Use of ERDF funding in JESSICA funds

Issue paper on the legal environment

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A. Introduction

With the JESSICA initiative, the **European Commission** and the **European Investment Bank** (EIB), in collaboration with the **Council of Europe Development Bank** (CEB), have developed new approaches which enable Member States to use a share their EU grant funding from the European Structural Funds to make repayable investments in projects included in an integrated plan for sustainable urban development. The different ways of implementing those approaches are examined in Germany at the level of the individual Länder. The EIB provides support in this process. The present paper has been produced in the context of that assistance.

The aim of this paper is to create a foundation for the common work of the Länder in Germany in setting up and implementing urban development funds in connection with the use of ERDF funding in accordance with the requirements of the European Commission's JESSICA initiative. In producing this paper, the progress made by the individual participants and their experiences in financing urban development projects were compiled using a questionnaire and used as a basis for further questions. In addition, wide-ranging ideas and suggestions were put forward by the participating Länder at a joint workshop and in bilateral discussions; these formed an important basis for the consultancy work. The results of this process have now been incorporated into this issue paper and are included at the relevant points. The paper therefore follows the course of the discussions in the range of subjects discussed and in its focuses.

The structure of the paper follows the logic of the implementation process for a JESSICA fund and the subsequent investment phase at project level. It reflects the situation at the beginning of 2010 and focuses on fund level on the basis of the implementing experiences in the individual German Länder at that time.

B. The JESSICA initiative in the context of the ERDF

JESSICA (Joint European Support for Sustainable Investment in City Areas) is a joint initiative developed by the European Commission and the European Investment Bank (EIB), in collaboration with the Council of Europe Development Bank. Under new procedures, Member States are being given the option to use their EU grant funding from the **EU Structural Funds**, in particular funding from the European Regional Development Fund (**ERDF**), to make revolving investments in urban projects. Such projects must be included in an integrated plan for sustainable urban development.[1]

I. ERDF

The ERDF has its legal basis in Article 176 TFEU.[2] Its function is to help to redress the main regional imbalances in the Community, which makes it the central financing instrument of Community regional policy.[3] Whilst in the 2000-2006 programming period the ERDF was still restricted to the objectives of 'development and structural adjustment of regions whose development is lagging behind' (Objective 1) and 'economic and social conversion of areas in structural difficulties' (Objective 2), in the 2007-2013 programming period the Structural Funds are focusing on the objectives of 'convergence', 'regional competitiveness and employment' and 'territorial cooperation'.[4] The ERDF forms part of the Community budget and does not possess legal personality of its own.[5]

ERDF funding is managed at European level by the Commission (DG Regio), whose role is restricted to examining the compatibility of the assistance projects submitted to it with the objectives of the structural policy. The Member States take specific management decisions with regard to beneficiaries in accordance with the principle of subsidiarity. [6] The Member States are also responsible in principle, under the principle of subsidiarity, for determining the eligibility of expenditure.[7]

An essential condition for ERDF support is the principle of national co-financing.[8] This combination of the Community funding and national funding significantly increases the leverage effect of Structural Fund resources.[9] Depending on the subsidy system, the Member

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[1] Article 46(1) of Regulation (EC) No 1828/2006.
[2] Formerly Article 160 EC.
[3] *Puttler* in Callies/Ruffert: Das Verfassungsrecht der Europäischen Union, 3rd edition, Munich 2007, Article 160 EC, section 1; *Holzwart*, Der rechtliche Rahmen für die Verwaltung und Finanzierung der gemeinschaftlichen Strukturfonds am Beispiel des EFRE, Berlin 2003, p. 121 et seq.
[4] Article 3(2) of Regulation (EC) No 1083/2006.
[5] *Bieber*, in: von der Groeben/Schwarze, EUV/EGV, Article 268 EC, section 3.
[6] Recital 65 in the preamble to Regulation (EC) No 1083/2006; cf. *von Danwitz*, Europäisches Verwaltungsrecht, Heidelberg 2008, p. 333, with further references.
[7] See recital 60 and Article 56(4) of Regulation (EC) No 1083/2006.
[8] Funding from the Structural Funds must be seen as complementary to national measures. See Article 9(1) and Article 15(1) of Regulation (EC) No 1083/2006.
[9] Recital 57 in the preamble to Regulation (EC) No 1083/2006; *Holzwart* (footnote 9), p. 187 et seq.

State in question, or in Germany the relevant Land, must contribute 25% (convergence) or 50% (regional competitiveness and employment) of the eligible costs in order to be able to request ERDF funding from the Commission.[10] This principle of national co-financing is relevant both at project level and at fund level. Under Article 3 of Regulation (EC) No 1080/2006, the following instruments may generally be used for investment of Structural Funds resources:

- loan funds
- interest subsidies for loans
- guarantee funds
- venture capital funds
- equity funds
- mixed forms for individual resources.

National co-financing can, on the one hand, be guaranteed completely by private capital, but does not preclude a solely public-law structure. This can be construed as meaning that at project level too only public funding may be used provided national co-financing is available. However, it should be borne in mind that non-ERDF public funding is also used in this case in order to guarantee the element of national co-financing at project level.

II. JESSICA

From a systematic point of view, the JESSICA initiative is to be seen together with the JEREMIE (Joint European Resources for Micro to Medium Enterprises) measures as a separately regulated instrument for the use of the Structural Funds. The aim is to supplement the previously dominant use of Structural Fund resources as pure grant funding through revolving **lending and financial engineering instruments**. The background to the European Union's efforts is the increasing phasing out of European grant funding and the consequent one-off award of lost assistance. Through a revolving system, Structural Funds are intended to be deployed on a more long-term and sustainable basis. **JESSICA** is **not** therefore **a supplementary support programme**, but enables a novel use of ERDF funding. The selection of projects eligible for assistance from ERDF funding is laid down through Operational Programmes on the basis of the Structural Fund regulations.

The individual Member States enjoy a margin of discretion in the development and implementation of a specific JESSICA fund architecture. This also holds in Germany for the individual Länder. It is a general requirement that the resources are invested in an '**urban development fund**' within the meaning of Article 46 of Regulation (EC) No 1828/2006.

[10] Article 53(2) in conjunction with Annex III to Regulation (EC) No 1083/2006.

They are then invested, in turn, in individual projects which are planned and executed as part of integrated urban development. Financing may also be effected through intermediate holding models between public funding and individual urban development funds.

It should be noted that under Article 46(1) of Regulation (EC) No 1828/2006 **special provisions** apply to an **urban development fund**. The important factor is that an urban development fund itself should invest directly in the development projects to be supported and **not in venture capital, loan and guarantee funds**. Consequently, as is clear from Article 46(2) of Regulation (EC) No 1828/2006, the urban development fund may use only the following instruments:

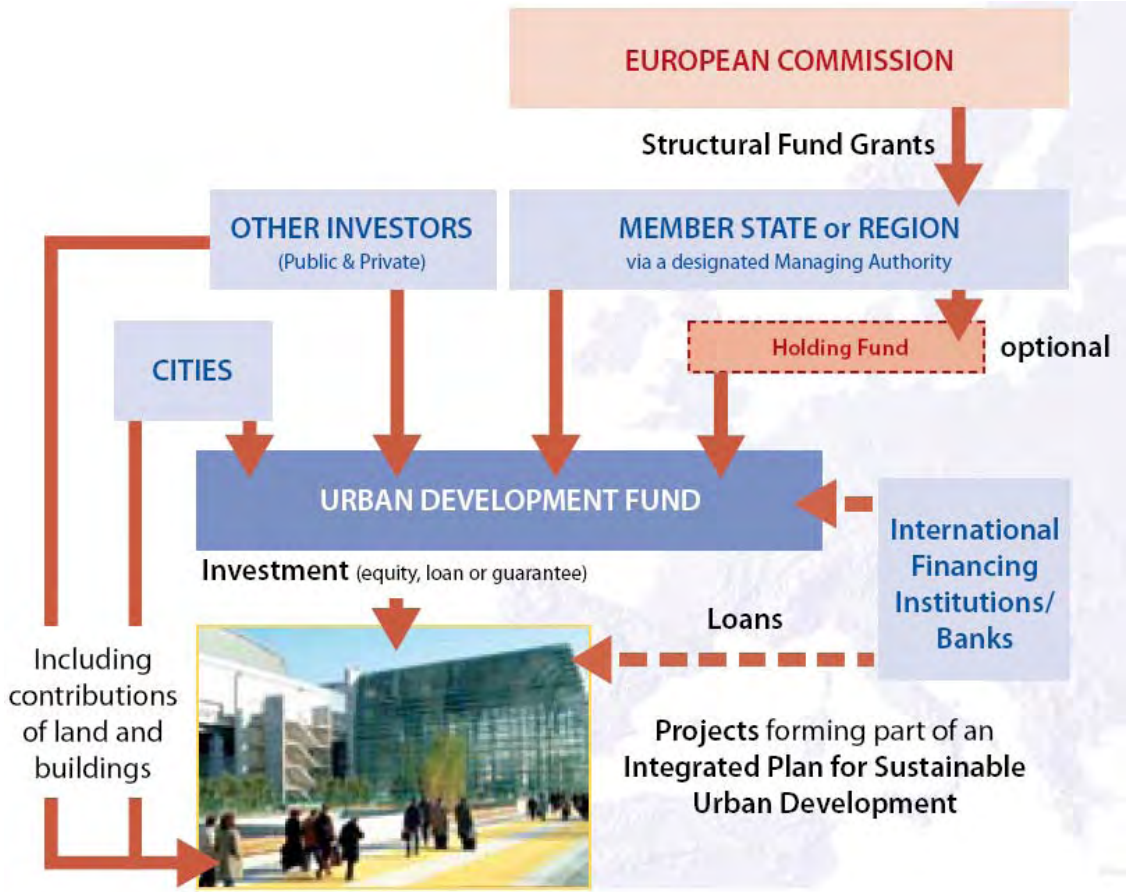
- equity
- loans
- guarantees
- instruments comparable with loans or guarantees.

By integrating a holding fund as a fund of funds at an 'intermediate level' above the individual urban development funds, there is also the possibility, however, to invest in instruments other than those mentioned. The basic idea behind using above mentioned financing instruments in urban development is the revolving use of funding, including funding from the ERDF. The aim is ultimately the effective **multiple use** of Structural Funds resources. Through the recycling principle of capital reflux, it is intended in particular to **integrate private investors (and private sector skills)** at the different levels of investment even for development projects which are not in themselves suitable for a purely economic investment.[11]

III. Structure and marketing

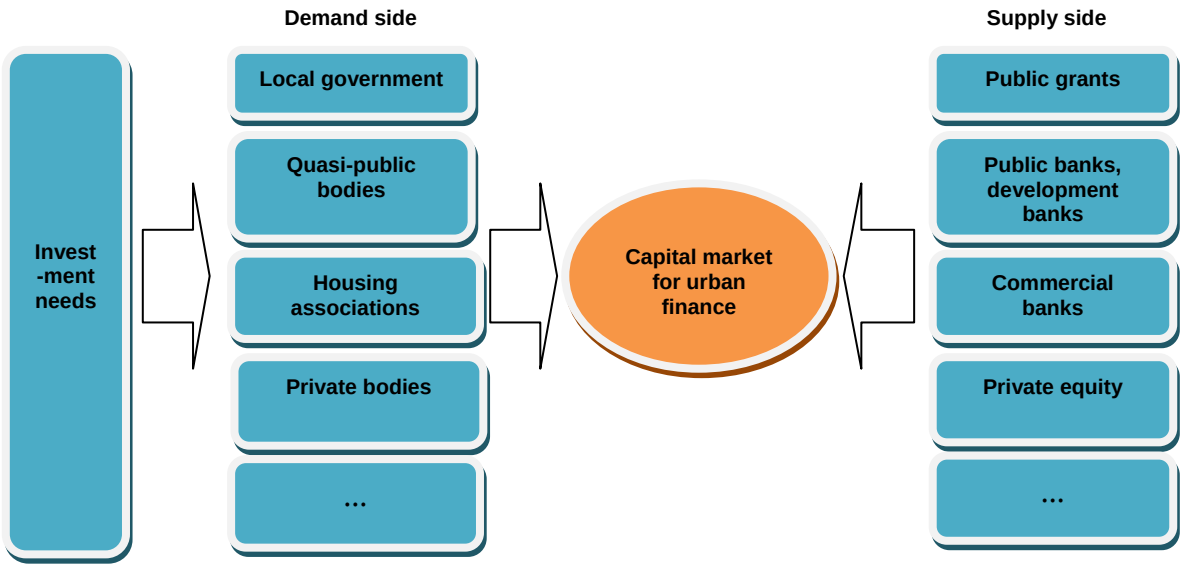
The European Commission has not laid down any specific implementing conditions for urban development funds according to the JESSICA criteria thus far. This creates significant legal challenges for the individual implementing Member States and Länder, but has the advantage that new instruments and approaches can be developed which are tailored to individual needs:

[11] Occasionally there is the possibility to replace public co-financing by the Member States completely with private-sector investment; cf. *Jakubowski*, RaumPlanung 2/2009, p. 23.



Source: EIB, JESSICA – A new way of using EU funding to promote sustainable investments and growth in urban areas.

A further opportunity which stems from this approach is **raising awareness on the capital markets**. In this respect, it should be taken into account that the network of European and national funding in connection with urban development and infrastructure funding for demanders of capital (cities, municipalities, quasi-public bodies, housing associations or private developers), which must be described as highly complex, could not always be fully exhausted and utilised. This is clear from a visualisation of the relationship between the demand and supply sides and the existing investment needs.



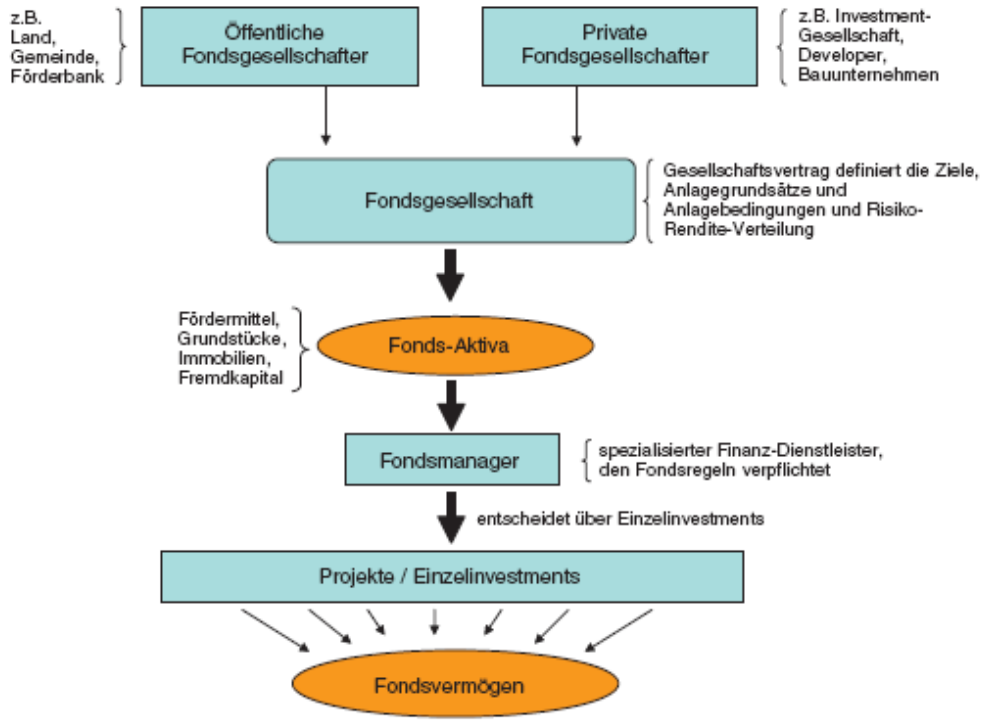
Source: ECOTEC Research and Consulting: Financing Investment in Sustainable Cities and Communities in Europe – the Role of the EIB – Brussels 2007.

IV. The revolving concept of JESSICA fund structures

On account of the revolving principle behind the JESSICA initiative, as has been shown, equity, loans or guarantees can be possible financial engineering instruments. However, this does not mean that fund financing cannot be **combined with grant-funding** which may go outside the urban development fund – as usual – to unprofitable (sub-)projects.[12] In practice, fully unsubsidised financing of urban development funds and projects is in many cases not feasible. The intention is to facilitate projects which are likely to generate revenue, but need a longer-than-average time for redemption or entail very high **pre-financing costs**. It is crucial that the recycling principle behind the JESSICA fund does not require projects to generate income on a profit-making basis immediately, but only calls for resources to be generally recycled back into the fund.[13]

This is the advantage of this financial engineering instrument, as profitability can be achieved only late in the generally **longer start-up periods for project investments**, which generally rules out involvement by private investors. It can also be said to perform a '**stirrup function**' in financing urban development projects. The schematic operation can be represented as follows:

[12] See Article 46(2) of Regulation (EC) No 1828/2006.
[13] See Federal Ministry of Transport, Building and Urban Development/Federal Institute for Research on Building, Urban Affairs and Spatial Development (ed.): Stadtentwicklungsfonds in Europa. Ideen zur Umsetzung der JESSICA-Initiative, BBSR online publication 02/2009, p. 18.



Source: Jakubowski, Informationen zur Raumentwicklung 2007, p. 579 et seq.

The intended multiple use of Structural Funds resources therefore requires a corresponding range of eligible projects which are linked (in the long term) with revenue generation. Conversely, it means that urban development projects with very low or no income are less suited to assistance from JESSICA funds, and are therefore more suited for grant-based support.[14] If no revenue generation is foreseeable for the JESSICA-supported project, as a rule the servicing of the financial engineering instrument (interest and repayment of principal for loans, guarantee charge etc.) would probably remain unsuccessful. In addition, such urban development projects and the urban development fund supporting such projects do not offer an incentive for private investors to be involved.

