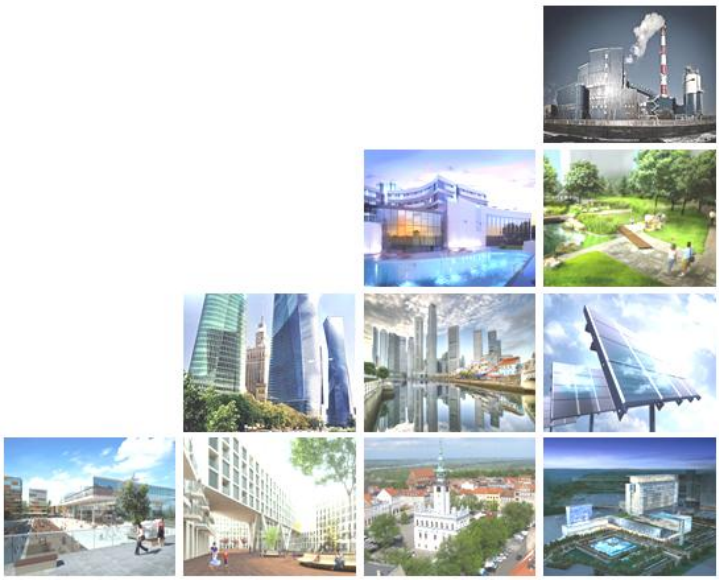
2014-2020 JESSICA Evaluation Study for Nine Polish Regions:

Kujawsko-Pomorskie, Łódzkie, Lubelskie, Małopolskie, Mazowieckie, Śląskie, Świętokrzyskie, Wielkopolskie, Zachodniopomorskie

Final Report

30 April 2014



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Part I

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Report completed by: Regional Project Managers: Cezary Gołębiowski, Marta Mackiewicz, Jacek Goliszewski, and Jan Fido
Report reviewed by: Agnieszka Gajewska, Project Team Leader and Lily Vyas, JESSICA Programme Manager
Report approved by: Bob Green, Partner, Mazars

EXECUTIVE SUMMARY

This Executive Summary presents key findings of the JESSICA Evaluation Study for Nine Polish Regions: Kujawsko-Pomorskie, Lubelskie, Łódzkie, Małopolskie, Mazowieckie, Śląskie, Świętokrzyskie, Wielkopolskie, Zachodniopomorskie ("Evaluation Study of Nine Polish Regions", "Study"). The Study has been performed to assist the Regions in incorporating Financial Instruments ("FIs") into the new Programming Period 2014-2020 to support urban and territorial development. The objective of this Study was to determine how and to what extent such FIs can facilitate, accelerate or amplify investment in sustainable urban and territorial development in the context of the 2014-2020 Cohesion Policy framework. The Study also seeks to demonstrate why the use of FIs can be, in certain contexts, more suitable to foster urban projects compared to other financial products including grants. The Study also defines the most appropriate FI structures that could be set up by Managing Authorities ("MAs") to best address their regional objectives in relation to urban and regional development.

JESSICA initiative

JESSICA - Joint European Support for Sustainable Investment in City Areas - is a technical assistance initiative of the European Commission ("EC") developed jointly with the European Investment Bank ("EIB") and in collaboration with the Council of Europe Development Bank ("CEB") with the aim of supporting sustainable urban development and regeneration through FIs. The objective of JESSICA is to address the challenges and complexity of sub-optimal performance within the urban sector, and to deploy FIs as a strategic tool for cities to promote investment projects as an integrated investment strategy rather than on a stand-alone basis.

Under procedures applicable in the 2007-2013 Programming Period, MAs in the Member States ("MS") are offered the possibility to invest some of their Structural Funds ("SF") allocations in FIs (revolving funds) supporting urban development and recycle financial resources in order to enhance and accelerate investments in Europe's urban areas. These FIs are Urban Development Funds ("UDFs") investing in Public-Private Partnerships ("PPPs") and other projects included in integrated plans for sustainable urban development. One of options available to MAs is to channel funds to UDFs using Holding Funds ("HFs"), which are set up to invest in several UDFs. This may offer the advantage of enabling MAs to delegate some of the tasks required to implement FIs to expert professionals.

The main benefits of JESSICA are the following: (i) it makes Structural Fund support more efficient and effective by using "non-grant" FIs, thus creating stronger incentives for successful project implementation, (ii) it mobilises additional financial resources for PPPs and other sustainable urban development projects, and (iii) it uses financial and managerial expertise from international financial institutions such as the EIB. This should allow public and private parties to develop small and large-scale urban development projects in cooperation. Since capital is given out as loans, equity or guarantees, not as grants, in general only projects that generate return flows (*i.e.* either solely through commercial returns or project revenues generated through payments from the public side, e.g. with availability payment to the project investors or other payments to projects lenders or from other appropriately justified and secured sources) can be financed.

Experience in using FIs for urban development and regeneration

Based on the findings of the Study, in general, **Polish MAs and other market participants** (including municipalities and other project developers) **have rather limited experience in using FIs**. The experience from utilising region specific local FIs providers and intermediaries (including regional guarantee and debt funds as well as local equity providers) is focused on SMEs sector and does not address specific project needs in the urban development space. Relatively weak understanding of FIs and lack of experience in their implementation have also been reflected in the quality of project applications submitted in response to a questionnaire that has been conducted as part of this Study among over 2,500 potential project promoters

("Questionnaire"). This area needs closer investigation during Ex-Ante Assessments and while designing specific solutions on the level of Regional Operational Programmes ("ROPs") to address the potential barriers in using FIs. Taking into account limited know-how and experience in designing and implementing FIs, the need for professional support to the potential beneficiaries in project structuring and implementation is very high. It is therefore highly advised that Technical Assistance should also be used to provide a high-quality professional support, in addition to ensuring adequate administrative capacity within the MAs[1]. The European Commission is currently developing a new Technical Assistance Platform to support the implementation of FIs .

Most of beneficiaries and MAs who already implemented JESSICA assess it very positive due to its clear benefits.

The best understanding of FIs has been demonstrated in the Regions that decided to implement JESSICA and JEREMIE[2] initiatives in the 2007-13 Programming Period. The implementation of JESSICA is assessed as generally positive and shows systematic progress with a steep learning curve, with several Regions reaching relatively **high allocation rate** as of the end of September 2013 (with the highest allocation rate measured as the amount of loan agreements signed to the funds allocated to the UDFs **of over 90% in Wielkopolskie** as of the end of September 2013). Current beneficiaries of JESSICA FIs mentioned the value-added of such instruments, in particular: 1) lower interest rates; 2) longer tenors than available in the commercial market and 3) no additional costs and extra fees. Private beneficiaries have indicated additional benefit of JESSICA FIs that allows for financing of significantly larger urban development projects than in the case of grants or financial instruments available for SMEs at the regional level.

Implementation challenges with FIs

Whilst stakeholders (both on the beneficiary as well as MA level) involved in implementing FIs to date within the Programming Period 2007-2013 were in general positive about the experience, many also noted the challenges involved with FIs. Stakeholders felt that improving and/or further supporting FI implementation would lead to increase in the attractiveness of FIs as well as potentially accelerate investments into suitable projects. In the 2007-2013 Programming Period, the major hurdle experienced by private beneficiaries was, according to the results of the interviews performed, the need to demonstrate an alignment of their projects with respective Local Revitalisation Plans. The general view of private sector beneficiaries is that the process of obtaining the necessary status in the Local Revitalisation Plan is challenging and time-consuming. While this factor should not be attributed to any specific UDFs or MAs, slow progress in this area that cannot be controlled by a private party often discourages potential beneficiaries. This however will not be a requirement for the 2014-2020 Programming Period.

