co-financing and after Co-Investment.
[29] Revised Guidance Note on Financial Engineering Instruments under Article 44 of Council Regulation (EC) No 1083/2006

Details of proposed UDFs

The proposed features of each UDF are itemised below:

UDF name	Energy*	Local economy	Guarantees
Project types and potential portfolio	SEM Posit'if or energy-saving refurbishment Geothermal sources Smart grids	Eco-districts** Business parks/industrial estates and retail spaces Creation of telework centres and co-working spaces	Potentially any project presenting a risk of bad debts or costs that are impossible to predict (e.g. decontamination)
Investment type	Mainly debt, then equity	Mainly equity, then debt	Financial guarantees
Potential partners and existing bodies	SEM Posit'if ADEME (see 2.3) CDC	CDC Ségécé Képierre, other private partners	Banks, insurance companies
Positive externalities	Reduction in CO_2 emissions, improved quality of life, stronger ties between people & government	Reduction in CO_2 emissions, employment growth, improved quality of life, balanced use made of the area, neighbourhood image	Covers all the objectives as not specific to one segment
Approach to risk	Low to moderate risk: Assessment of investments and returns based on technical studies and the use of known technologies	Moderate to high risk: Market-based assessment of value of assets acquired; potential returns from innovative activities harder to predict	The guarantees' dilution rate needs to produce a low to moderate risk profile to attract Co-Investment to this type of financial product
Investment period	9 years	9 years	9 years
Holding period	> 20 years	> 10 years	> 20 years
Target internal rate of return	7 to 10% over 30 years	12 to 15% over 30 years	To be set

***** In the short term, the energy UDF could invest in:

- geothermal energy projects based on implementation plans currently being examined in the region (for example the Seine Saint-Denis East geothermal project[30]) or that are already known and controlled by local authorities and district heating systems operators (such as CPCU in Paris),
- energy-saving refurbishment, and more especially SEM Posit'if, being an existing vehicle particularly well-suited[31] to revolving investment.

****** Only concerns sub-projects on the development of VSE / SME and innovation.

[30] See Appendix 3
[31] See 3.1.2 above

Estimated resources

The proposed resource allocations for each UDF are itemised below:

UDF name	Energy	Local economy	Guarantees
Absorption capacity of the market	SEM Posit'if Energy: €150m Geothermal sources: >€200m Smart grids: €150m	New eco-districts: €40 million to €200 million per project or site Services (e.g. telework centres): €50m to €100m	To be set
UDF budget	€450 million	€350 million	Will depend on the overall size of the funds allocated and on the desired dilution level see 3.1.2
Target leverage	4	15	Cannot be estimated
Of which Co-Investment	€338 million	€262 million	To be set
Of which co-financing*	€112 million	€88 million	To be set
Community contribution	€56 million (50%)	€44 million (50%)	(50%)

***** The co-financing must follow the same implementation plan as Common Strategic Framework Fund Investment and meet the eligibility criteria.

According to this analysis, based on interviews conducted during this study, the Fund of funds could therefore be given a **€100 million** CSF Fund contribution (outside of the Guarantees UDF budget and formation and operating costs[32]). This is a maximum estimate with regard to the potential CSF Fund contribution allocated to the region, but the estimate appears minimal in relation to the market's need and absorption capacity mentioned.

These amounts are to be confirmed, particularly during the ex-ante assessment to be conducted as the UDFs are formed[33]. Such an assessment is crucial to the successful deployment of funds and ensuring that the investment strategy will meet market expectations.

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A minimum total CSF Fund contribution budget (excluding co-financing and Co-Investment) dedicated to UDF funding of **€90 million** (equating to half the investment capacity recommended above) could therefore be considered as able to efficiently support "“Grey zone”" projects across all market segments.

[32] Creation and operating costs will need to be financed from funds allocated to UDFs as investments in projects will not be profitable enough to cover these costs.

[33] Financial Instruments in Cohesion Policy - SWD(2012) 36 final - 5.2. Improved legal framework proposed for 2014-2020 programming period

3.4 Arrangements and procedure from UDF formation to management

UDFs must invest projects in line with the compliance and regulations outlined in relevant programming documents, legislative framework, and policies. The recommended investment structure entails a number of stages and actions necessary to successfully invest in suitable urban development projects. These stages and the key points of the funds' structuring itemised below may require some technical assistance when funds are being created (see section 4.4).