[14] *Jakubowski*, RaumPlanung, p. 23.

C. Legal context of the Structural Funds regulations

As far as the legal environment is concerned, there are, first of all, '(Structural) Funds-specific rules'. Furthermore, regard must be had to the general regulatory framework under European and national law, which is dependent on the choice of options, but also gives rise to resulting reciprocal effects. As regards the influence on actual use of funding, a distinction must be drawn in particular between **fund level and project level**. This is clear from the process in the implementation phase. First, the fund must be created and structured, before support can be given to individual project promoters at the next level. [15] Similarly, the influence of the regulatory context is also different at this point. Whilst the European requirements are addressed directly to the fund itself, the project level must be engaged as far as possible through the legal obligations on the fund, unless there is direct enforcement of liability under the rules.

In principle, the JESSICA initiative is to be attributed to the EU Structural Funds, with the result that it generally falls within the scope of the **EU Structural Funds regulations** (Regulations (EC) No 1080/2006-1083/2006 and the relevant amending regulations). These currently have a **programming period from 2007 to 2013**. The relevant legal provisions here form the Community-law framework for JESSICA; only the core rules will be mentioned here. Note should also be taken in this connection of the publications of the Coordination Committee of the Funds (**COCOF**) and the planned adaptations of the relevant regulations.

I. Regulation (EC) No 1083/2006 (General regulation for the Structural Funds and the Cohesion Fund)[16]

Regulation (EC) No 1083/2006 contains rules, provisions and common principles for the ERDF, the European Social Fund (ESF) and the Cohesion Fund. It replaces Regulation (EC) No 1260/1999 and reforms European cohesion policy by orienting structural measures more to the EU's strategic guidelines, by concentrating more on the least favoured regions, and by carrying out significant simplification and decentralisation of the structural measures.[17] The aim of the regulation is to strengthen economic and social cohesion in order to promote the harmonious, balanced and sustainable development of the Community in the period from 2007-2013.

[15] This applies irrespective of whether suitable projects are identified in a feasibility study before funds are invested (bottom-up approach) or whether the fund as such is set up first and it then takes on all responsibility for identifying projects (top-down approach).

[16] Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999, last amended by Regulation (EC) No 284/2009 of 7 April 2009.

[17] Compared with its predecessor regulation, Regulation (EC) No 1083/2006 reduces the number of objectives from nine to three (Convergence, Regional competitiveness and employment, and European territorial cooperation) and the instruments used from six to three (ERDF, ESF and Cohesion Fund).

The regulation defines the context for cohesion policy and identifies the individual objectives for which the different funds are used. The regulation also defines the criteria for Member States and regions to be eligible, the financial resources available, and the criteria for their allocation. Lastly, it lays down the principles and rules on partnership, programming, evaluation, management, monitoring and control which apply between the Member States and the Commission.

The main relevant provisions are **Articles 36, 44** and **78** of the regulation. Article 44, which sets out the acceptable financial engineering instruments, allows the funds to use a holding model and lays down requirements governing the institution, in particular as regards the applicability of procurement law, is particularly important to the structure of the fund. Article 78 lays down rules for the statement of expenditure and the classification of fund activities for the purposes of the rules on State aid.

II. Regulation (EC) No 1080/2006 (ERDF regulation)[18]

Articles 4 and 5 of Regulation (EC) No 1080/2006 describe the different permissible areas of investment, depending on whether the objective of the applicable Operational Programme is 'Convergence' or 'Regional competitiveness and employment'. The requirements adopted on that basis in the existing Operational Programmes are then also relevant to the use of ERDF funding in the context of JESSICA funds.

Article 7 of Regulation (EC) No 1080/2006 lays down rules on expenditure and excludes certain categories of expenditure from ERDF support, thereby restricting the available possibilities under Articles 4 and 5.

Article 8 of Regulation (EC) No 1080/2006 essentially extends the scope of Articles 4 and 5 having regard to '**Sustainable urban development**', but the Commission has made clear that this cannot result in a general exemption for the Operational Programme. The Operational Programme already negotiated for the 2007-2013 programming period can be modified only subject to the conditions laid down in Article 33 of Regulation (EC) No 1083/2006. Although there is the possibility, under the **flexibility rule** in Article 34 of Regulation (EC) No 1083/2006, for derogations to be justified under certain conditions even without recourse to Article 33 of Regulation (EC) No 1083/2006, this applies only if the application of Article 34 of Regulation (EC) No 1083/2006 was not precluded in the Operational Programme from the outset.[19]

[18] Regulation (EC) No 1080/2006 of the European Parliament and of the Council of 5 July 2006 on the European Regional Development Fund and repealing Regulation (EC) No 1783/1999, last amended by Regulation (EC) No 846/2009 of 1 September 2009.

[19] This is the case in some Länder; see letter from the Commission to the Federal Ministry of Economics and Technology of 2 September 2009.

On the other hand, according to the Commission, **modifications** which do not affect the material content of the Operational Programme, and are therefore of a **purely technical nature**, can be agreed with the Commission.

III. Regulation (EC) No 1828/2006 (Implementing regulation)[20]

The provisions of **Section 8 – Financial engineering instruments** (Articles 43, 44, 45 and 46), which implement Regulation (EC) No 1083/2006 in relation to funds, are of particular relevance here. Detailed rules are laid down governing the organisation and the utilisation of the financing elements (management costs, business plan, and use of revenue). There are also specific requirements for holding funds and urban development funds.

These are essentially a continuation and extension of the '**Rule 8 criteria**' from the repealed Regulation (EC) No 448/2004 for the outgoing programming period. They are basically the familiar criteria for the establishment of funds, with newly added rules for holding funds and urban development funds. The applicable operating conditions include:

- Revolving use of resources beyond the end of the programming period for the benefit of urban development projects or in support of SMEs (Article 78(7) of Regulation (EC) No 1083/2006). It is also recommended that recycled resources be used in the region(s) covered by the Operational Programme (cf. COCOF 08/0002/03-EN, p. 4)

- The fund and not the enterprise is the beneficiary.[21] This means that the resources can be invested in a fund without proof of previous expenditure. Payments into the fund are regarded as expenditure and do not need to be settled until the end of programming period (the expenditure reimbursement principle does not apply at fund level). A profitable interim investment from ERDF funding is possible. This has the advantage that interest can be generated in the fund itself and capital growth can thus be achieved.

- Normal banking duties in relation to reporting and proof of ERDF use at the level of the supported enterprises at project level.

IV. COCOF notes

Under Article 103 of Regulation (EC) No 1083/2006, the Commission is assisted in applying the provisions of the regulation, by a **Coordination Committee** of the Funds. The committee provides guidance for practitioners, public authorities, beneficiaries or potential beneficiaries, and other bodies involved in the monitoring, control or implementation of cohesion policy.

[20] Commission Regulation (EC) No 1828/2006 of 8 December 2006 setting out rules for the implementation of Council Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and of Regulation (EC) No 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund, last amended by Regulation (EC) No 846/2009 of 1 September 2009.

[21] COCOF 07/0018/01-EN, p. 2.

Those bodies are to be given assistance on how to interpret and apply the Community rules in the area of cohesion policy. The COCOF notes do not have any legally binding **effect**, neither on the Commission nor on other users and parties affected by the relevant rules. The COCOF notes are expressly without prejudice to the interpretation of the Court of Justice and the Court of First Instance or evolving Commission decision-making practice.[22] Even though it is therefore ruled out that the Commission is generally bound by the interpretations put forward in the notes, the Commission will nevertheless not deviate from the published views without objective reason.

The interpretations which are of particular relevance for JESSICA are contained in the two **Guidance Notes on Financial Engineering** from 2007[23] and 2008[24] and the Guidance Note on eligibility of energy efficiency and renewable energies interventions under the ERDF and the Cohesion Fund in the building sector including housing[25]. The two Notes on Financial Engineering are given over primarily to interpreting and explaining the notions of 'operation' and 'beneficiary' and specific issues concerning financial engineering techniques such as selection of holding funds, selection of financial engineering instruments, selection of operations, management costs, and major projects. The second Guidance Note on Financial Engineering also contains an annex with a list of questions asked by Member States and the Commission's replies. In the COCOF Note on eligibility of energy efficiency and renewable energies interventions under the Structural Funds, it was originally stated that this kind of support through Structural Funds resources was not possible in the 'old' Member States (EU-15).[26] In the 'new' Member States, on the other hand, support for energy improvements in housing was possible from the beginning subject to certain conditions. Through amending Regulation (EC) No 397/2009, the European legislature extended the possibility of investments in energy efficiency and energy improvements in housing so that now, under the newly inserted Article 7(1a) of Regulation (EC) No 1080/2006, such investments are permissible in all – including the 'old' – Member States up to an amount of 4% of the total ERDF allocation.[27] Under the amending regulation, support for other investments in housing are still reserved, subject to certain conditions, for the 'new' Member States.

V. Further legal developments

According to the Commission, aside from the current amendments[28] and the existing proposals,[29] no further legal requirements are envisaged. There is a desire to stabilise the

[22] See, for example, the disclaimer in COCOF 08/0002/03-EN, p. 1.
[23] Note of the Commission services on Financial Engineering in the 2007-13 programming period (COCOF 07/0018/01-EN).
[24] Guidance Note on Financial Engineering (COCOF 08/0002/03-EN).
[25] Guidance Note on eligibility of energy efficiency and renewable energies interventions under the ERDF and the Cohesion Fund (2007-2013) in the building sector including housing (COCOF 08/0034/02/EN).
[26] In the 'old' Member States only investments in public buildings which are not used for housing are eligible.
[27] Under the second subparagraph of Article 7(1a) of Regulation (EC) No 1080/2006, Member States must define categories of eligible housing in national rules.
[28] Especially Regulation (EC) No 846/2009 of 1 September 2009.

existing legal framework so that it must be assumed that some flexibility will remain in that framework. It has been announced, however, that a further COCOF note is to be published to address, among other things, the evaluation of risks by funds in connection with the furnishing of guarantees.

[29] COM(2009) 384 final, 22.7.2009.

D. Optional establishment of a holding fund

Under the provisions of the Structural Funds regulations, it is possible to use a **holding fund** to pool resources for investments in the individual urban development funds.[30] This is advisable where several urban development funds are to be supplied from a **single central pool**. It is not a mandatory requirement for the Member States to implement a holding fund, but it offers benefits which should be examined in each specific case.

Synergies can be achieved because the awarding bodies combine the funding and pass it through from there to individual projects, with the result that competences can be transferred to selected experts. There is thus a **pooling of competence**.

Duties include a region- or Member-State-specific list of criteria for investments in urban development funds, which are in turn compatible with the requirements of the Structural Funds regulations at European level. Furthermore, model agreements and general guarantee clauses etc. are also drawn up at this level.

In addition, the holding fund structure offers the possibility of pooling different funding with other public and private resources and thereby creating a larger volume of finance. This is beneficial particularly in terms of **interest generation**.

Holding funds can be set up in particular in cooperation with the EIB. An autonomous legal form is not absolutely necessary provided it is ensured that separate accounts are kept within the financial institution for the holding fund.[31] Transferring responsibility for holding fund management to the EIB releases the competent Member States or regional managing authorities from the obligation to launch an invitation to tender for management of the holding fund.[32] In that case the basis for cooperation between the EIB and the managing authorities would be a funding agreement laying down financing conditions, target investments, project monitoring, reporting obligations etc.[33] A grant is awarded by the Member State or managing authorities where the EIB takes on these responsibilities.[34]

It has not yet been discussed at the level of the individual Länder whether to use such holding funds. Against this background, further analysis will be confined to the immediate fund level and project level.

By the beginning of 2010 eight funding agreements had been signed between ERDF managing authorities and the EIB in six EU Member States (United Kingdom, Italy, Lithuania, Poland, Portugal and Spain) with a total volume of around EUR 1 billion.

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[30] See the second paragraph of Article 44 of Regulation (EC) No 1083/2006.
[31] Article 43(3) of Regulation (EC) No 1828/2006.
[32] The Commission favours this option of entrusting the EIB with creating and managing a holding fund; see COCOF 07/0018/01-EN, p. 3.
[33] With regard to the minimum content of the funding agreement between the holding fund and the Member State or managing authority, see Article 44 of Regulation (EC) No 1828/2006.
[34] Letter (b) of the second paragraph of Article 44 of Regulation (EC) No 1083/2006.

E. Fund level

A JESSICA architecture is open to participation by private and public partners both at fund level and at the level of individual (PPP) projects. It is thus also possible to integrate private capital at the different levels. The decision as to the level at which private partners are to be involved is of crucial importance for the further structural organisation of the urban development fund.

In principle, the following **conflict** must be resolved: The **inclusion of private investors** at fund level brings many advantages in relation to the fund structure and the utilisation of private-sector know-how. On the other hand, in such a scenario the risk of possible confusion of interests at fund level must be taken into consideration and, if necessary, resolved as early as possible.

Where there is purely public promotion, whether by one or more public actors, this exists only to a limited extent. However, there is a danger that synergies with the private sector will be diluted.

Where public bodies and/or their subsidiaries participate in PPP and PPF projects through an urban development fund under JESSICA rules, aside from the requirements of the Structural Funds, the legal environment depends on numerous factors such as shareholder structure, legal form, corporate governance and the type and size of the investment.

This framework must also be defined and determined early in a project phase in order to be able to evaluate all available options in the light of their financial and economic consequences.

Private-sector participation in an entity like an urban development fund, together with a public institution, **generally requires a tender procedure** if such participation is connected directly with a public contract.

In the case of direct private participation in an urban development fund, for example by institutional investors such as pension funds, it should be borne in mind that in the tender procedure such investors would have to bid to participate, together with other tenderers, without the involvement of an urban development fund. Conclusively, also in this case, direct private participation of such investors would have an impact on competition.

In addition to the directly applicable European requirements, regard must also be had to the provisions of national budgetary law, unless they are contrary to EU law. This applies in particular to eligibility of expenditure, the requirements for which,[35] under Article 56(4) of Regulation (EC) No 1083/2006, must now in principle be laid down by the Member States.

[35] The Structural Funds regulations themselves contain only few requirements governing eligibility. Mention can be made, for example, of Article 7 of Regulation (EC) No 1080/2006.

I. Legal form/fund structure

No specific legal form is stipulated for the urban development fund. The choice of legal form and the specific structure of a JESSICA fund are contingent on the way in which the fund is to be technically structured. However, an urban development fund must be organised as an independent legal entity or at least a separate block of finance within an existing financial institution. This means that by keeping separate accounts, JESSICA must be clearly distinct from other assets of the financial institution or body in question. Where a German urban development fund invests through the financing instruments of loans, guarantees or similar instruments, those banking transactions within the meaning of the second sentence of §1(1) of the Kreditwesengesetz (Law on Banking) require an authorisation to that effect from the Federal Financial Supervisory Authority pursuant to § 32 of the Kreditwesengesetz (banking licence).[36]

In principle, it is possible, against this background, to model and modify the structure or composition of the fund – for instance in terms of the proportions of funding from complementary financing – over its life, provided it is ensured that for eligible projects the maximum contribution of ERDF funding depending on the co-financing rate (75% or 50%) and the programming of the OP is respected. However, in creating strucutres for precisely this kind of 'breathing fund', particular attention is to be paid to ensuring the long-term nature of the ERDF support. A certain degree of stability from abiding fund structures is perfectly desirable. The modelling and modification of the fund structure over the life of the fund would appear to be limited in this respect, particularly because the same OP is relevant for the duration of the programming period.[37]

In terms of **competence allocation**, an urban development fund can be set up nationally, regionally or locally/municipally in order to take due account of the size of the urban development fund and the programming strategy. Important parameters are:

- material and geographical scope of the fund company to be formed;
- definition of the level of commitment of private capital (fund itself or project level);
- acquisition and inclusion of private partners (depending on the definition of investment level).

II. Contributions to funds

Depending on the inclusion of participants in the funds, there are **different options or models** for making the necessary contributions into the funds. This is of structural importance to the

[36] If the urban development fund itself does not have the necessary banking licence, the loan may be granted by a cooperating financial institution which receives an interest subsidy payment through the urban development fund in order to be able to grant the borrower (supported project) a loan with interest-rate relief.
[37] In this respect it is advisable to adjust the OP's financing plan to the planned fund structure.

fund and, at the same time, offers the possibility of including in the funds participants who can provide tangible assets, which are important for furthering projects, but who do not have the necessary financial resources. Specifically, this means:

- definition of fund assets with reference to participating partners and specific area of investment;
- choice of financial means / sources, **e.g. from subsidy programmes, equity or mezzanine capital**;
- examination of contribution of **tangible assets**, in particular land and buildings.[38]

Private-sector involvement in the JESSICA fund can also take the form of outside capital. However, it should be borne in mind that urban development funds may not invest in the creation of venture capital, loan and guarantee funds (second subparagraph of Article 46(1) of Regulation (EC) No 1828/2006), but only directly in the financing of projects.

1. Release of ERDF resources and national co-financing

With regard to the release of ERDF resources on the basis of the national co-financing principle, three topics can be distinguished: **source, level and time** of the national co-financing to be provided.

a. Source of national co-financing

From the perspective of the Structural Funds regulations, it is essentially irrelevant to the existence of sufficient co-financing whether **public or private funding** is used. However, it should be borne in mind that specifically in the case of national public funding there may, on the one hand, be restrictions on combinations with other support funding[39], and on the other the question whether funding from co-financing is to be classified as public or private is relevant to subsequent legal questions, such as in relation to the law on State aid.