In some cases, beneficiaries also referred to time-consuming procedures on the UDFs' side. Private promoters indicated areas for improvement in the context of technical assistance in devising an acceptable project financial structure. An analysis of the UDFs' application procedures, in particular in relation to the procedures required by commercial banks, leads to a conclusion that the UDFs' procedures are in line with normal market practice (NB: UDFs in Poland are banks acting on the basis of the banking law), therefore a relevant information campaign at an early stage of FIs implementation could help potential beneficiaries to understand the requirements better, prior to submission of an application. In this context, while preparing for the 2014-20 Programming Period, the MAs should also consider simplifying the monitoring and reporting requirements and provide technical assistance in areas such as project financial structuring.

[1] The amount of the Funds allocated to technical assistance shall be limited to 4% of the total amount of the Funds allocated to operational programmes (Article 119 of the CPR).

[2] JEREMIE stands for Joint European Resources for Micro-to-to Medium Enterprises which uses FIs to support SMEs' access to finance.

New EU Programming Period 2014-2020

Detailed solutions as of new EU Programming Period for 2014-2020 and implementation mechanism adopted by Poland and Regions were not finalised at the completion of this Study. However, there were on-going discussions at the EC over the summer 2013 related to the preparation of delegated acts, implementing acts and guidance[3] for the European Structural and Investment Funds ("ESI") Funds 2014-2020 in the context of urban development. The overall approach and proposed solutions should facilitate joint planning and implementation for integrated urban and regional development. MAs should design FIs taking into consideration the following:

- **Multi-funding** - there will be an opportunity to combine European Social Fund ("ESF") and European Regional Development Fund ("ERDF") or ERDF and the Cohesion Fund ("CF") via integrated local approach to facilitate joint planning and implementation. The ERDF and the ESF may finance, in a complementary manner, a part of an operation for which the costs are eligible for support from the other Fund on the basis of eligibility rules applied to that Fund. It will be possible only if necessary for the satisfactory implementation of the operation and directly linked to it (the amount will be limited to 10% of EU funding for each priority axis of an Operational Programme ("OP"). In particular, the use of ESF and ERDF funds within one priority axis on the ROPs level for FIs will be allowed to ensure maximum flexibility for absorption of funds, as well as allowing MAs to take a more integrated approach in allocating EU funds for the purpose of supporting economic development. After discussing with the MAs, the detailed mechanism of joint use of ESF and ERDF has not been designed yet as of the end of August 2013 (e.g. by identifying under ROPs certain priorities or operations that will be funded jointly by ESF and ERDF). This Study **demonstrates the need for combining grants** (e.g. under ESF where it is more difficult to achieve revenue generation) **with FIs** (possibly under ERDF or CF) in the same project. Several Case Studies performed showed viability of structures whereas part of initial preparatory costs (in particular feasibility studies, technical assistance, energy audits) could be financed via grants and "hard" capital expenditure could be funded with FIs. It is also the case in some project types as large-scale urban regeneration or business environment / R&D projects that part of their capital expenditures still needs to be co-funded by grants, with FIs forming additional source of funding. Such an approach allows for optimal social benefits but also creates adequate incentives for potential private finance contribution[4].

- **Focus on 11 Thematic Objectives and the Areas of Strategic Intervention ("ASI")** – the new Programming Period 2014-2020 more than the previous ones, highlights the need for focus of Structural Funds on strategic areas, in particular on 11 Thematic Objectives ("TOs") to maximise their impact. Projects analysed as part of this Study link with one or more TOs and the alignment of any projects to be funded through FIs with these TOs will be a requirement.

- **Increase in importance of FIs as support mechanism** – although not quantified officially as of the end of September 2013, a significant increase in use of FIs in comparison with the Programming Period 2007-2013 is expected to constitute a significant shift in the way the Structural Funds are distributed and absorbed. For the new Programming Period 2014-2020, there is also greater incentive to use FIs, therefore, the Commission intends to encourage the take up of FI by increasing the maximum co-

[3] See for on-going discussions and presentation materials:
http://ec.europa.eu/regional_policy/what/future/experts_documents_en.cfm#1

[4] For more detailed discussion, please see Article 98 of the CPR relating to joint support from the Funds: 1) The Funds may jointly provide support for Operational Programmes under the Investment for growth and jobs goal. 2) The ERDF and ESF may finance, in a complementary manner and subject to a limit of 10 % of Union funding for each priority axis of an operational programme, a part of an operation for which the costs are eligible for support from the other Fund on the basis of eligibility rules applied to that Fund, provided that they are necessary for the satisfactory implementation of the operation and are directly linked to it (i.e.only ERDF and ESF at the level of project with 10% limit).

financing rate by 10 percentage points, where the entire priority axis is delivered through FIs. For example, the ESIF contribution will be 60% instead of 50%, and national co-financing will then be 40%, whilst the overall ESIF amounts for the OP remain the same[5]. This Study presents general findings as of expectations towards FIs to address market failures, mobilise private financing, present value added including pricing advantages and optimising leverage ratio; however in addition a detailed Ex-Ante Assessment needs to be carried out by each Region.

- **Role of functional areas of cities as opposite to administrative boundaries** – most of documents and initiatives, such as ITIs and CLLD, refer to functional areas as basic category for allocation of funding to ensure cooperation and regional synergies, rather than initiatives limited strictly to the administrative division. An increase in involvement of cities and urban areas in the management of ESIF and the delegation of certain functions to them will also be seen. Taking into account rather limited track record in cross-municipality cooperation in Poland to date, ITIs will require careful planning and proper incentives to facilitate integrated actions particularly so if FIs will be used to support ITIs.
- **Higher requirements with respect to assumed non-financial returns (socio-economic impacts) of regeneration projects** – although not defined in detail as of the end of August 2013 (no final versions of the ROPs in place yet), a more rigorous approach to assessment of socio-economic impacts of regeneration projects (possibly with introduction of effect-specific indicators) in the Programming Period 2014-2020 is expected. This will require better coordination of regeneration programs with the ESF and might create a challenge in the context of implementation of revenue generating projects via FIs. This Study demonstrates significant social effects (as for instance providing common social space in deprived areas, creating new employment in least-developed areas, providing affordable and clean energy to the public and SMEs) of certain regeneration projects. It is advised that these social impacts are taken into account in project selection as well as terms and conditions of FIs offered to such projects (e.g. lower debt pricing or expectations on equity returns for projects with high social impact), as has been proposed in this Study for several case studies with high social impact.

Potential interest in FIs in urban development and regeneration

The majority of 225 projects submitted represent viable urban development initiatives with potential for using FIs.