3.4.1 Arrangements for forming funds

Consistency with programming documents

UDF financing bodies would receive a portion of the funds allocated to the Managing Authorities through Operational Programmes, and under ERDF and potentially ESF. As a consequence, the following policies or agreements guiding the study made it possible to anticipate the potential eligibility of projects (subject to the eligibility criteria which will be approved by the Managing Authority):

- The European Union's "EU 2020" growth strategy and its five priorities
- The Common Strategic Framework for future cohesion policy 2014-2020 and its 11 thematic objectives
- The four potential priorities of the ERDF (not yet approved and may be supplemented by other funds) which will take 80% of the funds, these being research and innovation, support for SMEs, energy saving and renewable energy, and information and communication technology.

Urban development, meanwhile, would receive approximately 5% of ERDF funding.

Public strategy and policy Integration

The creation of an investment fund traditionally meets strategic, legal and structural criteria. The strategy needs to be defined at various levels:

a) Operational Programme
The priority axis of the Operational Programme define the issues in the public interest that the Managing Authority proposes to address using Structural Funds, and define objectives in terms of positive externalities such as job creation, innovation support, carbon footprint reduction, and so on.

b) The Fund of funds' investment strategy (if applicable)
The Fund of funds' remit will be to create the underlying UDFs. Its strategy is an adaptation of the Operational Programme and it defines the objectives to be reached in terms of investment, namely the relevant market segments, the amount of funds invested, and the key principles of governance and performance measurement.

c) Investment programmes for UDFs
Implemented by fund managers, this entails the translation of the Fund of funds strategy into one or more investment programmes at the UDF level. This includes an analysis of business plan over the fund's set duration defining the investment planned, projected financial income and cashflow, project selection criteria, risk diversity and management, feedback on expected investment, the corresponding positive externalities, performance monitoring tools and financial and non-financial indicators.

The Operational Programme for 2014-2020 (a) is **currently being prepared** by the Managing Authority. The investment strategy (b) is proposed in this study and investment programmes at the UDF level (c) will need to be drafted prior to the creation of the UDF, and could possibly receive technical assistance.

Governance of UDFs and the Fund of funds

The Financial Instruments' structure is **flexible** and offers various possibilities for overseeing fund governance. Governance will need to be determined on the basis of the organisations selected for fund management and the public- and private-sector investors participating. The most classic implementation would be to have an Investment Committee for the Fund of funds and for each UDF, upon which all the investors sit to decide on the projects to finance and the structure to put in place for each investment.

In addition, an Executive Committee within each entity, comprising a limited number of members, would approve the quarterly and annual reports (see section 3.4.3 below) and take the decisions falling within the usual remit of a commercial company's board.

3.4.2 Key stages and indicative timetable

The steps below are the key stages in forming the UDFs and Fund of funds to invest in urban development projects. They are based on the rules in force and will have to be approved once the new European regulations are known.

Where a Fund of funds is set up, the Managing Authority, possibly helped with some **technical assistance**, will need to:

a) Produce a preliminary assessment intended to identify or confirm the "Grey zone" market segments within which the UDF is likely to invest and draw up the investment strategy
b) Define the funds' structure and organisation together with the financial structure of investment
c) Conduct legal research to confirm the legal form selected for investment vehicles and the validity of the financial arrangements as regards the rules on state aid
d) Select the Fund of funds manager, by competitive tender if necessary
e) Sign a Managing Authority / Fund of funds financing agreement and form an Investment Committee[34]

When setting up one or more UDFs, the Fund of funds or the Managing Authority will need to:

f) Identify co-financing from public and private investors at the UDF or project level
g) Identify Co-Investment at the Fund of funds level
h) Adapt the investment strategy into investment programmes for each UDF
i) Identify fund manager(s) (by competitive tender if necessary) and negotiate management fees
j) Approve the UDFs' business plans
k) Sign a Fund of funds or Managing Authority / UDF financing agreement and form an Investment Committee.

Then, once it has been created, the UDF will need to:

l) Determine the arrangements for project selection, including the scoring and assessment methodology, and setting up the monitoring and reporting requirements, taking into account the need for a transparent system and for financial and non-financial indicators
m) Draft the various agreements (e.g. shareholders' agreement) and covenants (e.g. cash flow).

[34] Agreements will need to stipulate the fungibility of sums allocated if they are not invested within a given timeframe.