In the case of funding contributed by **public-law institutions** (e.g. regional banks), the question may therefore arise whether it is treated as public or private funding. This depends on whether the funding to be contributed can be attributed to a specific public source and from which resources the institution is financed. In the light of this question, it is of crucial importance what specific resources are to be contributed into the fund. If the funding came from its budget as a development bank and is disbursed as part of the performance of its

[38] For contributions in kind, a due evaluation of those resources must be made in order to ensure the transparency of the fund. To that end, Article 56 of Regulation (EC) No 1083/2006 was expanded by Regulation (EC) No 284/2009 of 7 April 2009 amending Regulation (EC) No 1083/2006.

[39] In the past, the use of urban development funding was barred on the basis of the Administrative Agreement on Urban Development (VV Städtebau), but the Structural Funds Regulations do not preclude such use. It is being discussed at present whether to open up the Administrative Agreement on Urban Development in future.

public duties[40], that funding is also to be regarded as public funding. If, however, no 'public funding' is passed on, but primarily other sources of financing, such as from cooperation with private financial institutions or investors, it is possible that the funding is to be regarded as 'private' from the perspective of the Commission. In order to be able to categorise the funding, the origin of the specific funding must therefore be explained in each specific case.

On the other hand, **EIB (global) loans**, which are regularly used by the individual Member States and Länder to raise national co-financing, should, as a rule, always be regarded as public funding. On the one hand, the Länder or the regional development institutions are borrowers and, on the other, the EIB is part of the EU institutional system and not therefore not a private actor.

A scenario is also conceivable where the retention of contributions to the fund by the Land in question is guaranteed. In such cases, the invested resources are essentially to be regarded as private funding despite being covered by a **guarantee from the Land**. This applies on the premise that the guarantee from the Land is effected on normal market conditions and is consistent with the rules on State aid, in particular the EU Notice on guarantees[41]. The question of the preferential allocation of returned investments into the fund under Article 43(5) of Regulation (EC) No 1828/2006 is to be seen against this background, since express reference is made therein to **investors operating under the market economy investor principle**. The State guarantee for the retention of the investment must therefore comply with this principle. This is confirmed by Article 43(7) of Regulation (EC) No 1828/2006, which requires the Member States to minimise impairments, inter alia, of the private guarantees market. Even though that provision is aimed primarily at fund activity, a careful examination is also necessary in the case of State coverage of the contributed fund resources. The classification of funding as private and public also plays a role if the examination for purposes of the law on State aid studies the activity of the fund from the perspective of the actions of a private investor. If the private investment is covered only to create private participation in private investments in unattractive funds, thereby disguising de facto public funding as private funding, the relevant funding from private sources should be classified as public.

Funding returned from **investments in another urban development fund** does not appear to be a possible source of national co-financing if the fund is still active. Irrespective of the commitments to which the recycled funding is subject in relation to its reutilisation, the transfer of funding from one urban development fund to another is prohibited under Article 46(1) and (2) of Regulation (EC) No 1828/2006. In so far as that provision prohibits investments from an urban development fund in other fund models[42] and the urban development fund is given certain investment instruments, this expresses the legislature's

[40] See, for example, §§ 2 and 3 of the SächsFörderBankG.
[41] OJ 2008 C 155, p. 10 et seq.
[42] Such investments are reserved for holding funds under Article 44 of Regulation (EC) No 1828/2006.

intention to grant resources from the fund directly – without passing indirectly through a further fund – to the project in question. This would appear to hold for general investment activity under the fund even after the first investment has been recycled.[43] If, on the other hand, there is a planned exit from the fund in accordance with the Structural Funds regulations, further use of the resources is possible.

b. National co-financing level

In the current programming period, national co-financing is generally provided at fund level, since this must already exist when the ERDF share is called. Since at present there cannot yet be any projects in a first fund to be set up, co-financing at project level is ruled out in this scenario. However, it is essentially possible.[44] Nevertheless, once the fund is invested, it can be proven to the Commission that co-financing is guaranteed at project level itself and funding can then be called. Particularly where co-financing is to be by the municipalities in question, this can be done either at project level or at fund level. Relevant factors are the structure of the specific projects and the capacity to identify the relevant co-financing share. A statement of account under Article 78 of Regulation (EC) No 1083/2006 on the closure of the Operational Programme must, of course, be made through the fund. Consequently, in this case too, the contribution of co-financing at project level must be documented.

It must also be taken into consideration that participation by municipalities regarding the reflux of resources into the fund can therefore take place only if the municipality is also involved at fund level. The way in which the municipality proceeds with that recycling is determined, first of all, by the structure of the fund and, secondly, by budgetary law. Whether tying reflux funding for individual municipalities as 'fund members' is reasonable is a strategic question, on the other hand. In general, co-financing at project level by a municipality without related conditions allows the fund greater flexibility with a view to the future.

c. Contribution of national co-financing

In principle, it is necessary for the national co-financing share to be invested in the JESSICA fund as the beneficiary at least at the same time as the ERDF funding is called. However, depending on the structure and organisation of the projects, the question may arise, in particular in connection with larger-scale financing, to what extent ERDF funding is to be paid first and the complementary funding only later on the closure of financing. In this regard it should be noted that the key factor is that at the end of the programming period each of the supported projects have received assistance from ERDF funding up to the maximum limit of the co-financing rates relevant for the OP. Against this background, it makes no difference how the individual financing tranches are composed. It should be noted, however, that

[43] In the following section it is shown that national co-financing can taken place at project level, so recycling from urban development fund investments as co-financing is ruled out only at fund level.
[44] *Jakubowski*, Informationen zur Raumentwicklung, Vol. 9/2007, p. 587.

complementary funding must be paid into the fund fully at the beginning. It is not possible in principle to **contribute the funding only when it is called into the fund itself**. The situation may be different, however, if the national co-financing is already **committed to the fund through a regional development bank,** but is not entered in the books until the funding is invested in a project in accordance with balance sheet requirements. The Commission declared such a course of action by the Investitionsbank des Landes Berlin (IBB) in the last programming period to be compatible with national co-financing.[45] In that case, the funding was set up as a separate block of finance within the IBB ('virtual fund'). That block of finance was allocated an auxiliary account in the investment bank's internal accounting system, and the keeping of separate accounts distinguished the new resources invested in the fund (including those contributed by the Structural Funds) from those available. The Land's ERDF funding was provided to the fund as a conditionally repayable grant in one sum. National co-financing is provided through the IBB by means of loans to the fund refinanced on the capital market. In the funding agreement between the Land of Berlin and the IBB, the IBB pledges itself to the Land of Berlin irreversibly to reserve and provide all co-financing of ERDF funding in the required amount. The Commission had declared this approach to be compatible with Rule 8, point 2.2 of Regulation (EC) No 448/2004, with the **following notes**[46]:

- timely contribution of national funding in accordance with the principle of proper accounting and verifiability;
- auditing of fund accounts by external auditors as part of the annual accounts;
- no alternative use of ERDF funding;
- repayment of unused funding at the end of the programming period.

2. n+2 restrictions

Article 93(1) of Regulation (EC) No 1083/2006 provides that the EU funding committed for the relevant Operational Programme is released automatically by 31.12 of the second year following the year of budget commitment, provided there have not been payments of pre-financing or interim payments or an admissible application for payment by that date.[47] The purpose of that provision is to require the Member States to comply with the respective financing plans within the stipulated time-limits. The tranche of financing which is earmarked for year n in the OP results in a corresponding commitment in the EU budget and must be called by 31.12 of year n+2. In view of the application of the cost-reimbursement principle, this means that the expenditure must actually be effected before it is reimbursed.

[45] See the letter from the Commission to the Land of Berlin of 10.11.2004, examination of a planned SME credit fund by DG REGIO; see also the letter from the Commission to the Land of Lower Saxony of 31.07.2008.
[46] Ibid.
[47] Article 75(1) of Regulation (EC) No 1083/2006.

Because the contribution of funding in the JESSICA fund is also regarded as appropriate expenditure, the n+2 rule no longer applies once the funding is paid into the fund. A decommitment is thus avoided from this perspective. However, it must be taken into account that the ongoing appropriate use of resources must be ensured and expenditure of resources from the fund must continue until 2015, or there will be an irregularity.[48] EU funding not used by the end of the programming period must be repaid to the EU.

3. Investment procedure on the basis of cost reimbursement

The principle of cost reimbursement also applies in the case of urban development funds. The statement of expenditure under Article 78(6) of Regulation (EC) No 1083/2006 requires a statement of payments paid from the urban development fund in implementing the operation. Eligible expenditure is assessed on that basis. In principle, **the principle of expenditure actually paid out** also applies to the statement of the management costs for a fund; such expenditure must be supported in each specific case by invoices or accounting documents of equivalent probative value, unless the fund management was found by means of a tender procedure under public procurement law. In the case of a fund solution, however, only the national co-financing must be documented first when resources are invested. At the end of the programming period on 31.12.2015, however, it must be proven that the resources invested were expended appropriately. The investments made by the fund then serve as proof of expenditure. In this connection, the use of the funding per se must be shown and appropriate measures must be taken to document the way in which that funding has been used at project level. This must be borne in mind in the formulation of the respective financing agreements.[49]

Furthermore, the new provisions on the statement of flat-rate costs simplify matters to a certain extent. Article 7(4) of Regulation (EC) No 1080/2006 was inserted in order to simplify the management of operations that receive an ERDF grant.[50] Before that provision was inserted, each grant was required to have corresponding expenditure actually paid out, which had to be supported by documents and receipts. As far as management costs are concerned, simplifications were made in particular through declaration as **indirect costs**[51] under Article 7(4)(i) of Regulation (EC) No 1080/2006 or lump sums under Article 7(4)(iii) of Regulation (EC) No 1080/2006, the latter being limited to a maximum of EUR 50 000. The effects of simplification would appear to be fairly weak, however, since declaration as indirect costs entails a thematic delimitation which covers only certain categories of incurred management costs. Classification of management costs under a lump sum could prove to be less attractive because of the limitation of the amount. A combination of categories of

[48] With regard to the concept of irregularity, see the legal definition in Article 2(7) of Regulation (EC) No 1083/2006. See also *Holzwart* (footnote 9), p. 296 et seq.
[49] With regard to the specific content of the support agreements, see below under G.V.
[50] See recital 6 in the preamble to Regulation (EC) No 397/2009.
[51] This means costs which are not directly connected with the operation, but which are necessary for its implementation, such as telephone and electricity costs; see Press release No 9400/09 on the 2940th Council meeting - Economic and Financial Affairs.

expenditure is precluded by the condition laid down in the second subparagraph of Article 7(4) of Regulation (EC) No 1080/2006, under which the types of cost must each come under a different category of eligible costs or be used for different projects within the same operation. Whilst the first alternative is ruled out because the same category of management costs is relevant in this case, the second alternative is not possible because indirect costs for an urban development fund cannot in practice be attributed to individual projects.

III. Requirements laid down by Operational Programmes

Under Article 37 of Regulation (EC) No 1083/2006 and Article 12 of Regulation (EC) No 1080/2006, the Operational Programmes contain the strategic framework conditions for the use of funding. Each Operational Programme relates to just one of the three objectives set out in Regulation (EC) No 1083/2006 and is financed from the single fund.

Each Operational Programme must seek to comply with the requirements laid down by the national strategic reference framework and the Community strategic guidelines on cohesion. It contains in particular an analysis of the existing economic situation in the region in question, an explanation of the funding requirement and the support strategy, a breakdown into priority axes, the individual support measures and a financing plan.

Some Operational Programmes in the German Länder do not specifically provide for the use of JESSICA instruments. Even in the absence of a specific reference to JESSICA in the Operational Programmes, however, the use of revolving financial engineering instruments is an option. Nevertheless, it is recommended that the Operational Programmes within the 2007-2013 programming period be adapted in such a way that **Structural Funds resources are explicitly identified for JESSICA funds**. Contributions to a specific financial engineering instrument do not necessarily have to come from a single Operational Programme. Rather, it is possible to have contributions from more than one Operational Programme to the same financial engineering instrument if it is ensured, for reporting and audit purposes, that separate accounts are kept or an adequate accounting code is maintained for the contribution from each Operational Programme.[52] It follows, conversely, from the possibility of combining resources from different Operational Programmes that it is also possible to combine resources from different priority axes within a single Operational Programme.

If the financing plan for the Operational Programme provides for co-financing of urban development projects solely by means of public funding, the addition of private funding should be regarded merely as a technical modification to the Operational Programme, provided the amount of national co-financing is ensured. Such a technical modification would have to be agreed with the Commission. The procedure under Article 33 of Regulation (EC) No 1083/2006 could be dispensed with unless the material content of the programme is subsequently to be modified.

[52] COCOF 07/0018/01-EN, p. 1 et seq.

IV. Budgetary law

In addition to the European legislation, regard must also be had to the requirements of national budgetary law, unless European law provides otherwise.[53] Because of the **primacy of the European Community law**, it may be necessary to adapt national budgetary law to the European requirements.[54] In most cases, however, national budgetary law appears to contain provisions which go beyond the rules of European Community law and which must then be taken into account in implementing the urban development fund. This includes, for example, restrictions in some regional budget regulations with regard to the acquisition of holdings in private enterprises or amounts borrowed.[55] Depending on structure, it may be necessary to harmonise the requirements of budgetary law, in particular in view of the investments from the fund in projects.

If the urban development fund seeks investment in an urban development project through an equity participation in a private enterprise, this generally also requires – depending on regional budgetary law – the agreement of other regional authorities, which is in turn dependent on the satisfaction of certain criteria.

It should also be borne in mind that under certain circumstances **restrictions under municipal budgetary law** preclude participation by local authorities in urban development funds. For example, a municipality which is subject to budgetary stringency may not participate in setting up an urban development fund since any income must be used, first and foremost, for debt repayment. Returned funding must therefore be used to repay debts rather than, as is required, be reinvesting in urban development projects or SMEs.

V. Fund structure

By integrating private capital at fund level, numerous advantages can be created, but consideration should be given to focusing initially on public promotion when setting up a fund, and extending it subsequently by possible private-sector involvement. Even in the case of purely public promotion, however, further specific questions arise in relation to the way in which the legal structure of the fund is to be reasonably organised.

1. General criteria

The urban development fund may be set up as independent legal entity or a separate block of finance within a financial institution[56]. In the latter case, the financial institution acts as trustee for the fund's assets and the fund is subject to special implementing rules which, in

[53] The provisions of the regulations apply directly in the Member States and do not require any implementation. If national rules conflict with European requirements, the latter apply. European law takes precedence over national rules.
[54] With regard to the primacy of Community law, see *Ruffert*, in Calliess/Ruffert, Das Verfassungsrecht der Europäischen Union, 3rd edition, Munich 2007, Article 249 EC, paragraph 22 et seq.
[55] e.g. § 65 of the North Rhine-Westphalia Landeshaushaltsordnung (Regional Budget Regulations)
[56] e.g. a national development bank.

particular, provide for the keeping of separate accounts, with a distinction between new resources invested in the fund (including those contributed from the Operational Programme) and from those originally available in the fund.[57] A crucial question is therefore whether an autonomous, independent legal entity is to be created or an '**internal solution**' within a regional development institute is chosen. Various technical aspects are relevant:

- Organisational structure in the light of fiscal considerations
- Transaction costs
- What funding instrument is to be granted?
- In case of loans, with the result that the legal entity must have a banking license? If it does not have one already (so an existing regional development institute is possibly preferable), one must be acquired.
- In case of equity investments, the fund must, as a rule, be implemented as an autonomous, independent legal entity since some regional development institutes may not directly acquire shares in businesses under their internal rules. The relevant requirements must therefore be examined. The same applies to possible restrictions under regional budget regulations, which are, however, generally clarified by the rules governing the development institutes.

From a technical point of view, mention should be made of Article 78 of Regulation (EC) No 1083/2006, one of the key rules for the operation of the fund from a financial engineering perspective, which lays down the necessary content of the statement of expenditure to be drawn up by the fund.

The crucial implementing rules for the financial implementation of the Structural Funds regulations are contained in Regulation (EC) No 1828/2006; particular reference should be made to Chapter II, Section 8, starting at Article 43. The general requirements laid down include:

- the business plan or other appropriate document (Article 43(2)),
- being set up as an independent legal entity or as a separate block of finance within a financial institution with separate accounts (Article 43(3)),
- a competitive tender for the management of the fund, if it is intended for depart from the stipulated percentages (Article 43(4)),

[57] Article 43(2) of Regulation (EC) No 1828/2006.

- the conclusion of a funding agreement for the financial engineering instrument between a duly mandated representative and the Member State or the managing authority (Article 43(5)).

In preparing the business plan, it should be borne in mind that it must also include the expected returns from returned capital. There is no 'minimum return quota', however, but the business plan should be sufficiently detailed and specific to allow an estimate of expected returns. This is evident, first, for reasons relating to internal requirements of self-control and, secondly, from the fact that a private investor will be prepared to invest in the fund only if it has a certain rate of return on its investment. This means, ultimately, that the aim of private-sector participation in the fund can be pursued only on the basis of a certain level of expectation.

2. Fund management

Another crucial question is the **appointment of and allocation of responsibilities to the fund manager**, who takes the relevant investment decisions and is responsible for managing operational business. The fund manager must, for operational reasons, have sufficient discretion in decision-making. On the other hand, he must operate within the defined legal framework for the funding. This applies in particular to project identification and selection. In this connection it is necessary to devise a streamlined, but sufficiently integrated organisational solution for the fund.