The main tool to assess potential interest in and readiness to implement FIs for all Regions was the analysis of **225** projects submitted in response to the Questionnaire sent to more than 2,500 potential urban project promoters. The projects were **submitted by both private and public entities** (including municipalities and their companies as well as universities and others). These findings, supplemented with the analysis of the Local Revitalisation Programmes in the largest cities in each Region and other available documents, identified urban development projects with potential for the use of FIs. The projects submitted represent **various development stages and diversified mix of sectors** in line with the 11 Thematic Objectives. The significant part of projects submitted represents integrated regeneration efforts. Special focus in relation to potential use of FIs should be placed on municipalities and their companies that accounted for over 70% of all respondents[6]. They could potentially originate a significant part of urban regeneration projects in the future and are facing difficulties with financing such projects due to restrictions on public debt. The high interest in FIs on municipal level proves a considerable level of investment needs that coupled with decreasing potential of municipalities to fund the projects creates a potential demand for FIs. Significant interest in FIs on municipal level results also from the positive initial experience in implementing FIs via JESSICA in the 2007-13 Programming Period by the municipalities so far, **with several municipalities**

[5] See: Art 120(5) of the CPR and the *template for Operational Programme 2014-2020 in Poland with comments*, the Ministry of Regional Development, September 2013, p.13.
[6] Municipalities accounted for 67% and public companies and entities for 4.9% of all respondents.

planning to use the funding through FIs again for their future projects. More concerns have been raised by those entities that do not have experience in implementation of JESSICA and were not able to assess benefits of FIs in practice. The higher response rate from public entities might however be seen in the context of generally higher willingness of public bodies to participate in surveys in comparison to private entrepreneurs (that was the case in several surveys conducted by the Project Team for various assignments in Poland).

The Study demonstrates predominant interest in grants as the most desirable method of financing - on average, almost 65% of all respondents asked about preferred form of financing for their projects named grants.

Successful implementation of FIs (including JESSICA) helps with the cultural shift from grants-only towards more diversified market for financing urban development.

This represents the natural preference of potential beneficiaries for "free money", especially taking into account last years of intensive use of grant-funding in Poland. The Project Team also believes that some potential beneficiaries indicated grants as the most favourable source of finance for their projects in an attempt to influence MAs to continue grant-funding to the largest possible extent. However, the preference for grants is significantly lower than average in the Regions that implemented FIs in the current Programming Period, with the two Regions with the longest tradition in implementing FIs via JESSICA demonstrating the lowest rates of below 50% (Wielkopolskie 48% and Zachodniopomorskie 44%). This, supported by series of interviews with various stakeholders, proves that the successful implementation of FIs helps change the mind-set of potential beneficiaries: from grants towards more market-oriented instruments.

Despite general preference for grants, there is however considerable declared interest among project promoters in using FIs should they represent the only method of financing (as opposite to availability of grant financing). In that case, **almost 53% respondents declared their interest in FIs already** with additional 26% not being able to decide at this stage. Most of those who do not see FIs as a way of funding their projects (less than 21% of all respondents) refer to the lack of revenue potential and future inability to repay the FIs from projects' cash-flow. Again, the highest readiness to use FIs has been declared in the Regions that already implemented JESSICA in the 2007-13 Programming Period. For example, in Śląskie almost 70% of respondents already confirmed their interest in FIs. This finding is in line with interviews conducted in the Regions that have already implemented JESSICA - where the MAs and beneficiaries assess JESSICA initiative generally positively. In addition, it should be noted that the analysis of projects implemented under JESSICA so far showed that the beneficiaries who used FIs often had not envisaged them as the possible model of funding their projects at the early stages. Taking this into account, the 21% of respondents that excluded financing through FIs in the Questionnaire might also represent potential for intervention through FIs. It will require appropriate information and promotion activities, as the recognition of FIs, especially in respect of FIs other than loans, is still relatively low.

Market Inefficiencies

The Study identified several market inefficiencies in provision of funding for potentially viable **projects with the broad economic, social and environmental impact. Many of these projects have not been successful in obtaining financing (through grants or commercial loans) for various reasons including that of market failure** (e.g. projects located in contaminated or deprived areas or projects in early development stage with high levels of risk and uncertainty). The three main reasons for negative credit decisions from commercial banks were: 1) **insufficient equity contribution** and/or **inadequate collateral value,** 2) **uncovered early development** risk and in selected cases 3) **market risks** inherent in the project and unacceptable to commercial banks. Additionally, several projects suffered from relatively short tenors to be offered by commercial banks that do not correspond with the project forecast payback period.

MARKET FAILURE

Market failure is defined as any situation in which the market does not lead to an efficient economic outcome. In the economic theory "market failure" means that the market entities are not able or willing to agree on the terms of transaction – price, quantity, financing etc. and the desired social outcome does not occur. Market failure also refers to failure of the market mechanisms to achieve optimal or efficient outcome. One of reasons of market failure is the presence of externalities (costs or benefits that are not captured by the price). Market failure leads to financing gap understood as situation in which sizeable share of enterprises cannot obtain financing from banks, capital markets or other commercial suppliers of finance.

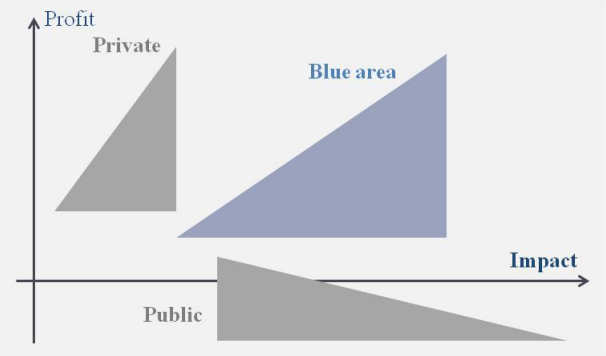
Source: The SME Financing Gap. Theory and Evidence. Volume I. OECD 2006. p 16.

In addition to market failure conditions as described above, public support, including through FIs, might be required to achieve policy objectives in case of suboptimal investment situations as mentioned in Article 37 of CPR.

Despite relatively strong Polish banking system, there is insufficient supply of FIs suitable for funding urban development projects. Several Regions have established guarantee and debt funds, as well as potential seed capital providers and business angels' networks. However, their investment policies and criteria as well as the amount of financing offered are mainly focused on support for SMEs and do not address the need of larger and more complex urban development projects. Additionally, there are several Regions where the market of FIs in general is underdeveloped and the supply side is very limited, with few market players and insufficient financial assistance offered for major urban development schemes.

Unlocking the "Blue Area"

The **Blue Area** relates to projects that have a positive economic, social and environmental outcome, and are economically viable but not necessarily to the degree required by the private sector. These projects should not be financed by the public sector alone, but rather through a combination of grants and private finance.



Current investment market practice continues to show a significant investment gap between profit-driven and policy-driven investments, despite the fact that they are very often complementary. The public sector designs projects that are focused on socio-economic and environmental benefits, but which may not necessarily be financially viable. Under current limitations on increasing public spending, public

authorities need to find alternative funding models. There has been a paradigm shift in financing urban development projects and the days of extensive public-sector grants are unlikely to return. FIs follow an investment strategy that combines socio-economic impact with financial viability and long-term view on urban development.