These stages are all key to the success of the UDF and the selected urban development projects. However, project **evaluation and selection** (stages a) and l)) warrant special attention. It is essential that the assessment methodology is developed, possibly with some technical assistance (see section 4.4 below), in a **uniform and transparent** way, and that the UDF is adequately promoted and communicated to potential project managers. Similarly, the application process should be explained, if needs be, by means of a guidance note on making funding applications. Among other things, this assessment methodology needs to cover:

Eligibility, economic viability, positive externalities, risks, budget …

- The project's eligibility in respect of relevant strategy documents and policies, including European programme documents, the use of CSF Funds, the Operational Programme and the investment strategy of UDF Financial Instruments at a regional level ("Grey zone" and segments),
- Determining the project's economic viability and its ability to generate a profit via an optimised financial structure (and the type of UDF investment, i.e. equity, loan or mixed) and profit distribution (presence or otherwise of preference shares),
- The project's positive non-financial externalities, if possible quantified in terms of jobs created, renewable energy generated or energy saved, land area regenerated, businesses formed, etc.,
- Project risks following a predetermined checklist (market risk, scheduling risk, management risk, etc.) and meeting UDF dilution criteria,
- An accurate budget and estimating of eligible / ineligible expenditure along with the investment leverage,
- Approval of the business plan and financial modelling of the anticipated income and outgoings, including the investment phase and return on investment,
- A legal opinion if the financial arrangements differ from the package approved by the high-level study.

Promotion, communication and explanation from the UDF(s) to potential project managers about the methodology for assessing applications for financing will enable the project managers to set up or adjust their projects taking these factors into account, in order to maximize their chances of securing funding. This in turn will enable UDFs to increase the number of sound applications received and financed, thereby building a robust project pipeline eligible for financing from the UDFs.

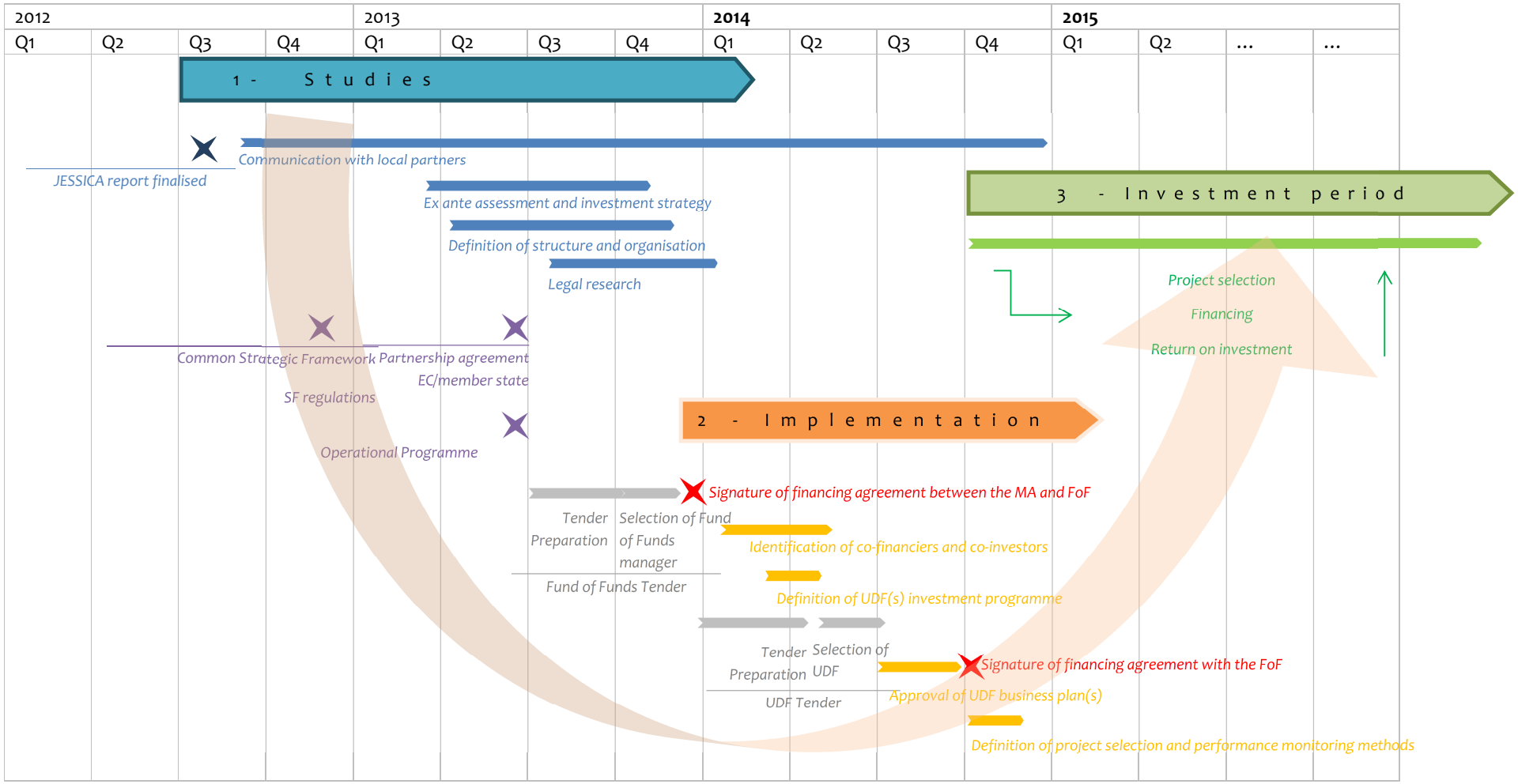
The activities and stages below complete the list of tasks assigned to UDFs:

n) Publicity campaigns directed at project managers
o) Analysis of project applications, the project's feasibility and schedule (especially in relation to the programming period) and approval of the optimal financing structure
p) Release the funds and implement the project
q) Measure project and UDF performance.

Communication and project identification (stage n) is essential to the UDF's success (see section 4.2 below). Performance measurement (stage r) is just as important (see 3.4.3 below) to increase resources allocated to UDFs in future and also especially to strengthen the "signal" effect transmitted to the private sector and thereby to increase the share of Co-Investment.

A summary timetable of the tasks to be carried out is shown overleaf:

Urban Development Fund implementation schedule – Period 2014 – 2020 (option with a Fund of funds)



3.4.3 Performance evaluation and indicators

Measuring performance and monitoring results should be done using bespoke tools designed specifically for this purpose. These tools will enable quarterly or six-monthly reports to be produced. The reports will include the following information:

- A description of the project's activity and any highlights
- A comparison between financial forecasts and actual figures
- An update of the financial and non-financial indicators

The indicators could be as follows:

- **Financial indicators:** The project's internal rate of return, net present value discounted at the average rate of inflation, leverage of the investment, updated budget and eligible/ineligible expenditure, quarterly and annual returns over the life of the investment, return on equity, compliance with bank lending covenant ratios, market value of financed assets if any, special-purpose structure's debt ratios, long-term financial independence, solvency ratios, working capital, margin, distribution level, repayment periods, etc.
- **Non-financial indicators** (to be finalised by a special study): Within their operating cycle, UDFs will also need to incorporate a qualitative assessment of the projects they finance, so as to confirm their consistency with the EU 2020 strategy. For two of the UDFs for which actual projects are expected to materialise, an incomplete list of "non-financial externalities" indicators for funded projects has been identified. Listing all the indicators would enable qualitative monitoring of UDFs' effectiveness.

Financial, social, economic and environmental performance indicators

An indicative list of non-financial indicators is shown in the table below:

Energy UDF	Local economy UDF
- **kW of renewable energy generated** - **kW of energy saved through energy-saving refurbishment work** - **Tons of CO_2 saved** - **Number of housing units refurbished and residents benefiting** - **Metres of geothermal-sourced heating network installed** - **Number of housing units connected to the district heating system** - **Percentage of renewable energy in the "energy mix" for a district heating system** - **Number of housing units / offices / amenities connected to a "smart grid" scheme** - **Percentage of energy saved through the installation of a "smart grid"** - **Number of partners belonging to the "smart grid"**	- Number of jobs created / kept within the geographic area - Turnover of businesses created - Percentage increase in businesses' turnover - Number of patents filed - Contracts completed by businesses formed within projects - Extent of regional reach (number of times project mentioned in the press) - Surface area of premises developed - Amount of rent obtained on the projects developed - Number of re-categorised business parks - Number of outlets accommodated in redeveloped shopping centres - Number of employees using telework centres

Information Report

Once a year, the Managing Authority has to submit a report to the European Commission including[35], as regards Financial Instruments:

"

a) *Identification of the programme and of the priority from which support from the CSF Funds is provided;*
b) *description of the Financial Instrument and implementation arrangements;*
c) *identification of the bodies to whom implementation tasks have been entrusted;*
d) *total amount of support by programme and priority;*
e) *total amount of support paid or committed in guarantee contracts;*
f) *revenues of, and repayments to, the Financial Instrument;*
g) *multiplier effect of investments made by the Financial Instrument and the value of investments and participations;*
h) *contribution of the Financial Instrument to the achievement of the indicators of the programme and of the priority concerned."*

These reports, and in particular the performance monitoring, will demonstrate the effectiveness of UDF Financial Instruments, and increase firstly the amount of CSF Funds allocated to UDFs and secondly the proportion of co-financing and Co-Investment delivered by the public and private sectors.