It is particularly important to **integrate municipal decision-makers** adequately. This means sufficient powers of co-determination with optimum flexibility in management of the fund. Lastly, potential conflicts between funds and municipal co-decision-makers in the structure must be minimised (e.g. administrative agreements in connection with urban development support).

The fund manager must nevertheless have responsibility to take his own decisions and be required to comply with the agreed fund rules. An (optional) fund advisory body may be set up to support the fund management, to make recommendations and to provide advice.

Against this background, it is all the more important to have a full understanding of the project selection criteria in order to ensure that project financing is consistent with public requirements and at the same time is return-oriented. The **regional development banks** are able to play a special role for the fund management since they have the necessary financial know-how and, as holders of a banking licence, allow direct lending from the fund.

When it comes to the organisation of the fund management, public procurement law is to be considered. As long as the fund (contribution) remains in the ownership of the Land and a ministerial/administrative department of the Land (Stabsstelle) itself performs relevant

management tasks, public procurement law is not applicable. However, in such cases, public procurement law will have to be considered when above mentioned department is procuring external advisory services (e.g. from private banks or regional development banks).

If the contract for management of the fund is awarded directly or indirectly by a public local authority to a regional bank/development institute, in the award of the contract the provisions of Section 2, Part A of the **Verdingungsordnung für Leistungen (Rules regarding Public Supply Contracts – VOL/A) are applicable** if the management of the fund is a priority service contract within the meaning of § 1a(2)(1) of Section 2 of VOL/A in conjunction with Annex I A which meets the threshold of EUR 193 000 under Regulation No 1177/2009 of 30.11.2009 (§§ 2(3), (4)(1) of the Verordnung über die Vergabe öffentlicher Aufträge (Regulation on the Award of Public Contracts)). Fund management would appear to belong to Category 6 of Annex I A of Section 2 of VOL/A (bank services).[58] We also assume that the threshold is exceeded. The contract is thus subject in principle to cartel procurement law.

There is also no exception from the scope of cartel procurement law under § 100(2) of the Gesetz gegen Wettbewerbsbeschränkungen (Law on restrictions of competition). Even though the regional bank/development institute, as the contractor, would in turn be a contracting authority under § 98(2) of the Gesetz gegen Wettbewerbsbeschränkungen,[59] it does not provide fund management on the basis of an exclusive right (§ 100(2)(g) of the Gesetz gegen Wettbewerbsbeschränkungen) and is also not to operate in the context of raising capital (§ 100(2)(m).

Lastly, the rules on preferential in-house procurement developed by the European Court of Justice do not appear to be noticeable. Irrespective of the further requirements laid down, it is likely that there is generally ‘a lack of control similar to that exercised over its own departments’ in the relationship between managing authority and fund management. However, in individual cases, the direct award to a regional development bank would appear justifiable, provided the relevant regulations of the Land as well the specific structure of the regional development bank in question lead to the assumption that ‘control similar to that exercised over its own departments’ characterises the relationship between the Land and the regional development bank.

3. Funding agreements

Article 43(6) of Regulation (EC) No 1828/2006 lays down the minimum content for the funding agreement between the JESSICA fund and the managing authority. In addition to arrangements on the investment strategy and planning and monitoring of implementation, the

[58] See also Regulation (EC) No 213/2008 of 28 November 2007 amending Regulation (EC) No 2195/2002 (CPV regulation), CPV Codes 66000000-0 et seq. (e.g. ‘bank services’, ‘deposit services’, ‘investment banking’, ‘financial consultancy’); for details, see *Hailbronner* WM 2002, p. 1674 et seq.

[59] cf. VK Stuttgart, order of 06.06.2001, Neue Zeitschrift für Baurecht 2002, 173 for public development institutes.

funding agreement must in particular contain exit rules for the contributions from the Operational Programme and winding-up provisions for the fund. Notes on the detailed content of the exit rules for the contribution from the Operational Programme and the winding-up provisions can be found in the second COCOF document on financial engineering.[60] It states that the conditions under which resources contributed from Operational Programmes and returns recycled into the fund are repaid to the managing authority in cases of conflict or in case of failure of the investment should be clarified, so that the risk of irregularities can be reduced.

4. Necessary information sheets and guidelines

In addition to the abovementioned provisions of national budgetary law, the eligibility guidelines of the Länder also define the support legal framework.[61] The existing eligibility guidelines have been drafted for grant-based support. For support through urban development funds it is important, in a top-down approach, to notify potential projects in advance of the eligibility criteria in order to enable them to apply for support and to assess their prospects of success. It is not possible to make a general statement on whether such publicity of the eligibility criteria should be by means of eligibility guidelines, information sheets etc. In particular where a public tender procedure must take place, the eligibility conditions may be indicated in tender documents. Ideally, the project's eligibility should be ascertained before the initiation of the procurement procedure. If support can be granted only on the basis of an already supported project, the tenderers must be required, for the purposes of the tender procedure, to assume eligibility in drawing up their tenders. One award criteria could then be the extent to which (e.g. up to a stipulated maximum amount) the respective tenderers intend to have recourse to support funding. In the tender documents and the enclosed draft contract rules must be laid down on applications for funding and the risk of refusal.

5. Calculation of management costs

Article 43(4) of Regulation (EC) No 1828/2006 governs what costs can be covered from the contribution of the Operational Programme, and at what amount. It lays down the different amounts of the maximum possible reimbursement for the management of the fund. The maximum amounts are ***on a yearly average:***

- 2% of the capital contributed from the Operational Programme to holding funds[62]
- 3% of the capital contributed from the Operational Programme or the holding fund to other financial engineering instruments, including JESSICA funds. [63]

[60] COCOF 08/0002/03-EN, p. 17 et seq.
[61] Under Article 56(4) of Regulation (EC) No 1083/2006, it is essentially for the Member States to lay down the eligibility criteria.
[62] Article 43(4)(a).
[63] Article 43(4)(b).

The 3% threshold therefore applies in the relationship between the urban development fund and the OP or an intermediate holding fund. If the actual management costs exceed that limit, the necessary funding must be provided additionally; in the view of the Commission, it is also possible to cover the costs from ordinary and extraordinary income from the fund.

There are two issues in connection with the practical calculation of management costs:

- definition of management costs within the meaning of Article 43(4) of Regulation (EC) No 1828/2006
- claiming of costs outside the scope of Article 43(4) of Regulation (EC) No 1828/2006.

In principle, fund management in its entirety is subject to the 'principle of sound and efficient management'[64]. Under that principle, all the abovementioned points must be taken into consideration.

a. Definition of management costs within the meaning of Article 43(4) of Regulation (EC) No 1828/2006

The fund may in itself also produce costs higher than the abovementioned 3% threshold. However, they may then no longer be financed from the OP contribution. Furthermore, the 3% threshold should not be understood as a flat-rate limit, which may be met without regard to the specific requirement. In past programming periods, the following categories have been recognised by the Commission as appropriate management costs:[65]

- Staff costs, including travel and subsistence expenses, the cost of offices, equipment, IT systems, consumables and supplies, directly linked to the management and investment of contributions from Operational Programmes to financial engineering instruments and holding funds; such costs being incurred in carrying out activities such as selection and tendering procedures, controls, monitoring and reporting, consultancy, information and publicity.
- Overheads of the financial institution acting as a financial engineering instrument or holding fund in the management and investment of the contribution from the Operational Programme(s).

It should be noted that this is not an exhaustive description of the eligible categories of costs, but a fundamental component of the costs in the context of sound fund management. The extent to which other categories of costs may be covered must be examined in each individual case and it must therefore be proven that the absorption or generation of costs is consistent with sound and efficient management principles.

[64] Principle of sound and efficient management (cf. COCOF 08/0002/03, p. 17; COCOF 07/0018/01-EN, p. 5)
[65] COCOF 08/0002/03-EN, p. 17.

b. Claiming of costs outside the scope of Article 43(4) of Regulation (EC) No 1828/2006

With regard to the arguments presented under (1), the question arises whether costs can also be charged by the fund outside the scope of Article 43(4) of Regulation (EC) No 1828/2006, without these being financed from income from the fund.

There is the question, on the one hand, of the levying of fees at project level, such as **loan fees**, and, on the other, of the agreement of specific cost-allocation rules, such as a **spread** in relation to the fixing of lending rates or the passing on of **due diligence costs** to the target project.

The limit is set here by **Article 80 of Regulation (EC) No 1083/2006**, which provides: '*No amount shall be deducted or withheld and no specific charge or other charge with equivalent effect shall be levied that would reduce these amounts for the beneficiaries*'.

(1) Validity of Article 80 of Regulation (EC) No 1083/2006 at project level

According to this wording, the provision applies only to 'beneficiaries', which the fund itself is, with the result that it could be assumed that this restriction no longer holds at project level. This status held by the fund is certainly apparent from the COCOF notes, although it can be assumed in the general context, particularly in the light of the relationship between the notions of 'operation' and 'beneficiary', that the provision is also intended to apply at project level.[66] This holds in particular given that it is possible for the financial engineering instrument to charge management costs. However, it should be pointed out that strict reference to the wording may also preclude the general validity of Article 80 of Regulation (EC) No 1083/2006 at fund level.

(2) Scope of Article 80 of Regulation (EC) No 1083/2006

If it is assumed that Article 80 of Regulation (EC) No 1083/2006 is also valid at project level, the levying of charges by the fund is essentially precluded. This means that the allocation of resources from the fund may be linked neither **indirectly** nor **directly** to **other payment obligations** which ultimately reduce the amount paid out. This is undoubtedly true in the light of Article 43(4) of Regulation (EC) No 1828/2006, since the 'processing' itself is intended to be settled precisely from the management costs.

However, since management costs are governed by the principles of 'sound and efficient management', there is some flexibility, in connection with those principles for the specific project, in formulating the terms for the recycling of the funding. However, a crucial factor is that this is not a simple setting-off linked solely to the extension of funding.

As regards the cost-allocation arrangements for services by third parties, such as due diligence costs at project level, it is possible to adopt various lines of argument which are dependent in particular on the specific structure.

[66] COCOF 07/0018/01-EN, p. 1.

Such an arrangement certainly does not constitute a charge or fee in the traditional sense, as it is linked to a service by third parties and is not fixed unilaterally from a legal point of view. The extent to which this comes within the scope of Article 80 of Regulation (EC) No 1083/2006 was originally argued from two perspectives.

One approach in the discussion focused on the fact that due diligence costs generally had to be borne by the target/applicant regardless of a positive decision on participation. Thus it can be argued that the resources for due diligence must in any case be paid from corporate liquidity. Furthermore, having regard to general private-sector practice, it is a common course of action in finding investors, with the result that it is also possible to talk about 'non-influencable costs'. In addition, this is an exchange of services, since the target company ultimately benefits from the result of the due diligence assessment and receives a definable service in the form of the assessment.[67]

The **counter-argument** is that a de facto obligation is created with regard to the target project because if such a due diligence assessment is not conducted at its own expense it will not be selected for investment. Ultimately, from an economic point of view, the beneficiary target company does not receive the support funding undiminished, since it receives it only reduced by the cost of the due diligence assessment. The assumption that the costs for establishing the basis for the decision on participation must be borne by the target enterprise itself is therefore difficult to reconcile with the basic idea behind the provision of support, especially since the agreement on the assumption of due diligence costs should be made between the fund and the target company prior to the decision on participation. In this situation, there would be support for the fund in the form of participation only if the target company declared that it was prepared to assume the costs. It cannot therefore be ruled out that the decision by the target company to agree to assume the costs would not be taken freely, but under some economic coercion.

Conclusion: The arguments justifying a broad scope of Article 80 of Regulation (EC) No 1828/2006 appear to be more comprehensive. Furthermore, the Commission appears to have put forward the latter (unfavourable) view towards Brandenburg. The official correspondence is not yet available, however. If it is assumed that this question is still considered to be open, two points should be taken into account when deciding on the line to take:

- First of all, it is justifiable, at least on the basis of the wording, to dispute the general application of Article 80 of Regulation (EC) No 1828/2006 here and to argue on two levels (see above).

[67] A query with relevant, much more comprehensive arguments was submitted by Brandenburg to the Commission in September 2009, but a reply has not yet been received. The arguments also covered certain specific features of project selection in the case of venture capital funds under Article 45 Regulation (EC) No 1828/2006.

- Secondly, the costs which are generally incurred in the selection of projects are included in the description of the recognised management costs in the COCOF note, which suggests that they should be classified as management costs. If they exceed the ceiling, they must be financed from returns from the fund. If it is borne in mind that the contractual arrangement with the target project can and should be based on principles of 'sound financial and efficient management', there should be nothing to prevent, with regard to those costs, an arrangement being made in relation to recycled funding and income in the project. The question therefore arises whether it is absolutely necessary for the costs to be assumed at project level.

7. Publicity and documentation obligations for the fund

A comprehensive description of documentation and reporting obligations can be found in Regulation (EC) No 1828/2006, which sets out rules for the implementation of the Structural Funds regulations. The JESSICA fund, as a beneficiary, is subject to the reporting obligations laid down and must allow a review by the managing authorities and other audit bodies (e.g. audit authority, European Commission, European Court of Auditors).

Because the fund and not the enterprise is the beneficiary, documentation must be provided and the requirements complied with at that level. For the supported enterprise itself, there are no obligations in relation to proof of use aside from those which are normal banking practice.[68] From the perspective of the fund, however, it must be ensured that the information required from the project companies is provided. This fact does not therefore lead to the project level being decoupled entirely from the requirements of the Structural Funds regulations. It is clear that the principles for ERDF-supported operations must be observed at fund and project level because the fund must ensure, by means of the financing agreements with the project promoters, that the legal requirements laid down by the Structural Funds regulations are not circumvented.

In this respect there are therefore no strict requirements for 'settlement formalities' at project level. In general, individual supporting documents must be examined only if this is not provided for by the fund itself. In any case, however, the flow of resources from the fund at project level must be documented, since this is the specific purpose of the fund.[69] The fund must therefore prove to the Commission that payment of the funding was made duly in accordance with the Structural Funds regulations and there were no 'irregularities' in the use of the funding. The fund therefore has a margin of discretion in implementing its documentation obligations, although conscientious documentation of the award and use of funding is sensible and necessary for other reasons (law on State aid, internal liability, exit documentation).

[68] *Jakubowski*, Informationen zur Raumentwicklung 2007, p. 582. Detailed evidence of expenditure must be retained by the enterprise receiving support, however, if the urban development fund investment in the enterprise is conditional on certain expenditure. cf. COCOF 07/0018/01-EN, p. 8.
[69] COCOF 07/0018/01-EN, p. 8

8. Compensation for losses

A further important characteristic of JESSICA financing is the possibility of compensation for losses. The losses which occur in the fund can be offset first by Structural Fund resources and national co-financing resources, before capital from private investors is used.

This possibility is not directly regulated. Article 43(7) of Regulation (EC) No 1828/2006 mentions only the preferential allocation of returns to private investors. However, this 'reverse possibility' follows from the organisational freedom enjoyed by the fund. At contractual level, such a course of action can be agreed with investors.[70] It does not have to be laid down explicitly provided the general limits of European law – in particular law on State aid – are complied with.

This 'first loss risk' serves a buffer function which is generated as a result of the public resources in the fund and thus makes it possible to mobilise private capital. Various options can be selected which ultimately give private partners the assurance that losses occurring as part of the fund's activities will be cushioned first, and up to a certain limit, by public funding. This is then done in the fund itself. As a result, the potential returns of private partners are increased, thereby raising the incentive to participate. However, such cover of the first loss risk requires a public-private solution at fund level.

Project financing, which does not cover costs particularly in the first investment phase, is thereby made more attractive to private investors and enables them to be involved on the basis of economic considerations. The extent to which such use of private capital is already intended, politically and structurally, at fund level is subject to a decision by the relevant Member State or Land.

With regard to first loss, the law on State aid must always be observed. Questions in relation to the law on State aid arise in connection with the involvement of private investors in the urban development fund in particular where they are permitted, through specific measures, to participate in the fund on more favourable terms than would have been the case without those measures. Furthermore, State aid would be relevant, for example, where private investors can participate in the fund on better terms than public investors.[71] In the abovementioned case of the contractual arrangements to cushion the first loss risk, this is relevant in so far as a private investor is able to participate in the fund almost without risk, whilst public fund participants bear the risk of loss.[72]

9. Fund exit

A situation is conceivable where, even though all expenditure and investments were made to the best of knowledge and with due care, a JESSICA urban development fund has suffered a

[70] See also *Jakubowski*, Informationen zur Raumentwicklung 2007, p. 579 et seq.
[71] cf. Vademecum on State aid rules (footnote 93), p. 53.
[72] With regard to State aid, see below under F.VI.3

considerable loss after a certain period (e.g. five years) has passed. In that case, the fund would probably be dissolved. The question would then arise whether the Commission may claim back the ERDF funding if it was used in accordance with the requirements of the Structural Funds regulations. With reference to Article 57 of Regulation (EC) No 1083/2006 it can be inferred that, from the criteria laid down therein, durability or a certain survival time for the investment is not relevant. The crucial factor is that funding which might remain in the case of failure is reinvested in appropriate projects. This is true both in the case of losses and in the case of profits, since it is in the nature of the fund to assume a certain start-up risk.

A follow-up question which then arises is what is to be done with funding not yet paid from the fund in terms of the statement of expenditure. Because it has already been declared as expenditure made, but has not yet been used, the n+2 rule would be applicable. Regard must be had to the spirit and purpose of the fund, which is to support precisely this kind of project, which runs the risk of failure. Consequently, assumption of risk should not be penalised. Against this background, it must be assumed that where a fund fails, it does not contain any more resources, as the resources not paid out can be used in principle to prevent failure. If there are nevertheless resources which have not been paid out where the fund is dissolved, they would have to be repaid. If, however, the fund only fails in the subsequent period, the resources are duly expended anyway and thus exempt from the n+2 restriction.