The Study shows that the projects with high potential social impacts are often unable to attract funding for different reasons: (1) innovative projects with a novelty barrier and little or no track record do not inspire the confidence of investors; (2) pilot projects may face difficulties in coming to the market as different resources are required and large-scale investors have different objectives compared to seed funders or venture capitalists; (3) some low profitability projects cannot benefit from grant funding as they do not meet required criteria and objectives but are not attractive enough for investors; and (4) other small projects require a proactive and flexible investment approach that traditional public funding cannot address. These projects constitute a potential market gap that in particular may benefit from the use of FIs.

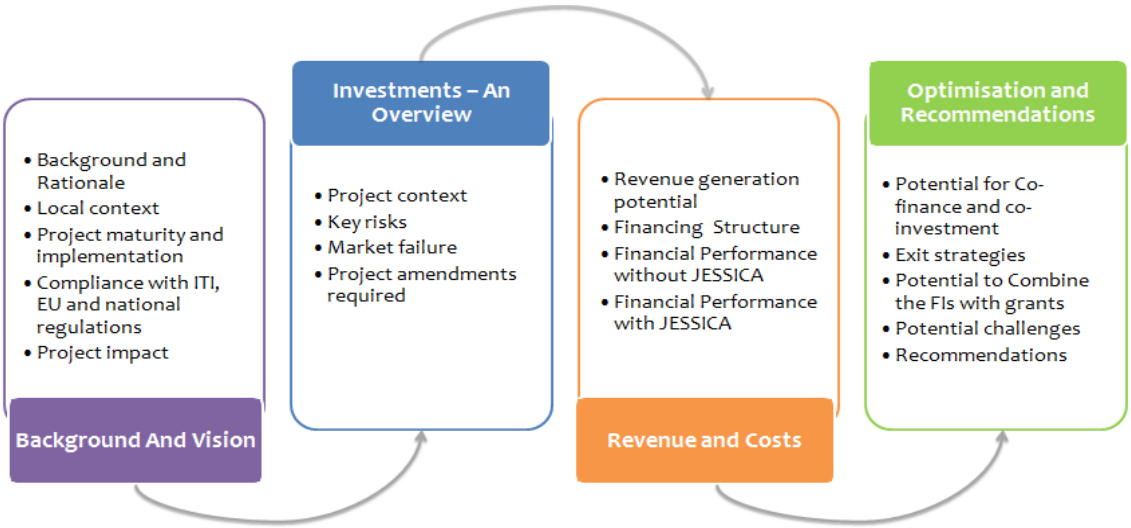
FIs should seek to fill this gap by addressing existing limitations in commercial market in case of deprived urban areas and mitigating the risks of such investments for private sector participants. The FIs investment criteria should enhance the project's potential for successful implementation by developing a consistent approach to business planning and risk mitigation. Once properly set up (in particular by providing necessary expertise and co-investments), FIs should allow for a better use of public funds and a strategic shift from the "grants only" culture.

Case Studies

The Case Studies undertaken as part of this Study represent various types of projects, sectors and project promoters as well as different implementation structures that might be put in place to manage FIs. Detailed analysis of two Case Studies for each Region (with exemption of Śląskie where three Case Studies have been analysed) included in particular the rationale for the project, project maturity, business plan, funding structure, and financial modelling. Simplified financial models have been prepared for each of the 19 Case Studies to make explicit the key payment flows and financial streams between the different parties and the key financial indicators, with and without support of FIs.

In general, the Case Studies have demonstrated the potential added value of FIs. In some cases, the sole use of FIs will not enable implementation of projects without additional grant funding (be it EU, central or regional funding or a combination thereof). This is in particular the case for large-scale complex regeneration projects and business environment and R&D enterprises. However, even in those cases, FIs might create a vital co-funding instrument that ensures proper business planning and risk mitigation on project promoters' side.

Figure 1: Areas Covered within each Case Study



Size, structure and investment strategy for Funds in the Regions

While preparing for the implementation of FIs, the MAs need to consider the following areas: (i) the general market need for FIs in predefined sectors, (ii) general financial structures for projects, including optimal type and size of FIs given possible co-investment on a project and Fund level (iii) specific requirements on the ROPs level to offer the maximum incentives and flexibility for potential beneficiaries and co-investors, and (iv) actions that need to be taken and the implementation schedule.

Potential financial gaps for FIs in the Regions have been defined taking into account: 1) a general definition of potential project demand in defined sectors in each Region and 2) a structure and estimation of FIs values to be used to cover project demands in defined sectors in each Region. The potential project demand has been defined based on the results of the Study-specific Questionnaire and available market data, weighted with probability of project completion and projected appetite of potential project beneficiaries, given competing funding options available in the market (in particular in energy efficiency sector).

The demand for and structure of FIs recommended for each Region depends on assessed project demand in pre-defined sectors and general willingness and experience in using FIs, as well as objectives defined in that Region. The estimated potential demand for FIs varies from EUR 80-95M (for the least experienced and smallest Świętokrzyskie) to EUR 300-355M (for Śląskie, which is one of the largest and the most experienced Regions demonstrating the highest level of understanding of FIs and significant market demand). The estimations made are valid at the moment of the Study completion and may be subject to changes in line with an Ex-Ante Assessment, as well as modifications in line with the market and strategy developments at later stages during the 2014-20 Programming Period. The FI typology and proposed implementation structure reflect the estimated demand in each Region. All Regions are recommended to establish one (or more) general Urban Development Fund, with possible ring-fencing of several objectives (e.g. post-industrial areas etc.). All but two Regions have been recommended to set up energy-focused UDFs that reflect the project demand in these Regions on the basis of the Questionnaire (energy-focused UDFs could also be established in other Regions, subject to the results of Ex-Ante Assessments) and also specific expertise requirement for such UDFs. Several other UDFs proposed in some Regions on the basis of the Questionnaire reflect these Regions' specific objectives and challenges that could be addressed by focused use of FIs, often supplemented by grant funding (e.g. large-scale regeneration of degraded city areas in Łódź Metropolitan Area or support for business environment and R&D build around strong

academic centres in Małopolskie). Since this Study recommendations concerning UDF types to be established in each Region are based on the results of the Questionnaire with limited sample, it should be noted that particular solutions to be adopted by MAs should be preceded by detailed Ex-Ante Assessments. The Study recommends use of diversified FIs in each Region, with possible adoption of different FIs for one project - in most cases offering combined JESSICA equity and debt best responded to identified project needs and offered the most desirable project financial structure. This approach needs to be reviewed in detail before the UDFs are established to avoid potential conflict of interest while offering different FIs.