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Studying the regional market, the projects selected and the role of financing tools in the region makes it possible to draw up recommendations for the preparation of the upcoming Ile-de-France Operational Programme and the framework for the use of Financial Instruments.

[35] Article 40 paragraph 2 of Commission proposal COM(2011) 615.

4. Recommendations to the Managing Authority - Conclusions

To conclude this study, having evaluated the potential work of UDFs on the basis of market needs and of the Common Strategic Framework Fund Managing Authority's objectives, the following recommendations have been produced for the Managing Authority, including the likely need for technical assistance in setting up and managing such funds.

4.1 Invest in identified "“Grey zone”" market segments

This study has demonstrated the need to invest in identified **market segments**, the feasibility of the implementation of Financial Instruments, and the **benefits from using Financial Instruments through UDFs** to support projects in the “Grey zone”.

Financial Instruments are not a replacement for grants, but are additional tools made available to Managing Authorities. Investments from the UDF in a particular project could also be supplemented by a grant, depending on the financial and non-financial characteristics of the project in question.

For the Ile-de-France region, the sectors identified can be grouped into two investment UDFs, from which the following positive externalities would be expected:

a) **Energy saving and renewable energy**
   Reductions in the carbon footprint, energy consumption and dependency on non-renewable energy sources, support for economic growth through the development of this economic sector.
b) **Support for the local economy, the development of VSE-SMEs and innovation.**
   Job creation, promotion of innovative businesses, reduction in economic inequality between geographical areas, support for economic diversity and local growth.

Additional studies could be conducted to quantify the precise economic impact of such investments.

As shown previously (see section 3.1.2), investments may take place in the form of a loan, an equity stake in a special-purpose company, or by standing in as a guarantor. As the positive impact of the UDF investment (the signal given to the private sector) works with modest sums (about 10% of a company's equity), it would be preferable to focus on the number of projects supported and not the amount invested in each one.

4.2 Promote investment in partnership with the private sector

The public and private sectors are complementary within the "**“Grey zone”,**" working collaboratively and capitalising private sector’s knowledge and expertise, whilst also benefitting from advantageous **long-term financing offered** by the public sector.

These "“Grey zone”" projects generally require high levels of investments with low levels of income, therefore the public sector can help reduce the impact of the low income by contributing to low-cost long-term financing.

To compensate for the high initial investment required, joint ventures between the public and private sectors can deliver a viable funding structure. The public sector will contribute to capital by bringing assets to be developed (such as land) in exchange for shares in the companies, and the private sector brings equity to finance all or some of the construction and fitting out work. Under such an arrangement, a UDF could help to finance this work with assistance from a long-term loan, for example. There are many **advantages** to this model:

- Optimum financial structure that limits the consumption of capital and financial income
- Profits and market risk are shared between the public and private sectors (while under a traditional scheme a planning authority might sell land very cheaply to a property developer which, a few years later, reaps the full benefit of higher prices for such assets)
- Public interest maintained over the long term (the public sector is involved in project management and in decisions affecting strategy and performance)
- Control over divestment scenarios (future resale, conversion, etc.).

To permit the development of this type of model, it seems however that a clarification of the rules for using CSF Funds and greater flexibility in their allocation is necessary.

Communication and Information

Promotion and communication with all the relevant public-sector bodies, project managers, and the private sector in the broadest sense, will have a **significant impact** on the UDF's ability to identify investment opportunities and thus fully perform its role. Ensuring support from business networks, brokers, agents, the media and so on will increase the number of funding applications received. However, this communication will always need to be accompanied with technical explanations, for example through a guidance note to making funding applications, as mentioned earlier, designed to maximize the potential eligibility of applications received.

Events (conferences, meetings between market stakeholders) could usefully complement the creation of a document reference base, including actual examples or studies of pilot projects made available to the public.

A change in the perception held by the private sector of public-sector financing bodies is necessary. Likewise, the public sector also needs to familiarise itself with Financial Instruments, as well as their advantages and challenges to ensure their success.

The identification of projects meeting the eligibility criteria ought to be an objective for the fund manager and this could be linked to its remuneration.