VI. Capital market and company law

In addition to European law and the public-law framework, numerous questions also arise in the implementation of a fund which, aside from general civil law, **fall within the scope of capital market, company and tax law**. In this regard, it must be borne in mind that these questions arise primarily in specific cases in response to economic implementing decisions. These subjects are therefore of particular relevance where institutional investors are involved. They include:

- Compliance with binding **investment principles** on the basis of the regulatory environment for certain investors (insurance, pension funds, provident funds)
- Implementation of individual profit-sharing clauses and preferential rights for individual investors (the market economy investor principle within the meaning of Article 43(7) of Regulation (EC) 1828/2006)
- Definition of liability rules both for external fund actions and internal responsibility, agreement of exemptions from liability, if necessary
- Structuring of ‘loss protection clauses’ if there are to be investments in non-profit projects
- Creation of exit clauses for investors if they wish to leave before the end of the programming period

- Consideration of the **requirements of tax law**, in particular income tax, VAT and property acquisition tax
- Consideration of joint investments in the target project by private investors
- Determination of exit structures before the different possible expiry and exit scenarios (end of the relevant programming period, expiry of the supported projects etc.)
- In the case of participation by private investors through an appropriate fund structure, it must be ensured that political interests and objectives can be achieved without hindrance. If appropriate, joint investments with the private sector are possible at the level of the project company/projects.
- Clarification of the **tradability of shares in the fund**.

It must be borne in mind that an answer can be given to the individual questions and corresponding options only with reference to the specific case on the basis of the circumstances in the respective Länder and having regard to the selected approach. In the light of the fact that at present the approach adopted by the individual Länder tends to be first to supply the fund solely from public funding and to set up the fund at a regional bank or regional development bank, not many questions arise. Nevertheless, **it is recommended that before the fund commences operation a comprehensive examination is conducted** in relation to the implementation of the detailed rules so as not to lose any optimisation potential and not to give up legal flexibility unnecessarily. This applies in particular where it is planned to extend the group of investors at fund level in future.

F. Project level

It is a mandatory requirement for the successful establishment of a fund that there are a sufficient numbers of applications in the priority areas of urban development which are open to credit financing or quasi-credit financing and whose project cycle permits such financing.

I. Eligible projects

On the basis of the Structural Funds regulations, the possible applications for fund financing, subject to the individual requirements under, inter alia, Articles 4 and 5 of Regulation (EC) No 1080/2006, are as follows:

- brownfield rehabilitation and redevelopment with subsequent sale
- nurseries, schools, initial and further training institutions, universities, scholarships (encouragement of specific subjects) on a credit basis
- business parks, technology centres and environmentally-friendly public transport projects
- measures to improve energy efficiency and renewable energy development.

This is only an overview of the basic possibilities as an illustration and not an exhaustive assessment of eligibility which can be applied to a specific case. It should also be noted that the individual support projects which are mentioned in the subparagraphs under **Articles 4 and 5 of Regulation (EC) 1080/2006** do not contain any further restriction of the different umbrella headings such as 'Tourism' and 'Culture'. The wording of the regulation states, in each case, 'including' and is not therefore exhaustive.

It must also be noted that certain projects are listed as **not eligible** in the individual regulations (e.g. housing, except for investments in energy efficiency and renewable energy in certain Member States). In order to ensure that accounts for the eligible parts are audited in accordance with the Structural Funds regulations, in such cases separate accounts must be kept in the fund for those parts.[73]

A clear classification of the parts which are supported by revolving financial engineering instruments and by grant-funding must be ensured. The individual financial cash flows must be kept separate in order to allow an appropriate calculation to be made.[74]

In the case of a **combination of grant-funding and support** from a financial engineering instrument, it should also be borne in mind that the application of Article 55 of Regulation

[73] Details can be found in COCOF 08/0002/03, point B. 3)
[74] This is clear from Article 60(d) of Regulation (EC) No 1083/2006; for details see COCOF 07/0018/01-EN, p. 2.

(EC) No 1083/2006,[75] which contains restrictions on the grant-funding of revenue-creating projects, was precluded only for the financial engineering instruments. This means that in the case of simultaneous grant-funding a different calculation of the eligible costs may possibly have to be carried out.

With regard to major projects, the COCOF notes state that the contribution of resources into the fund cannot be considered to be a **major project** within the meaning of Article 39 of Regulation (EC) No 1083/2006.[76] However, with regard to the financing of projects from the fund, that provision remains applicable because the fund is still required to comply with the requirements of the Structural Fund regulations. This also applies in the light of the fact the fund is to be regarded as the beneficiary, since the non-applicability of Article 39 of Regulation (EC) No 1083/2006 stems specifically from the fact that the bundling of ERDF funding in a fund cannot have comparable consequences to a investment in major projects. If the fund does this, however, the restriction is still applicable. The extent to which ERDF funding is contributed to such a major project is irrelevant, since the relevant threshold of EUR 50 million (or EUR 25 million for environmental projects) applies to the total project costs.

The bunching of eligible projects into project companies, which are then supported by the fund, is possible provided their support can be attributed to a task under the OP. It would therefore have to be ensured that the project companies, in accordance with specific descriptions of tasks, are to perform several similar operations (e.g. land improvement and development in the context of a specific urban development concept). The crucial condition here is also that the project companies are required to serve their purpose sufficiently clearly and that a “holding” fund structure is not ultimately created by a further ‘capital reservoir’ below the JESSICA fund.

II. Evaluation of need for investment and selection of specific projects

With a view to a proper assessment of the eligibility of a project, it is necessary to consider the basis for the need for investment. The individual projects are then to be evaluated against this background. The main criteria include:

- need for adaptation investments (conditioned by alterations in economic structure or demographic change)
- age and structural condition of municipal capital stock (property portfolios, public infrastructure, public spaces)
- corporate and political aims and strategies of modernisation schemes

[75] With regard to the restriction of the applicability of Article 55 of Regulation (EC) No 1083/2006, see COCOF 08/0002/03-EN, p. 7 et seq.
[76] COCOF 07/0018/01-EN, p. 5.

- appraisal of investment gaps
- efficiency of existing market structures
- political and corporate priorities
- comparative market analysis
- potential for growth in market efficiency in an international comparison of market segments
- determination of possible existing procedural and production deficits
- transferability of marketable instruments and procedures from different areas on the demand side to the urban development segment.

III. Framework of EU Structural Funds regulations

A **combination of ERDF-co-financed urban development projects with non-eligible part-investments is possible**, provided they are kept structurally separate. The contribution of ERDF funding in a broader framework is thus possible. There must be a precise analysis of the relevant planning concept in order to ascertain the extent to which it conforms to JESSICA.

The general principles governing participation by the EU funds, such as the principle of additionality or individual questions of, essentially apply both at fund and at project level.[77] The contrary view cannot be reconciled with the intention behind the JESSICA initiative. JESSICA is aimed at the long-term and sustainable use of European funding, and not the circumvention of eligibility criteria. JESSICA neither creates additional funding, nor may JESSICA funds be invested in projects which would not be eligible under the rules on support. It is correct that the beneficiary within the meaning of Article 2(4) of Regulation (EC) No 1083/2006 is the financial engineering instrument, i.e. the fund itself. However, the eligibility conditions do not end with the receipt of the funding by the beneficiary, but are geared to appropriate use in the operation. This means both the contribution to the financial engineering instrument (fund) and the subsequent investment in, or provision of loans or guarantees to, enterprises, or urban development projects.[78] If, then, it is required that the specific investment satisfies the eligibility criteria laid down in the ERDF regulation, this must inevitably also apply to the funding disbursed as part of the investment. The funding from the urban development fund invested in the project is therefore subject, in a way, to the eligibility conditions. A narrow approach which considers only the fund to be subject to the

[77] COCOF 08/0002/03-EN, p. 16.
[78] COCOF 07/0018/01-EN. p. 2.

eligibility conditions does not go far enough. Even if the provisions of the ERDF regulation relate only to the operation, they also apply indirectly, through the mediation of the fund, to the ultimate end beneficiaries. For example, a loan provided by the urban development fund may not be used by the project promoter for investments in urban housing if this is contrary to the restrictions under Article 7(2) of Regulation (EC) No 1080/2006.

The only difference with the influence at fund level is that the project promoter himself is not directly bound by European law, but the fund is responsible for ensuring that these principles are complied with. Thus, in the context of project promotion it must be ensured that the principle of additionality is observed in the case of municipal projects. In connection with the eligibility of expenditure, the question arises whether, for example, in the case of **purchase of land the maximum amount of 10%** under Article 7(1)(b) of Regulation (EC) No 1080/2006 is to be applied to the volume of the fund or the total project expenditure. If the basic position is taken, in keeping with the first COCOF note, that the fund is the beneficiary, it can be argued that only the fund is bound by that provision as well. Consequently, it would have to be ensured only at that level that no more than 10% of the total volume of the fund is invested in land purchase transactions.

The resources actually used are relevant, however. If there are other resources in the fund (aside from those from the ERDF and the relevant national co-financing share) which permit the relevant expenditure, a correspondingly higher investment is possible with reference to the total volume of the fund. It must nevertheless be borne in mind that where the municipalities and the Länder participate in the fund itself, it is possible to contribute land to the fund as contributions in kind. This will not be covered, since no resources from the fund are being used for that purpose. However, the criteria on the basis of which such contributions in kind are assessed are relevant.

In order to ensure the eligible use of investments from the urban development fund in the supported project, agreements are required to that effect between the urban development fund and the project.

In so far as the first COCOF note[79] states that evidence of expenditure is only required to justify financial assistance from the Structural Funds exceptionally where the investment is conditional on certain expenditure, this presupposes a situation where essentially no requirements in this regard are imposed on the supported enterprise. This holds for support for SMEs.[80] As far as investments from urban development funds in urban development projects are concerned, however, such requirements are necessary in order to guarantee that funding is also used at project level in accordance with the eligibility conditions. This certainly does not require the fund to stipulate the permitted uses of the funding by a project. Rather, it is

[79] COCOF 07/0018/01-EN, p. 7.
[80] cf. COCOF 07/0018/01-EN, p. 7.

sufficient to identify non-eligible use by contractual agreement and to exclude it from possible investment use.

IV. Precedence of the Operational Programmes

It should be noted that the requirements stemming from the Operational Programmes under Article 4 and 5 of Regulation (EC) No 1080/2006 are relevant to the question of eligibility. It is important, first of all, whether the relevant Land an area is eligible under Article 4 of Regulation (EC) No 1080/2006 **(convergence)** or Article 5 of Regulation (EC) No 1080/2006 **(regional development and employment)**. There are considerable differences between the available areas of investment at this level.

It is also relevant that in the context of the Operational Programme these possibilities have generally already been further clarified and, as such, it takes precedence. If the possibilities under the Operational Programme are more limited than was intended, an adaptation of the Operational Programme must be discussed and agreed with the Commission pursuant to Article 33 of Regulation (EC) No 1083/2006. This also applies in the light of Article 8 of the regulation, which permits measures in addition to those listed in Articles 4 and 5 of Regulation (EC) No 1080/2006 in the context of 'sustainable urban development'. Under Article 8 of Regulation (EC) No 1080/2006, sustainable urban development measures may be supported by the ERDF. This possibility is expressly opened up 'in addition to the activities listed in Articles 4 and 5'. This subject was discussed with the Commission in connection with the drafting of this briefing. DG Regio took the position that the eligibility criteria are in principle defined in Articles 4 and 5 of Regulation (EC) No 1080/2006 and in the relevant Operational Programme and that the managing authorities must decide whether projects are eligible on that basis. In the **view** expressed by the Commission, Article 8 of Regulation (EC) No 1080/2006 merely provides that integrated concepts are necessary as an additional requirement for support of urban development projects.[81] As a result, subsequent modifications to an Operational Programme which are not purely technical are also possible on the basis of Article 8 of Regulation (EC) No 1080/2006 only subject to the conditions laid

[81] An unofficial statement by the Commission reads as follows*: 'The basic rule for all operations co-financed by the ERDF is that in Convergence regions Article 4 of Regulation 1080/2006 applies and in Regional Competitiveness and Employment Regions Article 5. Article 8 formulates additional principles which apply in the case of sustainable urban development. In particular, it highlights the need for integrated urban development concepts. In appraising eligibility the Länder must therefore consider the following:*

- *The principles of Articles 4 and 5 always apply in their respective geographical eligibility areas.*
- *In addition, the text of the approved Operational Programme applies and it can specify and also limit the scope of Articles 4 and 5. For example, in the course of the negotiations it may have been agreed that certain items are excluded from eligibility under the OP.*
- *Projects are eligible under Article 8 if they are part of an integrated urban development concept.*

This leads us to the understanding that as long as the obligations of this Article 8 are met it is legally possible to support social and educational infrastructure in regions with the goal "regional competitiveness and employment" falling under Article 5. In other words, as long as the support of this kind of infrastructure measures is necessary and is a part of an integrated urban development concept it can be considered eligible (again, under the Article 8 conditions). It is an obvious pre-condition that all the conditions laid down in the OP are respected.'

down in Article 33 of Regulation (EC) No 1083/2006. This in turn requires a reason for the modification and gives an exhaustive list of possible reasons.

Furthermore, Article 8 of Regulation (EC) No 1080/2006 lays down the condition that support for urban development strategies is intended '*to tackle the high concentration of economic, environmental and social problems affecting urban areas*'. It is uncertain whether, against this background, only measures implemented in districts or urban areas with higher than average economic, environmental and social problem are intended to be eligible or whether in principle measures can be supported in all districts or urban areas. An example would be the financing of investments in economic/academic infrastructure which can take advantage of special economic opportunities and open up positive development prospects for the city as a whole. According to the wording, the development of strategies to tackle the high concentration of economic, environmental and social problems can be supported. Strictly speaking, this is the aim of the urban development strategies and not of the support itself. The strategy must therefore be geared to that aim, which can essentially be determined with reference to the specific assistance situation, that is to say the eligible project and its effect. It is clear that this can cover projects in '**problem neighbourhoods**'. However, it should be noted that this characteristic will be determined using **different criteria across Europe**. Furthermore, attention must be paid to the respective characteristics of the individual Länder in which there may be very different assessments of this issue on account of geographical and demographic structure. The city states (Stadtstaaten) in particular play a special role here. Moreover, in negotiating an OP, arguments can be put forward to the Commission that an urban development strategy which provides for measures outside the 'problem areas' is likely to alleviate the economic, environmental and social problems in the 'problem areas' themselves, thereby fulfilling the purpose of the strategy.

V. PPPs and PPF

A particular feature of the establishment of urban development funds is that their aim is to implement projects which are in themselves not marketable specifically because they cannot produce normal market returns. This was previously addressed by **PPP (Public Private Partnership) and PPF (Public Private Finance) projects**, where public and private funds were combined to get over that obstacle.

Specifically with regard to PPP projects or PPF financing, it must be stated that, partly because of the federal structure in Germany, modern financial engineering instruments (mezzanine financing, diversified PPP models or revolving funds) have thus far been used only in a very limited and cautious way, without being frustrated by the legal framework.

Essentially, PPF is a further development of the project-oriented idea of PPP in the pure sense, since PPF sometimes covers a framework which is not solely project-based. **PPF** is distinguished by the following criteria:

- definition of general areas of investment, and not specific projects
- pooling/accumulation of public and private capital
- financial and investment management
- use of commercial financial engineering instruments
- linkage of financing PPPs and project PPPs in fund models

Analysing the abovementioned criteria for JESSICA funds, it can be seen that the **areas of application overlap**. The largest common denominator and therefore also the key criterion in the context of the JESSICA initiative is identifying **investment targets**, which can be described as 'projects that cannot be represented as solely private-sector'. This is the main difference with commercial funds.

VI. Core content of financing agreements

In the case of purely public promotion, the urban development fund may also use as an instrument the public-law forms of the (beneficial) administrative act and the administrative agreement. Whilst the administrative act does not fulfil the character of a financial investment instrument[82] for the urban development fund, the relationship between the urban development fund and the project may be the subject of to a public-law agreement under § 54 et seq. of the German Verwaltungsverfahrensgesetz (Law on administrative procedure). However, it must be examined to what extent the possibilities under § 54 et seq. of the Verwaltungsverfahrensgesetz are sufficient to lay down the necessary rules governing the contractual relationship. Alternatively, the structure of the financing agreement must therefore always be examined as a private-law agreement. The financing agreement governs the relationship between the urban development fund (promoter) and the company implementing the project (recipient of support). The content of the financing agreement depends on the means of financing. The ability of the public authorities to influence the supported projects varies depending on whether the urban development fund operates through the contribution of equity capital, through the provision of loans or through guarantees. The risks of project promotion and the potential profits vary according to the financial engineering instrument used. The attractiveness for private investment (at fund and at project level) is also determined by the nature and the size of the public investment. The implementation of exit rules, which must also be defined in relation to projects, is also of particular importance[83].

[82] Article 46(2) of Regulation (EC) No 1828/2006.
[83] cf. Article 43(3)(c) of Regulation (EC) 1828/2006.