Figure 2: Indicative Financial Instrument Value and Strategy by Regions (EUR M)

	K-P	ŁDZ	LUB	MAŁ	MAZ	ŚLA	ŚWT	WLKP	Z-POM
Estimated Potential Demand for FIs in 2014-2020* (in EUR million)	€80-€95M	€220-€255 M	€130-€150M	€270 - €320M	€255-€300 M	€300-€ 355M	€70-€85 M	€205-€245 M	€155-€185 M
Estimated Leverage Effect[7]	~2.6	~2.7	~2.3	~2.2	~2.2	~2.3	~2.3	~2.2	~2.2
Recommended Implementation Structure	FoF	FoF	FoF	FoF	FoF* possibly adopting existing HF Structure	FoF* possibly adopting existing HF Structure	FoF	FoF* possibly adopting existing HF Structure	FoF* possibly adopting existing HF Structure
FI Typology	UD SME EE	UD EE	UD EE	BE/ R&D UD EE	UD EE	UD EE	UD EE	UD EE	UD EE
Intervention Areas									
	Urban Development	*City of Łódź*	*Urban Development*	*SME/University/ R&D*	*Urban Development*	*Post-Industrial Regeneration*	*Post Industrial Regeneration*	*Energy Efficiency*	*Urban Development*
	Business Environment	*Other Cities*	*Energy Efficiency*	*Energy Efficiency*	*Energy Efficiency*	*Post-Industrial for Business Environment*	*Urban Development (incl. Cultural Heritage/ Tourism)*	*Urban Development*	*Energy Efficiency*
		Energy Efficiency		*Urban Development*		*Energy Efficiency*			

FoF - Fund of Funds/UD - Urban Development/ EE - *Energy Efficiency/ BE* - Business Environment

***** It should be noted that this is an estimated demand for FIs, however, the size of FI should be subject to a full Ex-Ante Assessment in due course. The EIB/EC will be issuing guidance on Ex-Ante Assessments in early 2014.

[7] Pursuant to Article 140(2) of Financial Regulation, the leverage effect is defined as: "*the Union contribution to a financial instrument shall aim at mobilising a global investment exceeding the size of the Union contribution according to the indicators defined in advance.*" However, for the purposes of this Assignment, the leverage effect is based on the upper limit range of the estimated potential demand for the Financial Instrument. Leverage effect is calculated as the total project value divided by the value of Financial Instrument and reflects the effect of public spending (including EU funds) activating private investments and multiplying the total amount of investments because the level of co-financing was not clearly defined by Regions at the time of the Study. The leverage effect will be examined more thoroughly in the Ex-Ante Assessment.

Potential demand values for FIs as estimated in the Figure 2 have been assessed against potential RPOs values as proposed and published by the Ministry of Regional Development (currently, the Ministry of Infrastructure and Development) ("MRD" or "MID") and potential FIs' allocation for each Region for the Programming Period 2014-2020. The table below compares potential demand for urban development related FIs as estimated in this Report with potential allocation to FIs in each Region. The amounts allocated to FIs have been estimated either based on the information provided by the Region (as in case of Małopolskie, Śląskie and Zachodniopomorskie) or as 10% of total ROP value as indicated as an initial reference figure by the MID on several occasions[8] and which the Project Team believe to be a possible FIs allocation for the Programming Period 2014-2020. In all cases, demand for urban development related FIs estimated in this Study constitutes a significant part of potential total allocation for FIs. It needs to be taken into consideration that the demand estimated for urban development related projects refers only to one potential group of beneficiaries who can use FIs. In several Regions (in particular Łódzkie, Mazowieckie and Wielkopolskie) the demand for urban development related FIs as defined in this Study would potentially utilise the entire potential FIs allocations. The Project Team recommends that these findings be additionally verified during the *Ex-Ante Assessments* in each Region.

Figure 3: Estimated demand for urban development related FIs in context of proposed ROPs values and estimated FIs allocation per Region

Region	ROP value* as proposed by the MID (M EUR)[9]	Estimated FIs allocation (M EUR)	Estimated potential demand for urban development related FIs** as per Report (M EUR)	Coverage of potential FI allocation by estimated potential FI demand ***
Kujawsko - Pomorskie	1,706.5	170.7	80-95	45-55%
Łódzkie	2,022.5	202.3	220-255	110-125%
Lubelskie	2,000.0	200	130-150	65-75%
Małopolskie	2,580.3	530[10]	270-320	50-60%
Mazowieckie	1,923.6	192.4	255-300	135-155%
Śląskie	3,117.0	616[11]	300-355	50-60%
Świętokrzyskie	1,223.3	122.3	70-85	55-70%
Wielkopolskie	2,196.6	219.7	200-245	90-110%
Zachodniopomorskie	1,435.5	220 - 295[12]	155-185	55-85%

* including national co-financing

** including Energy Efficiency and Business Environment

*** % relates the estimated *potential* demand for investments through FIs with potentially allocated amount to FIs in the Region. The Regions with relatively high % potentially represent situations where a significant share of FIs could be allocated to urban development related projects as defined in this Stud (i.e. including Energy Efficiency and Business Environment).

[8] http://www.mrr.gov.pl/aktualnosci/fundusze_europejskie_2014_2020/Strony/DzienInstrumentowZwrotnychUniiEuropejskiej19122012.aspx?M=T

[9] http://www.mrr.gov.pl/fundusze/fundusze_europejskie_2014_2020/strony/start.aspx

[10] „Założenia regionalnego programu operacyjnego dla województwa małopolskiego na lata 2014-2020", June 2013

[11] Presentation „Wstępny podział alokacji RPO WSL 2014-2020", 2013

[12] Presentation "Założenia do perspektywy finansowej na lata 2014 – 2020", 2013

Implementation Options for the Regions

In accordance with Article 38 of the CPR, the MAs have two basic options while deciding on FIs implementation:

- implementation on the EU level, managed directly or directly by the European Commission; or
- implementation on the national, regional, transnational or cross-border level directly or indirectly by the MAs.

The details of implementation for both options have been covered in Chapter 10 of this Report. Each option offers certain benefits and creates challenges that have been summarized in the table below:

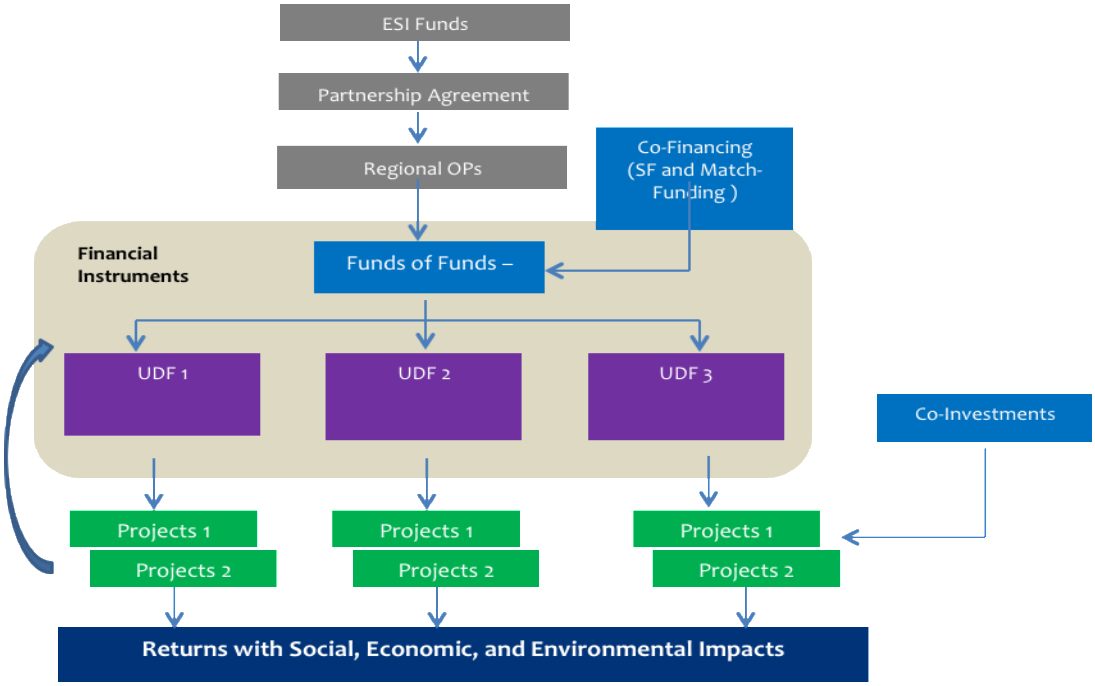
Figure 3: FI Implementation Options

Implementation options	Advantages	Weaknesses
Contribution of Operational Programme ("OP") allocation to EU level instrument		
	• Co-financing rate up to 100% • Set-up phase skipped as EU level instrument delivery system used • No need for on-the-spot management verifications or audits.	• Limited experience on EU level in implementation of such schemes • Implementation still at the conceptual phase.
• **National / regional / trans boarder implementation**		
Traditional implementation (including Fund of Funds Structure)	• If implementation is entrusted to experienced Financial Institutions - use of competent and experienced institutions to perform set-up, managing and control tasks, with limited need to create additional internal resources within the MA • Possibility of using off-the-shelf instruments to simplify implementation.	• There is generally a longer timescales involved due to the need for procuring fund managers in line with EU and national procurement rules.
Direct implementation by MA	• No need to establish a fund (reduced set-up time) • Potential involvement of local entities currently distributing grants (subject to them having adequate resources and know-how in FIs).	• Applicable only for guarantees and loans (no equity instruments to be available under this implementation option) • Payments from COM like for grants (reimbursement of loans disbursed or guarantees committed. No advance payment to the "fund") • Management costs not eligible under the same operation (can be covered under TA) • Extensive involvement of MA employees, internal know-how and resources needed. It should be noted that direct implementation is subject to national legislation. MA should seek legal advice before proceeding.

Taking the above into account and after discussing experiences from the 2007-13 Programming Period**, the MAs are generally recommended to implement FIs on a regional level through the Fund of Funds structure**, i.e. in cooperation with a specialised entity (in the 2007-13 Programming Period the EIB has been acting as a JESSICA Holding Fund for Polish MAs) that will take over several set-up, management and control tasks. The MAs with experience in implementing JESSICA in the 2007-13 Programming Period might consider setting up a **direct implementation of FIs without the Fund of Funds structure**, however taking into account the scope of works designed to a Fund of Funds and the internal capacities within MAs the Project Team does not recommend this option even for more experienced MAs. In addition, the Regions

currently implementing JESSICA have the option to adopt the existing Holding Fund structures, thus allowing quicker set-up, subject to national and European public procurement and State Aid rules.

Figure 4: Recommended default FIs Architecture



Conclusions and recommendations

The Study proves existence of the market need for FIs in the urban and regional development in Polish Regions. During the Programming Period 2007-2013, Poland has experienced an unprecedented inflow of financial means to cover the country's investment needs, including urban development and regeneration projects. The market has been dominated by grant funding, however, several types of projects still suffered due to limited sources of finance, be it grant or commercial funding. It is envisaged that limitations resulting from public debt constraints of public entities (including municipalities) will put an additional burden on the investments in the future. Additionally, despite the relatively healthy condition of the Polish banking system, tenors and covenants reflect an aversion to certain risks, and to long-term financing, so much needed in case of urban development projects.

In certain areas and sectors, the private sector is not in a position to carry out major investment projects alone, as the returns are relatively low and should be leveraged to attract potential investors. In addition, private investors might not be sufficiently incentivised to realise the expected socio-economic benefits; therefore the public sector has to step in to support the initiative. The use of FIs to support urban development is not only promoted by the European Commission but also justified economically to address market inefficiencies. The challenge is to combine, in an efficient and attractive way, multiple funding sources such as budgets of local governments, ESIF and private investments to create a sustainable source of finance of urban development on a regional level. The region-aligned investment strategy as well as implementation structures of FIs have been proposed to each Region separately, however there are several areas of critical importance for successful deployment of FIs across all Regions that may influence the structure and establishment of future FIs and its proposed investment strategy.

Areas of critical importance for successful deployment of FIs across Regions

- **Clear demarcation between grant and FI eligibility and national and regional intervention areas**

Taking into account the natural preference for the traditional grant-funding model among potential project beneficiaries and the early experience from implementing JESSICA in the 2007-13 Programming Period, it is critical to establish on a ROP level a clear division between types of projects eligible for grants from other projects that could potentially use FIs in order not to create counterproductive competition that might negatively influence interest in FIs. On a central level, it is important to draw a line between projects eligible for financing on regional or rather national level to facilitate planning in this respect. These concerns are of particular relevance to R&D, sustainable transportation, healthcare and several environmental projects.

- **Impact of use of FIs on public debt**

Taking into account a limited potential for further increase in the indebtedness level, most municipalities have already or will shortly reach their limits on financing capital investments from their balance sheets. As a result, the municipalities search for developing and financing much needed capital investments without further increase in their debt level, including off-balance sheet structures. The successful implementation of FIs will, to a significant extent, depend on innovation of potential UDFs and their expertise in implementing FIs that will create opportunities for off-balance sheet financing for revenue-generating projects, including PPPs and other potentially suitable instruments as revenue bonds, support agreements from municipalities or public sector owners, capital contribution agreements, ESCOs etc. The Case Studies have demonstrated potential use of FIs that potentially do not impact debt level of municipalities.

- **State Aid**

State Aid issue should be considered at every stage of implementing FIs, particularly in defining the investment strategy. Thus far, the State Aid has been addressed for the purposes of implementing FIs in Poland on a final recipient level through so called General Block Exemption Regulation ("GBER") that is applied through a regulation of MID[13]. As such, the GBER authorises the following aid types: aid in favour of SMEs; aid for research and innovation; regional development aid; training aid; employment aid; aid in the form of risk capital; environmental aid; and aid promoting entrepreneurship. A full State Aid notification is not foreseen for the Polish Regions with regards to urban development in the 2014-20 Programming Period.

- **Available FIs**

The only financial products used as part of the JESSICA FIs so far in Poland have been preferential loans. This was a well-founded approach given the time constraints in the 2007-13 Programming Period, lack of regulations allowing for provision of equity instruments and relatively poor understanding of FIs other than loans among potential beneficiaries. The Study confirms that the understanding of equity, mezzanine instruments or guarantees is very low. In the majority of Case Studies the respondents misinterpreted their investment needs and applied for loans in cases where their use would not bridge their funding gap. The Case Studies have proved that only targeted use of equity or mezzanine instruments, often along with preferential loans made the projects bankable. **Equity contribution bridges the ever-recurring market inefficiencies resulting from the relatively underdeveloped equity market in Poland**. The equity contribution provides developers who does not have the financial resources and/or who face the lack of interest from private equity side, especially due to early development or construction stage and the risks associated and/or lower than acceptable potential level of returns. This Study demonstrates that availability of loans (irrespective of their potentially attractive terms and conditions) helps the projects' economics (i.e.