4.3 Mention UDFs in the Operational Programme

The lack of any reference to UDF-type financing mechanisms in the Operational Programme makes them more complicated to implement. These mechanisms have many advantages as stated above and make it possible to develop projects meeting the desired strategic objectives under sustainable economic conditions. Furthermore, these mechanisms have the benefit for the Managing Authority of **recycling the funds invested**.

Whether in the form of loans, equity stakes or guarantees, these monies will be returned to the Managing Authority, plus interest or capital gains, in addition to the positive externalities benefiting projects' immediate environment. Financial Instruments therefore make it possible to take what was previously a grant - absorbed into a single project - into a **'recyclable fund'** which allows investment in other projects (and in theory to do so in an unlimited way). Moreover this will increase the funds available over time with the interest or capital gains generated.

This shows the need to make provision for the **inclusion of UDF**-type **Financial Instruments** in the priorities set out for investments in urban areas. To the extent legislation allows, such instruments could be considered under a priority axis devoted solely to urban measures, or in an axis wholly implemented by means of Financial Instruments.

One immediate benefit would be the **substantial reduction in administrative tasks**: if a single project is financed by a Financial Instrument referring to more than one axis, then that same number of different sets of reports (one per axis) is currently required. A single transversal axis would make just one set of reports necessary for all projects financed using Financial Instruments. The **flexibility of the funds** would also be improved, and natural market absorption would guide the investment carried out, as opposed to budgets being pre-allocated to priorities that are set for the entire programming period.

To avoid concentration of funds on a single project type or a single priority on the basis of the investment opportunities that arise, investment criteria could be defined, also specifying a minimum level of dilution of funds through several priorities, or a maximum level of funds (relative to the total) to be allocated to one project.

With simpler rules for the allocation of funds to a project (after examination and approval of eligibility, see the assessment methodology in section 3.2.2), project managers would have less risk of submitting funding applications in vain and therefore of wasting time and money. Funds would also be available (being already invested in the UDF) and invested in projects much faster.

Finally, the incentives that could be proposed by the Commission when a priority axis is entirely implemented using Financial Instruments[36] include the increase of the maximum co-financing rate,: "*The maximum co-financing rate [...] at the level of a priority axis shall be increased by ten percentage points where the whole of a priority axis is delivered through Financial Instruments or through community-led local development*."

Technical assistance could help to define an axis devoted to Financial Instruments in the Operational Programme and related investment strategy.

[36] Article 110, Proposal for a Regulation of the European Parliament and of the Council 2011/0276 (COD)

4.4 Organise technical assistance

To ensure the successful implementation of UDFs and the successful implementation of investment programmes, technical assistance to the Managing Authority and project developers would bring a number of advantages.

To the Managing Authority

Whether composed of members of the Managing Authority specialising in Financial Instruments, EIB representatives or outside consultants, the purpose of such technical assistance would be to:

- guide the Managing Authority through the stages in creating and managing funds, the supervision of studies (ex-ante and legal), and if need be in drafting the UDF-specific Operational Programme priority objectives,
- assist the Managing Authority in tendering procedures,
- assist the Managing Authority in negotiations with public and private investors,
- propose an investment programme for each UDF in consultation with fund managers,
- to build a project assessment methodology,
- conduct a periodic review of the project financing process on the basis of the UDFs' performance and the pace of investment observed.

To project managers

Whether provided by fund managers, outside consultants, or others, the purpose of such technical assistance would be to:

- provide information to project managers on a permanent basis,
- explain the project assessment methodology to the projects developers applying for funds and guide them through the process to maximize their chances of selection,
- provide technical assistance in assembling project financing,
- assist the various parties in negotiations with public and private investors.

This technical assistance could be financed by the Structural Funds[37] up to a maximum of 10% of the funds allocated to the UDF, including co-financing.

An essential factor in the success of the overall mechanism, technical assistance must enable three different areas of expertise to work together, namely project financing, management of structural funds and state aid issues.

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Next stage

This report has described the market gap (the "“Grey zone”") and the needs of the economic segments for which Financial Instruments could provide a **viable and sustainable response**. The benefit of a UDF for the Managing Authority has been demonstrated and the actions to be implemented have been addressed.

The next stage in the development and use of Financial Instruments in the region is, in the short term, the possible establishment of technical assistance, negotiation of the next Operational Programm,e and preparation of the structure and organisation to be put in place to create UDFs.

[37] Article 109, Proposal for a Regulation of the European Parliament and of the Council 2011/0276 (COD)

JESSICA Evaluation Study

The implementation of Financial Instruments to support urban development in the Ile-de-France region