1. Implementation of European requirements

From a formal point of view, the fund is the supported operation and it must therefore also satisfy the requirements. As has been explained, however, some of the conditions apply at project level.[84]

It is important, first and foremost, that the eligibility conditions for the use of ERDF funding must also be complied with at project level. This is illustrated by investments in urban housing[85], which may not be financed from ERDF funding in the 'old' Member States. A combination of eligible and non-eligible investments is nevertheless possible. The PPP or urban development project supported from the urban development fund can therefore also cover non-eligible parts of projects. However, it must be guaranteed that ERDF funding paid through the Operational Programme is also used at project level only for eligible purposes. For this reason, the urban development fund must keep separate accounts, which allows it to keep tabs on financial flows up to project level. This corresponds with the project promoter's obligation also to distinguish between eligible and non-eligible expenditure. To create this obligation, in the absence of explicit rules, a contractual arrangement must be included in the financing agreement. That arrangement must define the eligible use of funding and require the project promoter to document its use properly. Only in this way can it be guaranteed that the urban development fund is in a position to comply with the reporting obligation and to enable the audit under Article 60(c), (d), and (f) and Article 90 of Regulation (EC) No 1083/2006 and Article 15 of Regulation (EC) No 1828/2006.

The basic idea behind the new financial engineering instruments under Article 44 of Regulation (EC) No 1083/2006 is the revolving use of Structural Funds resources. The urban development fund must therefore in any case seek to **maintain the capital invested in it**, and must ensure that funding is recycled from the project to the urban development fund. The financing agreement must therefore contain explicit rules on the recycling of resources. Their specific formulation will be different depending on which financial engineering instrument is used. In the case of lending from the urban development fund, the reflux of funding is ensured by means of relevant debt service conditions (interest and repayment of capital). Where a credit guarantee is issued, the urban development fund levies a guarantee charge, which thus secures the reflux of funding. If the urban development fund invests by means of an **equity participation**, resources are recycled either by means of a regular **dividend** over the life of the project or by **selling** the shareholdings (at greater value) at certain times (for example, after the completion of development of initially undeveloped land). In order to guarantee the revolving character of the urban development fund, the financing agreement must therefore contain an arrangement on the ongoing or subsequent recycling of funding at the beginning of the investment.

[84] See above under G.I. and G.III.
[85] With the exception of energy improvements.

Investments by the urban development fund in the PPP or the urban development project may be made only if they are included in an integrated plan for sustainable urban development. Urban development fund investments would therefore appear to be **unlawful** where the supported project departs from the requirements of the integrated plan for sustainable urban development. For that reason, the financing agreement must contain an assurance from the urban development fund to the effect that the support is provided subject to compliance with the requirements of the integrated plan for sustainable urban development.

Of course, the same considerations apply to observance of the aim of the project, which is the basis for the decision on eligibility by the urban development fund. Any changes to the aim of the project or apparent failure to meet that aim must be notified to the urban development fund without delay. The financing agreement must guarantee this flow of information between the project promoter and the urban development fund by means of relevant clauses.

In addition, other general provisions must also be included in the financing agreement, such as the specific definition of the project, its duration, arrangements for revocation or termination, rules on liability etc.

2. Procurement law

If the project promoter is a local authority, in particular a municipality, the tender procedure for the project to be supported is subject to the general rules. In the case of PPP projects, the awarding of contract is generally done by a negotiated procedure after a prior competition or, alternatively, in the case of technically complex operations in particular, also by a competitive dialogue.

Private-sector involvement takes place at the level of the contractual performance of duties (urban development) for which the public authorities are responsible. The '*public-private*' element is therefore reflected in the contractual arrangements, and in particular in the allocation of risks between the private and public partners in PPP operations. In the case of the formation of a mixed company with public and private participation, it should be borne in mind that, with the exception of a few projects relating to the armed forces, it has not been possible thus far to implement sustainable projects in the PPP landscape. Many contracting authorities specify, in the award of PPP projects, that the contracting authority will not under any circumstances take on a participation in a project company formed with a view to the performance of contractual duties.

Participation by a private investor in a JESSICA fund does not preclude its participation in an individual project as a capital backer for a tenderer or a tendering consortium. On the other hand, if the investor participating in the fund itself stands as a tenderer or a member of a tendering consortium, e.g. by participating as an institutional provider of equity, it must be ensured that the dual participation does not result in competitive advantages compared with tenderers which have no links to the fund. This would not appear to raise problems in general

because participation in the fund is structured differently from involvement in a specific individual project and because the fund is not itself the awarding authority. For this reason, the provisions on project managers laid down in § 4(5) of the Verordnung über die Vergabe öffentlicher Aufträge (Regulation on the Awarding of Public Contracts) are not applicable to this scenario. If a private investor involved in a JESSICA fund subsequently participates in the tender procedure for a project to be supported, he does not '*advise or otherwise assist the awarding authority before the initiation of the tender procedure*'.

Where management of the fund is to be performed by a **regional development institute**, there are therefore no reservations against **participation by the development institute** in the funding at project level (e.g. by making grants from other support programmes or complementary bank loans). At project level, the financing requirement in the specific case must be covered, alongside financing from fund resources, by **other sources of financing**, particularly where it is not possible to finance the entire project completely from the fund. Provided such **additional support measures do not create a distortion of competition at project level**, there is some flexibility. Under this premise, a development institute may also provide grant-funding from other programmes, e.g. for expenditure which cannot be refinanced by ERDF funding. It is also conceivable for complementary financing to be provided for the project from non-subsidised bank loans. In this respect it is important to carry out a study of the law on State aid and competition law.

The decision on which projects are included in a support programme is not affected by procurement law. The inclusion of projects in a support programme is not connected with a public contract, but makes it easier for the project promoter, generally a local authority, to invite tenders for an operation which might possibly not be implemented without support through the fund. Procurement law therefore comes into play only in the relationship between the project promoter and the enterprises tendering for the specific operation. Bidding/inclusion in a support programme forms part of the preparation for the award within the meaning of § 16(1) of VOB/A 2006.

The private contractor for a project which is supported by the fund would be regarded as a contracting authority under § 98(5) of the Gesetz gegen Wettbewerbsbeschränkungen if more than 50% of the operation in the field of civil engineering or certain structural engineering is financed by a contracting authority. This is not financing in the sense of remuneration for a public contract, but a subsidy, i.e. a non-reimbursable grant. At least where the operations supported by the fund are intended to fit in with the current PPP landscape, the support does not serve to facilitate uneconomic projects, but to overcome difficulties in the representation of essentially economic projects. It should not therefore be assumed that the 50% limit is exceeded. It should also be pointed out that simply because support is provided through loans from public authorities, this does not necessary mean there is subsidisation; the important factor is whether the loans are granted on normal market conditions. The question whether the fund is actually to be regarded as a contracting authority, with the result that the award of a

grant can in principle '*infect*' the private recipient under § 98(5) of the "Gesetz gegen Wettbewerbsbeschränkungen", depends on the organisational structure. If there is no legal autonomy and if the fund is established at a regional bank, the fund's status as an awarding authority also stands and falls with its classification as a contracting authority. In the case of legal autonomy and participation by private partners, it is conceivable that there is not sufficient proximity to the State, which is necessary for classification as a public institution under § 98(2) of the "Gesetz gegen Wettbewerbsbeschränkungen"; this is a question of the practical implementation of the fund.

3. State aid law

The requirements of the law on State aid under Article 107 et seq. TFEU[86] must in principle be observed in all State financing measures vis-à-vis enterprises. European law on State aid forms part of the European rules on competition and, as such, seeks to prevent infringements of competition by the Member States.[87]

In principle, Community aid – which includes ERDF funding – does not fall within the scope of Article 107 et seq. TFEU[88]. Even though the contributions to and the investments from the fund are, to some extent, ERDF funding, the support does not fall outside the scope of European law on State aid. Irrespective of the legal form of the fund and the origin of the contributions, under Article 9(5) of Regulation (EC) No 1083/2006 the provisions of the EU Treaty must be complied with for operations financed by the Structural Funds.[89] The notion of 'operation' refers to both the contribution to the urban development fund and the subsequent investment in, or provision of loans or guarantees to, enterprises, or urban development projects,[90] with a result that the law on State aid is applicable on both levels. The law on State aid is relevant in particular where private investors are to be involved in JESSICA-supported PPP/PPF projects, since the use of public funding could be regarded as State aid to the private partner or third parties.

It should also be borne in mind that the payments from the Structural Funds are to the Member States[91] and are therefore to be regarded as part of State funding in subsequent use of the resources.[92] The existence of State funding within the meaning of Article 107 TFEU could not therefore be denied from this perspective either.

[86] Formerly Article 87 et seq. EC.
[87] *Heidenhain*, Handbuch des Europäischen Beihilfenrechts, Munich 2003, Chapter 1, § 1, section 1.
[88] *V. Wallenberg*, in: Grabitz/Hilf, Das Recht der Europäischen Union, (July 2009), before Article 87-89, section 14.
[89] cf. *Heidenhain*, (footnote 87), Chapter 2, § 3, section 13, on the predecessor provision in Article 12 of Regulation (EC) No 1260/1999.
[90] cf. COCOF 07/0018/01-EN, p. 1.
[91] Second subparagraph of Article 76(2) of Regulation (EC) No 1083/2006.
[92] Holzwart (footnote 9), p. 127 et seq., 242 et seq.

The Operational Programmes also contain standard form clauses under which the authorities managing the programmes must ensure that any public support under the Operational Programme complies with the applicable State aid rules.[93]

It is not possible to give a general answer to the question whether measures under the fund actually constitute State aid. Because the law on State aid is essentially geared to unilateral grant-funding, in situations where several participants are involved in a complex financing structure there must be a close study of the conditions of payment with reference to the individual case.[94] The notion of State aid is not static and does not therefore have a fixed definition.[95] Classification of a measure as State aid requires at least the grant of State support in the broadest sense ('no matter what kind').[96] The State nature of the measures under the fund must be confirmed in any case if the co-financing from the fund is from public resources. However, even in the case of purely private co-financing, the State nature of the resources from the fund would be confirmed, in the light of the above statements, because the ERDF funding is granted to the Member States and they control the use of ERDF funding through the selection of private co-financiers. It also makes no difference whether the urban development fund is organised on public-law or private-law lines. Even in the case of purely private fund operation, the (partially) public origin of the funding would be crucial. Therefore, the application of Article 107 TFEU does not necessarily require State action as such, but it does require a transfer of State resources.[97]

With regard to question of the beneficiary, because of the competition link in the law on State aid, the legal form and shareholder structure of the beneficiary enterprise are not relevant, but only whether it is participating in competition. In the event of doubt this is assumed to be the case.

The existence of State aid also requires that there is not sufficient consideration for the advantage granted.[98] In assessing whether the consideration is sufficient, because of the minimal experience and the absence of relevant case-law from the European Court of Justice, reference must be made to the general criteria and instruments of the law on State aid, in particular the '**private investor test'**. In the private investor test, it is necessary to consider whether in similar circumstances a private investor of a size comparable to that of the bodies administering the public sector might have acted in the same way.[99] If the State behaves in the same way as a **private investor**, there cannot be State aid in the legal sense.[100] Therefore, in

[93] cf. Vademecum on State aid rules, p. 15; available at: http://ec.europa.eu/competition/state_aid/studies_reports/studies_reports.cfm.
[94] Aside from grants, measures which are relevant for the purposes of the rules on State aid exist where State resources are used for loan guarantees, capital injections, etc.; Vademecum on State aid rules (footnote 93), p. 5.
[95] *V. Wallenberg*, in: Grabitz/Hilf (footnote 88) Article 87, section 8.
[96] *Heidenhain*, (footnote 87), 1. Kapitel, § 3, section 1.
[97] Vademecum on State aid rules (footnote 93), p. 5.
[98] *V. Wallenberg*, in: Grabitz/Hilf, (footnote 88), Article 87, section 15, with further references.
[99] European Court of Justice, Case C-305/89 *Alfa Romeo*.
[100] *Giesberts/Streit*, Europäische Zeitschrift für Wirtschaftsrecht 2009, p. 484 (p. 485).

an examination of the action of an urban development fund the question would also arise whether a comparable private investor would have invested under the same conditions. Given the basic idea behind the JESSICA initiative, that it is specifically projects which, because of their uncertain profitability, are avoided by purely private investors that are to be supported, the result of the private investor test is generally negative here.

Against this background, it is also necessary to clarify whether in a specific case of a project the ERDF funding can be temporarily exempted from the payment of interest (and possibly also repayment of capital). Even though no specific obligation to pay interest is laid down, there are, however, reservations over the exemption of certain projects from repayment of interest and capital under the rules on State aid if this is not comparable with the behaviour of a private investor.

The parallel question arises of the extent to which a public enterprise itself can grant or receive State aid. A single answer cannot be given since it depends on the assessment in the **specific case**. Some criteria have been laid down by the Commission in relation to guarantees in the Notice on Guarantees.[101] The key elements are whether the terms granted are **normal market terms** and the fundamental **restriction of the risk assumption to 80%** of the total volume. Here too there are exceptions for SMEs. If private joint investors are involved, their preferential treatment may constitute State aid.

With regard to the potential areas of activity of the urban development fund,[102] in general the following cases can be distinguished: If, for example, a municipality supported by the urban development fund develops or revitalises (possibly previously purchased) brownfield land and subsequently sells or leases it to enterprises wishing to locate there, this could be seen as State aid if the transfer of the land to the enterprise is not at market prices.[103] In order to rule out any suspicion of State aid from the outset, the land should be put to tender or at least an **independent expert should be commissioned to carry out a valuation**.[104] Even if the sale or lease is not on normal market conditions, this does not necessarily have to be regarded as State aid if, for example, the municipality carries out (partly) free of charge development measures specifically with a view to the relocation there of a certain enterprise, whose establishment there is hoped to attract other enterprises.[105] In that case, the municipality's action is consistent with the behaviour of a private investor.[106]

[101] Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees, OJ 2008 C 155, p. 10.
[102] See the illustrative list in *Jakubowski*, RaumPlanung 2/2009, p. 23.
[103] For details, see the Commission Communication on State aid elements in sales of land and buildings by public authorities, OJ 1997 No C 209, p. 3.
[104] *Soltész*, Europäische Zeitschrift für Wirtschaftsrecht 2001, p. 110.
[105] With regard to this 'anchor company' principle, see *Soltész*, Europäische Zeitschrift für Wirtschaftsrecht 2001, p. 110 with further references.
[106] See above with regard to the private investor test.

If the urban development fund invests in the construction of **infrastructure projects**[107], the project should not, as a rule, encounter any problems in terms of the law on State aid. In principle, the construction of infrastructure projects is a general economic-policy measure which does not come under the State aid regime.[108] That is not the case, however, if the measure is intended to benefit a specific enterprise, either through direct investments in the enterprise's land or through special preferential terms for the subsequent use of the infrastructure. The same applies to educational institutions[109], the support of which is not regarded by the Commission as State aid.[110]

If urban development fund resources are used for urban development measures which are carried out directly on the land of a certain enterprise, that measure is regarded as State aid to that enterprise if the enterprise does not pay a normal market consideration for the investments (betterment) on its land.[111]

If the urban development fund invests in infrastructure and development measures, the question essentially arises whether those measures are intended to benefit a specific enterprise. If that is the case, and the measure does not reflect the action of a private investor, it is reasonable to classify the measure as State aid within the meaning of Article 107 TFEU.

Support which, by its nature, is to be regarded as State aid, but because of its small scale and resulting low relevance for competition purposes, comes under the **de minimis rule**[112] is not covered by Article 107(1) TFEU.

It is also possible to grant funding in accordance with the rules on State aid outside the de minimis limit and the special rules for SMEs. Under the exception laid down in Article 107(2) TFEU, State aid may be compatible with the internal market or under Article 107(3) TFEU considered by the Commission to be compatible with the internal market. The crucial factor is always that the measure does not give rise to any distortion of competition.

If there is absolute certainty in advance that support is compatible with the law on State aid, the measure can be notified. In that **notification procedure** the Commission must be informed in good time, i.e. before the measure is carried out. If the Commission has all the information required to carry out the assessment, it decides within two months whether the support is lawful.[113]

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[107] e.g. motorways, airports, harbours etc.
[108] *Soltész*, Europäische Zeitschrift für Wirtschaftsrecht 2001, p. 108.
[109] e.g. universities and vocational education institutes.
[110] Sixth Survey on state aid in the European Union in the manufacturing and certain other sectors, COM(1998) 417 final, Annex III, paragraph 2.1.
[111] *Soltész*, Europäische Zeitschrift für Wirtschaftsrecht 2001, p. 109 with further references.
[112] Regulation (EC) No 1998/2006; see *Bartosch*, Kommentar zum EU-Beihilfenrecht, Munich 2009, section G.
[113] cf. *Sollgruber*, Grundzüge des europäischen Beihilferechts 2007-2013, Vienna 2007, p. 26.

Furthermore, under the **General block exemption regulation**[114] all State aid which meets the conditions laid down in that regulation is considered to be compatible with the internal market. This applies in particular to regional and educational aid and aid to SMEs.[115]

It is therefore necessary to carry out in advance an assessment from the point of view of the rules on State aid in order to ascertain which projects must be restructured on the basis of State aid constraints. In cases of doubt, consideration should be given to making a direct enquiry to the European Commission.

VII. Project default

If a project is considered to have failed, a decision can be taken, without effects on the ERDF funding, not to make a claim for repayment against the project promoters or to declare that the funding cannot be recovered. The question of when there is sufficient evidence to justify such a decision by the fund management depends on the individual case. The fund management essentially enjoys a certain margin of discretion. It will be relevant whether there are sufficient supporting documents for the decision and sufficient legitimation from the governance structure of the fund management (decision by the management/advisory body). The following may be indicators:

- conclusion of a warning notice procedure
- conclusion of an action/enforcement proceedings
- evidence of insolvency of the debtor.

Nevertheless, in this case questions in relation to State aid are raised at two levels. First of all, it must be ensured that repayments owed by the supported project have been adequately pursued in accordance with basic economic principles. At the same time, it is important in this case to be able to prove that the original decision to support the project promoter was based on economic considerations, and not purely on development considerations.