[13] Regulation of the Minister of Regional Development of 26.10.2011 on granting of financial engineering measures under the regional operational programs as amended by the Regulation of the Minister of Infrastructure and Development of 18.12.2013.

increases expected levels of returns to acceptable levels) but often does not allow for projects to "unlock" (i.e. to obtain required financing) that can rather be achieved by properly structured equity contributions. Predominant interest in loans results from a generally bank-oriented financial market in Poland and generally low understanding of FIs other than loans. To address this issue, more information campaign and promotion of FIs needs to be provided. Ability to use equity as common FIs is also of critical importance to promote much desired know-how transfer from private investors to public entities, and also to encourage further use of PPPs. The broader use of guarantees could address some market issues, especially by mitigating the risks that limit project bankability but needs to be assessed independently by each Region. The potential use of guarantee will depend on leverage model of the guarantee issuing entity, as it should have a critical impact on a possibility to offer capital relief to banks and relevant costing and tenor benefits.

Taking into account the potential use of FIs other than loans and the need for additional services as, for example, structuring or assistance in project development, **the shift towards more mature market with UDFs managed not only by banks but also by or in cooperation with other financial institutions (e.g. private equity houses or specialised companies) should be taken into account while selecting prospective UDF managers**.

- **Insufficient equity contribution and/or collatera**l

Insufficient equity contribution and/or collateral created problems for JESSICA financing in the current Programming Period, especially to smaller developers with obsolete or limited asset base as well as to companies at an early stage of development and Special Purpose Vehicles ("SPVs"). The MAs should address the issue of insufficient own contribution, also in case of municipalities (e.g. by extending the list of eligible collateral by inter alia municipal promissory notes and allowing for in kind contributions as a form of own contribution and/or substitute of cash equity contribution). It is also understood that the more flexible approach will be facilitated by clearer procedures for eligibility of contributions in kind to be covered in specific legal frameworks and EC guidance. This Study introduces contributions in kind (especially for municipalities) for certain Case Studies analysed.

- **Quality of suitable projects pipeline and Technical Assistance**

The initial potential UDFs' pipelines in the 2007-13 Programming Period included several projects that have not managed to receive JESSICA financing due to low level of preparedness and un-bankable structures proposed, in addition to the underlying market failures associated with urban development. The projects submitted as part of the Questionnaire for this Study present diversified level of preparedness, with the majority of them being at the conceptual stage, with very little information available or preparatory works completed. This fact has been taken into account while assessing the probability of project completion for the financial gap assessment. Nonetheless, **successful completion of projects will require proactive support to project promoters.** This statement is in line with market needs expressed by several stakeholders during the interviews carried out for this Study that have raised the issue of, in their opinion, rather passive approach and limited readiness of current UDF managers to assist in project structuring. The MAs might consider utilising an incentive structure to encourage UDF managers to actively source opportunities for external financing from private sector as well as encouraging project promoters to apply for financing through these FIs.

- **Combined use of FIs with grants**

A significant number of projects submitted, especially by the municipalities, have a limited revenue generation potential. This in particular applies to larger and more complex revitalisation programmes where the amount of initial capital expenditure required does not correspond with the revenue to be potentially generated. These projects will experience financing problems, irrespectively of their potential source of funding. Even if grants were available for these types of projects, significant part of municipalities would face difficulties in finding financial resources to cover their own contribution, given the limitation on their

indebtedness level. Therefore, ROPs should provide for combining FIs and private co-investment with grant funding, especially in case of larger-scale urban regeneration of critical social impact for the Region and other pro-development projects (e.g. business environment and R&D implementation in cooperation with private business). The ROPs should also encourage the structures, including a potential UDF set-up, in which part of "soft" costs (eg. preparatory, technical assistance and training) could be financed via grants and "hard" capital expenditure could be funded with FIs. However, as it is mentioned in Partnership Agreement, this approach may create practical difficulties in the implementation phase as foreseen by the Ministry of Infrastructure and Development and will require strong coordination mechanisms to assure complementarity of funding through grants and FIs)[14].

- **Interaction with local financial markets**

Despite the relatively good condition of the Polish banking sector, FIs have a role to play in order to fill a market gap that exists today, in particular in relation to tenors offered and risks accepted by commercial entities. The banking market is liquid and competitive for financing with maturities up to 5-7 years, which most often does not correspond with funding needs of urban development projects. This problem is exacerbated by Basel III requirements on financial institutions that requires higher capital ratios and put further constraints on long-term financing.

However, FIs should be structured in a way that supplements rather than competes or "pushes out" local commercial financial institutions. Several financial instruments available in the market, both on central and local level are believed to have a "push-out" effect on commercial financial institutions. Therefore, while designing the investment strategy, **MAs should carefully consider offering off-market terms and conditions of FIs** (as for instance better than available in the commercial market margins, subordinated positions or potential payment redemptions subject to State Aid eligibility) **and it should be justified by existing financial gap and/or social impact of the project**. In no circumstances, should the off-market terms and conditions of FIs create opportunities for unjustified high returns of project investors. This approach has been adopted while analysing the Case Studies and should be rigorously followed throughout the FIs implementation procedures.

[14] Draft Partnership Agreement (7 June 2013), Ministry of Regional Development p. 87

TABLE OF CONTENTS

1. INTRODUCTION

The purpose of the Evaluation Study conducted is firstly to understand and evaluate the demand for Financial Instruments to support urban and territorial policy in the Nine Polish Regions (Kujawsko-Pomorskie, Łódzkie, Lubelskie, Małopolskie, Mazowieckie, Śląskie, Świętokrzyskie, Wielkopolskie, Zachodniopomorskie) in the 2014-2020 Programming Period and to assess the potential pipeline of urban projects within each Region.

Secondly, this Study assesses the extent to which FIs via loans, equity, and guarantees can accelerate investments in sustainable urban development projects in the 2014-2020 Programming Period. In particular, the Study assesses the potential to combine FIs for urban development projects and other forms of financial support (including ESF and ERDF), with Integrated Territorial Investments and Community-led Local Development to be used at sub-regional level in cooperation with local action groups, as proposed for the Programming Period 2014-2020.

Finally, the Study focuses on designing the optimal architecture to deploy FIs, including through Fund of Funds model or directly by the MA.

The objective of the Study is to support Polish Managing Authorities in the preparation of the 2014-2020 Programming Period in outlining investment strategies and implementation action plan to support the deployment of FIs to support urban development and regeneration.

The Study has been organised under three overarching objectives to allow for a logical and compact approach to address the sub-task activities in order to produce a thorough and insightful report for Polish MAs.

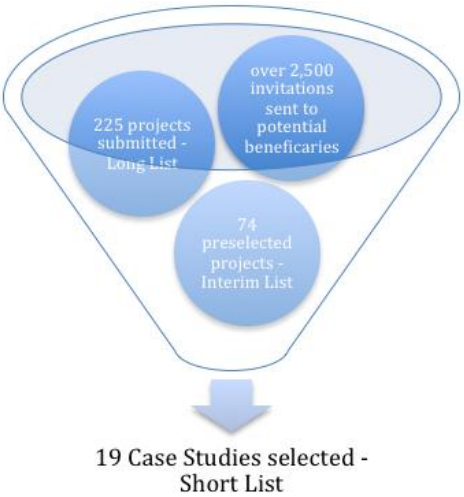
Objective 1: General Context & Evaluation Study Management Methodology (General Section)

The Tasks under Objective 1 were to set the framework for in-depth analysis of Poland in general and within the Nine Polish Regions regarding the possibility of establishing FIs to support urban development and regeneration in the Programming Period 2014-2020. In particular, it focused on analysing the experience to date, i.e. end of August 2013, including the challenges and bottlenecks, of implementing FIs in the current Programming Period, particularly with regards to Polish regions currently implementing FIs under the JESSICA initiative.