[114] Regulation (EC) No 800/2008.
[115] cf. *Lübbig/Martín-Ehlers*, Beihilfenrecht der EU, 2nd edition, Munich 2009, section 684 et seq.

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Abbreviations

COCOF	Coordination Committee of the Funds
CPV	Common Procurement Vocabulary
EC	Treaty establishing the European Economic Community
EC	European Communities
ECA	European Court of Auditors
EIB	European Investment Bank
ERDF	European Regional Development Fund
ESF	European Social Fund
EU	European Union
EUR	Euro
DG	Directorate General
DG Regio	Directorate General for Regional Policy
ed.	Editor
IBB	Investitionsbank des Landes Berlin
JASPERS	Joint Assistance to Support Projects in European Regions
JEREMIE	Joint European Resources for Micro to Medium Enterprises
JESSICA	Joint European Support for Sustainable Investment in City Areas
OJ	Official Journal
OP	Operational programme
PPF	Public Private Finance
PPP	Public Private Partnership
SME	Small and medium-sized enterprises
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European. Union

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Questionnaire

1) Is there any experience of integrating private funding in a fund solution?

   There has not yet been any such experience in Germany, as all the Länder are still in the feasibility study phase. Thus far, in the initial setting-up of the funds, there are not yet any specific plans to incorporate private capital at fund level itself. Nevertheless, that option should be kept open for the future. This means that the fund has to be structured in a suitably flexible manner. However, there has been relevant experience in England with the 'Priority Sites' urban development fund, which is a joint venture between the national development agency 'English Partnerships' and the Royal Bank of Scotland (cf. Jakusbowski, RaumPlanung 2009, p. 141, 142).

2) What possibilities of funds are there outside of support for SMEs and urban development?

   Support through the ERDF must be granted within the scope of one of the three objectives ('Convergence', 'Regional competitiveness and employment' and 'European territorial cooperation'). The relevant framework conditions are laid down in Article 4 et seq. of Regulation 1080/2006. The other possibilities of financing under the fund are set out in the Structural Funds regulations and are differentiated according to their purposes. ***(see B.I.)***

3) Is a distinction drawn between different target areas for projects which are eligible under JESSICA?

   Since JESSICA is not a supplementary support programme, but merely enables a novel use of ERDF funding, the range of projects which are eligible for support through ERDF funding is limited by the Structural Funds regulations. Against this background, the provisions laid down in Articles 4 and 5 of Regulation (EC) No 1080/2006 and their implementation in the OP are relevant. The extent to which modifications are possible here must be discussed with the Commission. ***(see B.II and F.I.)***

4) Can further amendments to the Structural Funds regulations be expected as a result of the amendments under Regulation (EC) No 397/2009 to Regulation No 1080/2006?

   On the basis of available knowledge, no amendments can be expected aside from those amendments mentioned by this briefing, that is to say under Regulation (EC) No 846/2009 (adaptation of Regulation No 1828/2006) and a proposal for the adaptation of Regulation No 1083/2006 currently being discussed. However, a further COCOF note has been announced. In addition, the Commission has made a general statement to the effect that

the tendency is to stabilise the legal framework and not to make any further amendments ***(see C.IV. and C.V.)***

5) In the case of guarantees, there is traditionally no outflow of funds except in the case of utilisation. From what point are guarantees regarded as having been disbursed, upon the legally valid conclusion of the agreement or only upon actual utilisation by the guarantee holder?

   The amount which the guarantor has guaranteed financially must be regarded as committed and therefore as disbursed. This is also the basis for Article 78(6)(c) of Regulation (EC) No 1083/2006 with regard to guarantees at the partial or final closure of the OP. In principle, statements made at European level on financial hedging instruments should be seen as non-technical since there are a wide range of different legal instruments in the various jurisdictions. This is also shown, for example, by the Commission's Notice on Guarantees, which presents a very comprehensive understanding of the notion of guarantee. The extent to which disbursement is to be assumed depends on the risk. Evaluation aids are to be provided in a future COCOF note. ***(see C.V.)***

6) Since guarantees are not issued by the fund and are not therefore recycled into the fund either, are the resources secured in the fund as guarantees nevertheless to be regarded as 'revolved' after the expiry of the guarantee?

   Guarantees can be regarded as an outflow of the fund provided they represent utilisation of resources. However, the extent to which they can be regarded as expenditure is relevant. This is based on risk leverage. The crucial factor here is that the guarantee cannot be paid at 100% of the guaranteed amount, but that, after a risk assessment has been conducted, the default risk for that guarantee determines the relevant amount. This is common banking practice. It is for the fund itself to evaluate that leverage. However, a further COCOF note on this subject has been promised. Ultimately, the relevant amount is the amount of reinsurance or a counter-guarantee against the total loss of the guarantee on the financial market. ***(see C.V.)***

7) Is it possible to model and to modify the structure of the fund (i.e. shares of funding from complementary financing) over the life of the fund if it is otherwise guaranteed that for eligible projects the maximum participation of 50% or 75% of ERDF funding is observed ('breathing fund')?

   It is possible to model the structure of the fund in principle. ERDF support is designed as long-term support. For this reason, some stability from consistent fund structures is desirable. In addition, the Operational Programme is important, i.e. it is advisable to

adapt the Operational Programme's financing plan to the planned fund structure. ***(see E.I.)***

8) There are discussions about granting resources from the fund to special purpose vehicles ('project companies'). In such a case, is there no need to submit specific invoices and proof of payments (see p. 7 of the COCOF Note of the Commission services of July 2007)? In that case, the loan or the guarantee would not be linked to a specific purpose, but could be used for all the company's activities. If so, are other more general documents (loan agreements, accounts, environmental certificates, de minimis confirmations etc.) sufficient?

   An actual project is necessary because expenditure must retain a link to a specific project. This must correspond with a relevant code number from the OP. It is not therefore possible to have a pure specific purpose vehicle as an intermediate 'reservoir'. Ultimately, such a company would only have the role of an additional fund below the JESSICA fund. However, this tiered scenario is already covered by the option of a holding fund. Nevertheless, if companies which, in accordance with specific descriptions of tasks, are to perform several similar operations (e.g. land improvement and development in the context of a specific urban development concept) are to be supported as a superordinate entity, that is possible. With regard to the submission of supporting documents, it should be pointed out that controls are exercised principally at the level of the fund. However, this means only that the fund must ensure contractually, in connection with its extension of funding, that it is supplied with sufficient proof at project level that funding has been used in conformity with the ERDF. ***(see E.I and E.V.7)***

9) What legal nature does the fund generally have under Article 44 of Regulation (EC) No 1083/2006?

   No specific legal form is stipulated by Article 44. It is contingent on the way in which the fund is to be technically structured. The specific structure of the JESSICA fund depends on numerous individual factors. ***(see E.I.).***

10) Where contributions in kind are possible, does the question arise of the amount offset or valuation? Are there special rules/recommendations on how a contribution in kind is to be evaluated at fund and project level? Against this background, how are contributions in kind (land) to the fund and the recognition of contributions in kind in the case of the borrower or the guarantee holder to be assessed?

    Contributions in kind by the different fund participants are possible, but a due evaluation of those resources must be made. For precisely that purpose, Article 56 of Regulation (EC) No 1083/2006 was expanded by Regulation (EC) No 284/2009. ***(see E.I and F.III I)***

11) Is it possible, in the case of larger-scale financing, to pay out the ERDF funding first and the complementary funding at the closure of financing, or is it necessary to observe the intended spit of resources for all instalments in the disbursement phase?

It is crucial, first of all, that at the end of the programming period each of the supported projects has received assistance from ERDF funding up to the maximum limit of 50% or 75%. Against this background, it makes no difference how the individual financing tranches are composed. It should be noted, however, that the complementary funding must be paid into the fund fully at the beginning or committed accordingly in order to call the ERDF resources in accordance with the proposed co-financing rates. ***(see E.II.1.)***

12) What options are there for investment of resources from the German grant programme for urban development ("Städtebaufördermittel") in a revolving fund (in combination with ERDF funding and without)?

In the past, such use of urban development funding was barred on the basis of the Administrative Agreement on Urban Development. It is being considered at present whether to open this up for the Administrative Agreement on Urban Development for 2010 which is currently being negotiated. ***(see E.II.1. – footnote 38)***

13) Is funding which a regional development bank (in this case the Sächsische Aufbaubank (SAB)) contributes to the urban development fund public or private funding if the institute is a public-law institution falling outside the regional budget.

It is of crucial importance what funding is to be contributed into the fund. If the funding came from the budget of the development bank and is disbursed as part of the performance of its public duties under the relevant legislation on development banks (here §§ 2 and 3 of the Förderbankgesetz), that funding is also to be regarded as public funding. If, however, no 'public funding' is passed on, but there are primarily other sources of financing, such as from cooperation with private financial institutions or investors, it is possible that the funding is to be regarded as 'private' from the perspective of the Commission. ***(see E.II.1)***

14) When a municipality raises co-financing, and wishes to secure it on a long-term basis, does it have to become a 'member' of the fund? For example, in a planned pilot phase for the urban development fund with the City of Leipzig, it has declared that it is prepared to contribute co-financing. However, it has attached the conditions that funds recycled from its participation be re-used solely for its own projects.

If co-financing is to be provided by the respective municipalities, this can be done either at project level or at fund level. The crucial factor is the structure of the specific projects. However, it is important that participation in recycling into the fund can therefore take place only if the municipality is also involved at fund level. The way in which the municipality proceeds with that recycling is determined, first of all, by the structure of the fund and, secondly, by budgetary law. ***(see E.II.1.)***

15) Is the reutilisation of ERDF funding which is recycled from investments in the fund precluded as national co-financing for an urban development fund?

With regard to a still active urban development fund, this does not appear to be possible, as under Article 46(1) and (2) of Regulation (EC) No 1828/2006 investment in other funds is not permitted. On the other hand, this would appear to be possible after an exit from the fund. ***(see E.II.1.)***

16) Is public participation also possible by means of a counter-guarantee? An example would be participation by the regional development institute, where part of the amount contributed is counter-guaranteed by the Land itself (Free State of Saxony).

As has been explained, this depends first of all on how the funding invested by the development institute is to be classified. If it is to be regarded as public, counter-guarantees are no longer relevant. If, on the other hand, it constitutes private funding, the question arises whether it must be reclassified on account of the State counter-guarantee. ***(see E.II.1.)***

17) When can resources be paid out of the fund? Does the principle of cost-reimbursement have to be applied, or can a payment of fund resources be made to the project promoter even before the investment is made? When is funding from the fund regarded as disbursed and when can the funding from the fund be settled vis-à-vis the Commission as disbursed (According to the COCOF notes and under Article 78(6) of Regulation (EC) 1083/2006, the resources must be contributed to the fund and disbursed from the fund again!)

The total expenditure paid in establishing urban development funds can be shown immediately after the fund is set up in the statement of expenditure, which forms the basis for the grant of Structural Fund resources (Article 78(6) of Regulation (EC) No 1083/2006). The fund thus retains the Structural Fund resources at the beginning of its activity. Only after the conclusion of the Operational Programme do the expenditure and its eligibility have to be proven. It should be noted, however, that the national co-financing share must be provided at the beginning, before the ERDF funding is reimbursed by the Commission in accordance with the proposed co-financing rate. The ERDF funding is disbursed once the resources have been contributed to the fund, with the

result that the n+2 rule no longer therefore applies. Individual funding may, on the other hand, be granted before proof of expenditure. The cost-reimbursement principle applies only between the Member States and the Commission and the fund expenditure to be documented in the final accounts is the loans extended to the beneficiaries of the fund or, in the case of guarantees, the resources committed to the beneficiaries of the fund. ***(see E.II.)***

18) Do all co-financing resources have to be contributed to the fund when the fund is set up or is the full national co-financing to be contributed to the urban development fund at the same time as the ERDF JESSICA funding from the OP (the fund is regarded as the 'beneficiary' within the meaning of the EU regulations and the beneficiary receives EU funding and the national share)? Or do the resources from national co-financing have to be proven and invested only when the instrument is used in a specific urban development project? In the case of the 'profitable interim investment' from ERDF funding, do the resources from national co-financing also have to be invested? What formal conditions must be satisfied in order to call JESSICA ERDF funding from the Commission in connection with the establishment of the fund? What procedures must be followed and what duties of proof does the managing authority have?

Article 78 of Regulation (EC) No 1083/2006 is relevant. It is essential to submit the statement of expenditure under Article 78(6). It is essential that the statement is made for each priority axis. The only element which the Commission requires is a contribution to the fund. The funding can then be drawn accordingly. This means that the Land must first raise the total volume, it submits the statement to the Commission and then immediately receives the ERDF-financing share. It is not possible for the fund to draw the ERDF funding first and only later provide co-financing. If, however, the funding is already committed to the fund through a regional development bank, this can, depending on the structure, be sufficient to accept the existence of national co-financing. A profit from interest along the lines of a profitable interim investment can be used subsequently for management, however. The Member States enjoy freedom in their action, provided there are no explicit restrictions under Article 78 of Regulation (EC) No 1083/2006. ***(see E.II.3.)***

19) By the integrated financing plan, in which only public (municipal) funding is shown, is the Free State of Saxony also bound by the JESSICA fund or can the co-financing also consist of regional funding or funding from the regional development institute (SAB)?

As regards an integrated financing plan in connection with the applicable Operational Programme, there is a binding effect in so far as the funding must be disbursed in accordance with the requirements. If the Operational Programme therefore provides for only public funding at first, there must be an adaptation. However, this would be regarded

as a technical modification and does not come under Article 33 of Regulation (EC) No 1083/2006. ***(see E.III.)***

20) We assume that within an urban development fund resources can be used for various priority axes in an OP. What principles and administrative procedures must be observed, from the point of view of the European Commission?

*Where resources can be used from different OPs (cf. COCOF 07/0018/01, p.2), that must be the case, conversely, for different priority axes. There must be a separate audit trail. The crucial requirement is that there is plan for an urban development fund. Exclusion criteria are laid down in Article 54 of Regulation (EC) No 1083/2006.****(see E.III.)***

21) In the provision of private co-financing or co-financing by the regional development institute (SAB) does the indicative financing plan have to be adapted to the Operational Programme of the Land? Financial planning under the Operational Programme in the Free State of Saxony currently provides for only a classification according to EU funding and national co-financing from municipal resources, and private co-financing resources or other co-financing is not envisaged. The question therefore arises whether as a result of the attraction of private co-financing partners at fund level or, for example, the description of national co-financing by the SAB it also becomes necessary to adapt the Operational Programme.

The extent to which such adaptation of the Operational Programmes is legally required in respect of those points in the indicative financing plan can in principle be assessed only on the basis of the specific formulation in the OP and the planned course of action. The crucial factor is whether Article 33 of Regulation (EC) No 1083/2006 applies or there is only a purely technical modification ***(see E.III.)***

22) Is a minimum recycling quota expected for the fund assets over a specific period, which must be proven at least mathematically in the fund calculation, for example?

In principle, the fund must draw up a business plan which sets out the expected returns from recycled capital. There is not a strict minimum recycling quota. However, a private investor will be prepared to invest in the fund only if it has a certain rate of return. The aim of private-sector participation in the fund can therefore be pursued only on the basis of a certain level of expectation ***(see E.V.I)***

23) What formal requirements must be observed by the fund management?

The relevant implementing provisions for the financial implementation of the Structural Funds regulations are contained in Regulation (EC) No 1828/2006; particular reference should be made to Chapter II, Section 8, Article 4 et seq. ***(see E. V.2.)***

24) Article 43(4) of Regulation (EC) No 1828/2006 lays down the different amounts of the maximum possible reimbursement for the management of the fund: 2% of the capital contributed from the ERDF to guarantee funds and 3% of the capital contributed from the ERDF to other financial engineering instruments with the exception of micro-credit instruments. What figures are valid for assessing the management costs for an urban development fund which, in addition to guarantees, also grants equity and loans?

As we understand it, Article 43(4) does not distinguish between individual financial engineering instruments but concentrates on different levels. The maximum permitted management costs of 2% under Article 43(4)(a) apply to cases where the funding from the OP is first contributed to a holding fund. The threshold of 3% applies to the relationship between the urban development fund and the OP or an intermediate holding fund (Article 43(4)(b)). The 'guarantee funds' mentioned in (a) are aimed at the revolving financial engineering instruments for support for SMEs which may be set up alongside JESSICA under the Structural Funds regulations (e.g. JEREMIE schemes) and does not relate to a situation where the urban development fund, which is expressly mentioned under (b), also provides guarantees. ***(see E.V.5.)***

25) Is there a definition or definitive description of what is meant by management costs under Article 43 of Regulation (EC) 1828/2006? Are there provisions which lay down more precise rules on the allocation of management costs? It is assumed that remuneration from fund resources for the management of an urban development fund is, as a rule, permitted on a yearly average of up to 3% of the capital contributed by operational programme in question to the fund. The returns generated can also be used to cover the costs of the fund management and/or third parties (Article 43 of Regulation (EC) 1828/2006), provided they are not management costs.

That assessment is correct. Reference should also be made to the descriptions given in the briefing. ***(see E.V.5.)***

26) It can be inferred from the COCOF notes that at the level of the borrower or guarantee holder, the question of revenue – Article 55 of Regulation (EC) 1083/2006 – is not applicable. Are there now any new findings, drawn from the Europe-wide parallel implementation processes, to the effect that other requirements should also not apply because of the particular features of the JESSICA structure?

No. It was discussed in the EU Council whether a similar adjustment is also necessary for Article 57 of Regulation (EC) No 1083/2006. It was concluded, however, that the current version of Article 57 does not require any further modification. Furthermore, to our knowledge, there is no discussion of the non-application of other provisions.

27) Essentially, the principle of expenditure actually paid out also applies to the settlement of management costs for the fund; such expenditure must be supported in each specific case by invoices or accounting documents of equivalent probative value, unless the fund management was found by means of a public tender procedure. Do the new rules on the on the statement of flat-rate costs (amended Regulation 397/09) offer possibilities for dispensing with specific supporting documents as proof of management costs actually incurred?

With regard to the possibilities for the statement of flat-rate costs and the general calculation of management costs, we refer to the report. ***(see E.III.1. and E.V.5.)***

28) Does Article 80 of Regulation (EC) No 1083/2006 prevent due diligence costs of the target enterprise being repaid? If they are repaid, they are not borne at all by the fund, and do not therefore come under the 3% restriction. The question has two parts:

- Is Article 80 applicable at this level (is the fund actually the operation) and
- Are they charges etc. which are inadmissible under Article 80 or an exchange of services?

Various approaches are possible, as we have shown comprehensively in the report. The Commission has now given an unfavourable opinion to Brandenburg. The correspondence is not available at the time of writing. ***(see E.V.5.)***

29) Are there rules which prohibit the management fee being calculated with reference to recycling of capital paid out (e.g. in the case of a loan granted at 2%, a further 2% is calculated for management costs, with the result that the effective lending rate is 4%)?

With regard to the calculation of management fees and allocation of costs, we refer to the comprehensive description given in the briefing. ***(see E.V.5.)***

30) Can expenditure for the fund construction (fund development phase) and costs of bodies (advisory body etc.) which assist with the ongoing operation of the fund be covered by ERDF resources? What is the situation with remuneration for other actors (expenditure for refinancing, sales partners, consultancy, implementation, expert opinions, and design)?

With regard to the calculation of management fees and allocation of costs, we refer to the comprehensive description given in the briefing. ***(see E.V.5.)***

31) Are there fundamental requirements with regard to the documents to be retained by the fund (duty to keep supporting documents, reporting documents etc. for the managing authorities)? At what level and in what depth must the funds report (e.g. regarding the financed projects)?

The fund is required to prove the use of funding to the Commission. Because it is not the project operator itself, however, it must ensure that appropriate documents are retained by the supported projects. There are no absolute, strict requirements, but effective proof must be provided ***(see E.V.7.)***

32) It can be inferred from the COCOF notes that the duty to keep supporting documents applies to the fund and the project promoter. Could this be clarified for both levels (fund and project promoter)?

The essential requirements stem from Regulation (EC) No 1083/2006, in particular as regards organisation. With respect to the detailed duties, reference is made COCOF Note 07/0018/01, point 4 (p. 6 et seq.) and the briefing. The effective result is important. It is possible to delegate documentation duties and to use storage in electronic form ***(see E.V.7.)***

33) A situation is conceivable where, even though all expenditure and investments were made to the best of knowledge and with due care, a JESSICA urban development fund has suffered a considerable loss after a certain period (e.g. five years) has passed. In that case, the fund would probably be dissolved. We assume that this is possible. We also assume that in this case too there will be no claim for repayment of ERDF resources by the Commission, provided they were used in accordance with the requirements of the Structural Funds regulations.

With reference to Article 57 of Regulation (EC) No 1083/2006 it can be inferred that, from the criteria laid down therein, durability or a certain survival time for the investment is not relevant. The crucial factor is that funding which might remain in the case of failure is reinvested in appropriate projects. This is true both in the case of losses and in the case of profits, since it is in the nature of the fund to assume a certain start-up risk. The spirit and purpose of the fund is to support precisely this kind of project, which runs the risk of failure. Consequently, assumption of risk should not be penalised. ***(see E.V.9.)***

34) An administrative categorisation and added-value classification is very difficult where it is not possible to distinguish clearly in a project between grant-funding and JESSICA support: What method should be adopted for making the calculation for such projects? Is it technically possible to set off grant-funding and JESSICA funding?

It must be pointed out that the individual financial flows must be kept separate. This is clear from Article 60(d) of Regulation (EC) No 1083/2006. The appropriate or reasonable action here is whatever is likely to separate the relevant sources. ***(see F.I.)***

35) With regard to major projects, the COCOF notes state that the contribution of resources into the fund cannot be considered to be a major project within the meaning of Article 39 of Regulation (EC) No 1083/2006. This provision nevertheless seems to apply in connection with the financing of projects from the fund. Is that correct?

Yes. ***(see F.I.)***

36) How can operations be divided structurally into an eligible and a non-eligible part? What formal requirements must be observed?

The projects supported by urban development funds can contain parts which are not eligible for Structural Fund resources (e.g. housing investments in the old EU Member States). In order to ensure that accounts for the eligible parts are audited in accordance with the Structural Funds regulations, in such cases separate accounts must be kept in the fund for those parts. ***(see F.I.)***

37) What requirements are to be observed in connection with the investment of different financial flows within a fund?

Where different funding is contributed to the fund, the possibility is created also to support projects which are not eligible under the ERDF. In that case, however, it is necessary to keep separate accounts and accounting trails. ***(see F.I.)***

38) Can the urban development fund take out loans?

Private-sector involvement in the JESSICA fund can also take the form of outside capital. Nothing should prevent the fund from raising outside capital. However, it should be borne in mind that urban development funds may not invest in the creation of venture capital, loan and guarantee funds (second subparagraph of Article 46(1) of Regulation (EC) No 1828/2006), but only directly in the financing of projects. ***(see F.II)***

39) Are there requirements for interest payments and use of profits from interest?

Yes. Article 78(7) of Regulation (EC) No 1083/2006 provides that they must be reutilised in urban development projects or financial engineering instruments for SMEs. The Commission has also confirmed that revolving financial engineering instruments can be combined with interest subsidies (COCOF 08/0002/03, point B.1). The interest subsidies are then regarded as part of the financial engineering instrument within the meaning of Article 44 of the general regulation and do not come under a separate regime. Regard must be had to EU law on State aid where interest subsidies are granted. ***(see F.II.).***

40) The fund is described as the beneficiary. Can a contribution therefore still be made, at the end of the programming period for example, to the fund, whose resources have been appropriately used, even though the resources have not been (fully) used for urban development projects by the end of the programming period?

Because the contribution of funding from the OP in the JESSICA fund is also regarded as appropriate expenditure, the n+2 rule no longer applies once the funding is paid into the fund. It must be taken into account that the ongoing appropriate use of resources must be ensured and expenditure of resources from the fund must continue until 2015. ***(see F.II.2.)***

41) Do all EU-specific ancillary provisions and eligibility provisions also have to be applied at project level for the 2007-2013 programming period (decommitment, publicity, information duties, auditing, retention of documents and files, revenue, major projects etc.)?

Because the fund and not the enterprise is the beneficiary, documentation must be provided and requirements complied with at that level. For the supported enterprise itself, there are no obligations in relation to proof of use aside from those which are normal banking practice. From the perspective of the fund, however, it should be ensured that the information required from the project companies is provided. This means that there are also certain de facto documentation duties at project level. However, they can be regulated in the financing agreement. ***(see F.III.)***

42) At what level are general principles of participation by the EU funds (e.g. additionality) and questions of eligibility to be observed?

As can be seen from the COCOF notes (COCOF/07/0018/01 p. 1 et seq. and COCOF 08/0002/03, p. 16), these principles must be observed both at fund level and at project level. ***(see F.III.)***

43) Under Article 8 of Regulation (EC) No 1080/2006, sustainable urban development measures may be supported by the ERDF. This possibility is expressly opened up ‘in

addition to the activities listed in Articles 4 and 5'. On this basis, can operations be financed which are not mentioned by Article 5, which is relevant for the Land in question, if they are included in an integrated plan for urban development? (For example, at present, as part of an integrated plan, a concept is being devised for the development of Berlin City West. The concentration of the university campuses located there takes on an important function. The plans include the construction of a university building for mechanical engineering and information technology which could play a key role in the development concept. Can such a measure, as an important component of an integrated urban development concept, be financed through a JESSICA fund? No provision is made for the financing of university construction in the Berlin OP. In the negotiation of other OPs with DG Regio, the financing of university construction from ERDF funding was refused if no direct business link could be demonstrated.)

This subject was discussed with the Commission. The basic position is that the Operational Programmes take precedence. Only in the framework of the OPs can Article 8 apply. A comprehensive description of this discussion is given in the briefing. ***(see E.III, F.III. and F.IV.)***

44) Requirements for the substantive organisation of the urban development fund by the Operational Programme: Can the urban development fund also support projects which are not covered by the priority axes under the Operational Programme, but are eligible under Articles 5 and 8 of the ERDF regulation (in extreme cases, can it concern projects which are even excluded by the Operational Programme)?

This subject was discussed with the Commission. The basic position is that the Operational Programmes take precedence. Only in the framework of the OPs can Article 8 apply. A comprehensive description of this discussion is given in the briefing. ***(see E.III, F.III. and F.IV.)***

45) Article 8 of Regulation (EC) No 1080/2006 explains that support for urban development strategies is intended '*to tackle the high concentration of economic, environmental and social problems affecting urban areas*'. Does this mean that only measures implemented in districts or urban areas with higher than average economic, environmental and social problem are intended to be eligible? Or can measures be supported in all districts or urban areas. An example would be the financing of investments in economic/academic infrastructure which can take advantage of special economic opportunities and open up positive development prospects for the city as a whole.

This subject was discussed with the Commission. The basic position is that the Operational Programmes take precedence. Only in the framework of the OPs can Article 8 apply. A comprehensive description of this discussion is given in the briefing. ***(see E.III, F.III. and F.IV.)***

46) Does the area defined for the projects not financed under the JESSICA funds also apply to the projects financed by the urban development fund under JESSICA or can projects be supported by the fund in other cities in non-disadvantaged urban areas of the 'ERDF cities'?

This subject was discussed with the Commission. The basic position is that the Operational Programmes take precedence. Only in the framework of the OPs can Article 8 apply. A comprehensive description of this discussion is given in the briefing. ***(see E.III, F.III. and F.IV.)***

47) Depending on the type of project and the material and geographical scope (urban development, urban regeneration, land conversion, SMEs etc.), the funding from the support programmes to be implemented under regional legislation (if permitted under budgetary rules, which is still uncertain) is to be used at fund level as revolving funding which may be invested temporarily in the capital market. Which budgetary legislation should be taken into consideration in particular? What factors must be taken into consideration in connection with the fund structure?

The relevant requirements are laid down by the budget regulations of each Land. It must be clarified for each Land individually what limits there are and to what extent adjustments to budgetary law might be necessary. A precise description of the action taken is therefore necessary. ***(see F.IV)***

48) Is the engagement of a development bank for operational fund management subject to the requirements of a tender procedure? What formal requirements must be complied with?

The extent to which the integration of a development bank comes under procurement law is dependent on the specific structure. ***(see F.IV.2.)***

49) To what extent may companies involved at fund level also act as project promoters at project level or have commercial contacts with the project promoter (e.g. as a contractor for project implementation or as a commercial bank)? May a commercial enterprise involved at fund level perform in-house transactions in relation to project implementation?

Even if the fund and the project enterprise are to be regarded as the beneficiary, efforts should be made to achieve an appropriate separation of functions. Questions relating to procurement law arise in other respects, depending on organisation. ***(see F.VI.2.)***

50) Where management of the fund is to be performed by a regional development institute, are there reservations against participation by the development institute in the funding at project level (e.g. by making grants from other support programmes or complementary bank loans). At project level, the financing requirement in the specific case must be covered, alongside financing from fund resources, by other sources of financing, particularly where it is not possible to finance the entire project completely from the fund. In such cases, provided accumulation is permissible, the regional development bank (SAB) would also provide grant-funding from other programmes, e.g. for expenditure which cannot be refinanced by ERDF funding. It is also conceivable for complementary financing to be provided from non-subsidised bank loans.

In principle, there is nothing to prevent such further support. However, it must be ensured that these additional support measures do not create a distortion of competition at project level. Particular attention should be paid in this respect to procurement law and the law on State aid. ***(see F.VI.2.)***

51) Under what conditions must the fund itself or the project promoter, as recipient of resources from the fund, comply with procurement law? Is a legal situation conceivable where procurement law is not applicable to the project promoter?

This depends of what contracts or projects are to be implemented and how the JESSICA fund itself is legally structured. In principle, procurement law must be observed in the case of purely public organisation of the fund. Even through the provision of support funding does not, as a rule, comply with the strict requirements of the Rules regarding Public Supply Contracts, the general principles (transparency, non-discrimination etc.) must be observed in connection with grant of public funding. Particular attention must be paid in the case of funds using a bottom-up approach, where projects have already been pre-selected in a feasibility study. ***(see F.VI.2.)***

52) What requirements does EU law lay down in relation to guarantees and exemptions from liability?

No specific restrictions on such measures are contained in the Structural Funds regulations themselves. From the point of view of the rules on State aid, however, regard should be had to the Commission's Notice on Guarantees in the case of both measures. ***(see F.VI.3)***

53) Does a counter-guarantee provided for a private participation in the fund by the Land in question result in the funding being 'infected', so that this funding could be regarded as a public contribution, and vice versa?

A counter-guarantee provided for participation in the fund would appear to be irrelevant in terms of the classification of the funding per se. However, such a counter-guarantee may have consequences in terms of the law on State aid. ***(see F.VI.3.)***

54) Under what conditions do the activities of an urban development fund have relevance for the purposes of the rules on State aid? Is the law on State aid also applicable at fund level? What factors should be taken into consideration in relation to fund structure?

The requirements of the law on State aid must in principle be observed in all State financing measures vis-à-vis enterprises. The legal form and shareholder structure of the beneficiary enterprise are not relevant, but only whether it is participating in competition. In the event of doubt this is assumed to be the case. Where ERDF funding is invested in the fund itself, this is not the case, provided the fund is organised purely on public lines and is confined to granting funding. The situation may be different, however, if private parties are involved at fund level.

The law on State aid is relevant at project level at the latest. Because the law on State aid is essentially geared to unilateral grant-funding, in situations where several participants are involved in a complex financing structure there must be a close study of the conditions of payment with reference to the individual case. Some criteria have been laid down by the Commission in relation to guarantees in the Notice on Guarantees. If private joint investors are involved, their preferential treatment may constitute State aid. ***(see F.VI.3)***

55) What factors must be observed in this regard in terms of the fund structure?

As has already been explained, the law on State aid must be examined with reference to possible legal relations both in the case of the provision of benefits under the fund and in relation to the formation of the fund. There are no schematic requirements. ***(see F.VI.3)***

56) Project promoters which form a target group for an urban development fund are often municipal project promoters, which are mainly non-SMEs. Do they operate economically for the purposes of the law on State aid? If so, what options for funding are available under the rules on State aid, aside from de minimis support and small aid arrangements (in particular for non-SMEs)?

The extent to which a public enterprise itself can grant or receive State aid cannot be considered uniformly and depends on the assessment in the specific case. Its role in competition is relevant above all.

It is also possible to grant funding in accordance with the rules on State aid outside the de minimis limit and the special rules for SMEs. The crucial factor is always that the measure does not give rise to any distortion of competition. If there is absolute certainty

in advance that support is compatible with the law on State aid, the measure can be notified. ***(see F.VI.3)***

57) Is it necessary to comply with rules on State aid – and, if so, which – in the provision of guarantees from the fund to project promoters in particular for non-SMEs)?

Guarantees from the fund are covered by the Commission's Notice on Guarantees. ***(see F.VI.3)***

58) What possibilities are there to support privately-dominated (>50%) public-private companies and what formal requirements must be observed?

The same requirements in relation to State aid apply in principle to support for mixed private-public enterprises as to support for purely private enterprises. However, it must be noted that the formation and provision of capital for such an enterprise may have relevance in terms of the law on State aid. ***(see F.VI.3)***

59) Is it possible, in a specific case of a project, to exempt the ERDF funding temporarily from the payment of interest (and possibly also repayment of capital)?

No specific obligation to pay interest is laid down. There could, however, be reservations over the exemption of certain projects from repayment of interest and capital under the rules on State aid. ***(see F.VI.3)***

60) Are there models for notifying a guarantee programme to the European Commission as there are for the municipal development fund?

At present, the answer is 'NO'. A separate model notification for JESSICA is not to be expected and the normal procedure is to be followed. Reference is made to the competence of DG Competition.

61) What elements are required for an ongoing project to be declared to have failed and – without detriment to a repayment of ERDF funding – a decision not to claim further repayment or to declare that the funding cannot be recovered?

- decision by the management/advisory body
- conclusion of a warning notice procedure
- conclusion of an action/enforcement proceedings
- evidence of insolvency of the debtor

Since this is an economic decision, there is a margin of discretion which is to be exercised by the fund management according to the best of its knowledge. The proposed points represent useful indicators in any case. ***(see F. VII)***

Annexes

Annex 1: Regulations (each without annexes)

a. Regulation (EC) No 1080/2006 of 5 July 2006

b. Regulation (EC) No 1083/2006 of 11 July 2006

c. Regulation (EC) No 1828/2006 of 8 December 2006

d. Regulation (EC) No 284/2009 of 7 April 2009

e. Regulation (EC) No 397/2009 of 6 May 2009

f. Regulation (EC) No 846/2009 of 1 September 2009

Annex 2: Correspondence with the Commission

c. Letter from the Commission to the Land of Lower Saxony of 31.7.2008

d. Letter from the Commission to the Federal Ministry of Economics and Technology of 2.9.2009

Annex 3: Commission information documents

a. COCOF/07/0018/01-EN

b. COCOF 08/0002/03-EN

c. COCOF 08/0034/02/EN

d. Vademecum Community Rules on State Aid