Objective 2: Analysis for each Region (Dedicated Study Sections)

The tasks and sub-tasks under Objective 2 focused specifically on the Nine Polish Regions to understand and analyse the potential for FIs, taking into account the specific regional issues. In particular, the sub-tasks aimed to assess the market gaps and the prospective demand for FIs, whilst also identifying eligible urban development projects for financing (including specific priority projects in Regional Operational Programmes that might be subject to dedicated calls for projects on UDF level) as well as providing an assessment of key players who could provide additional co-financing and/or co-investments at both the UDF and project levels. The Study identifies approximately 30 potential urban projects for each Region out of which two to three case studies were selected from a short-list of seven to twelve urban projects by each Regional Working Group for further detailed analysis.

Figure 5: Case Study selection process



As part of the scope under Objective 2 the Project Team also analysed lessons learnt from implementing FIs in the Programming Period 2007 – 2013 (i.e. experience till the end of August 2013 in five Polish Regions that used FIs through the JESSICA initiative) and proposed a viable organisational scheme as well as suggested the thematic and geographic focus for future deployment of FIs.

Objective 3: Conclusions and Recommendations (General Section)

Drawing upon the tasks and sub-tasks under Objectives 1 and 2, the Project Team summarised and synthesised the key findings to produce a series of recommendations for each Region and for Poland in general. This addressed the governance structure of FIs, elaborating on the added value of deploying FIs to support policy objectives, and outlining the FI architecture, as well as key lessons and implications from the previous experience in implementing FIs.

The Project Team conducted tasks within each of the three Objectives presenting them in Inception, Interim or Final Report. Each of the Reports was a continuation of the previous one. Conclusions included in this Final Report are a result of works performed during the entire Study.

Figure 6: Relation between Inception, Interim and Final Report and tasks addressed within the Objectives 1,2 & 3

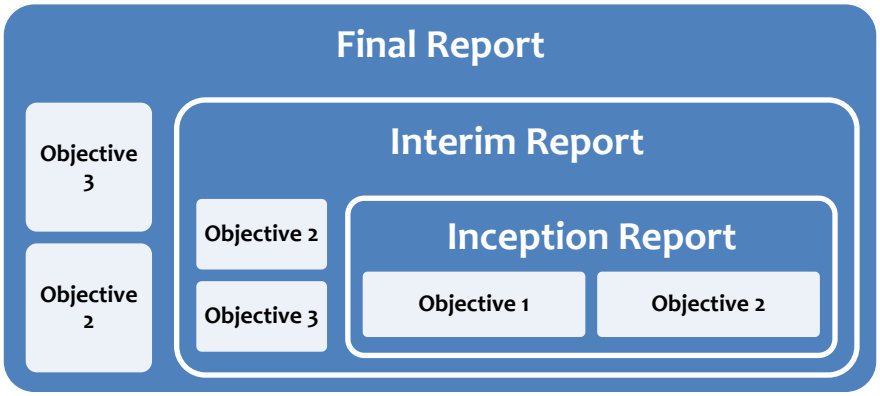
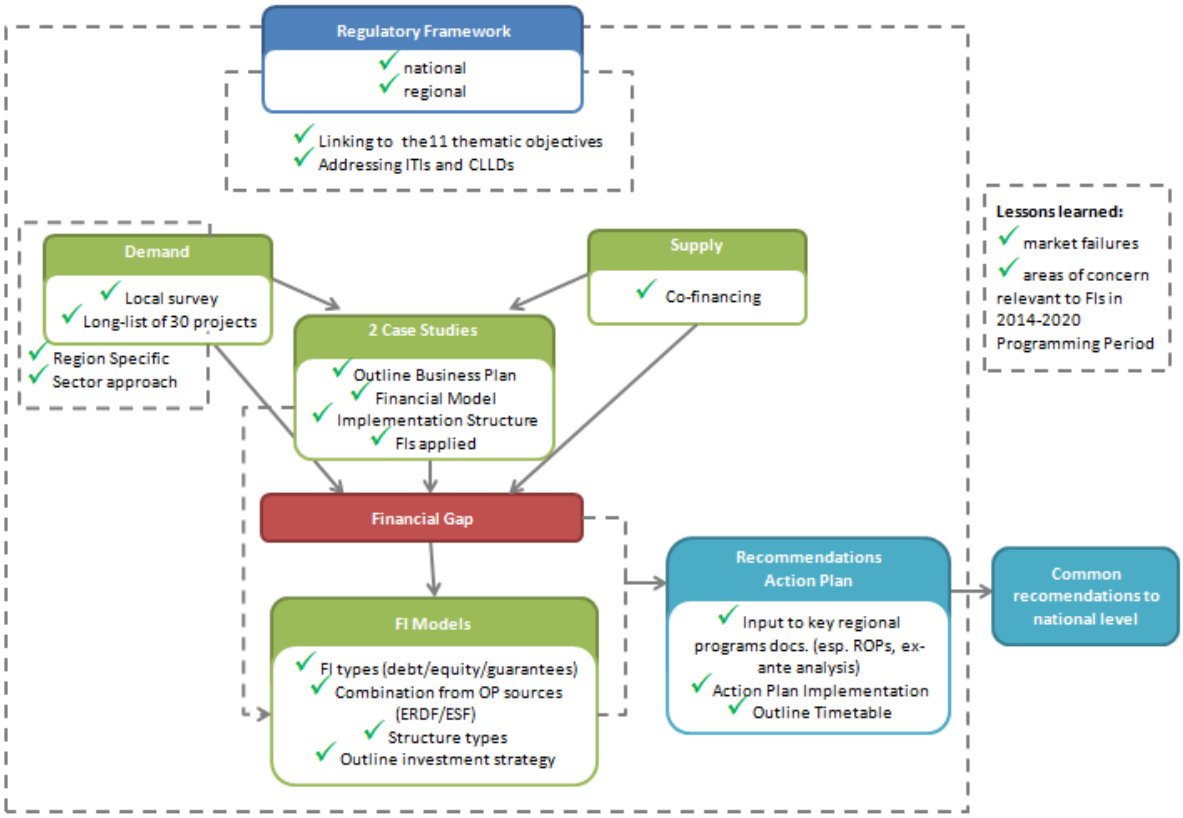


Figure 7: Tasks performed in accordance to the Methodology Approach



2. STRUCTURE OF THE REPORT

The Final Report builds upon the Inception and Interim Reports submitted as part of the tasks and outputs as required for this Evaluation Study.

Part I: General Part provides an analysis of the Polish policy context which include: new EU Programming Period 2014-2020, sectors of a key importance to urban development in the context of 11 Thematic Objectives as well as areas relevant to urban development such as off-balance sheet instruments, and documents on national level such as National Development Strategy, National Urban Policy, Operational Programme and National Strategy of Regional Development. *Part I* also provides information on experience in using FIs as of the end of August 2013 and aggregated results of a Questionnaire conducted by the Project Team. *Part I* also covers assumptions and general conclusions from Case Studies analysis and Financial Gap definition. Detailed analysis of Case Studies including the rationale for the project, project maturity, business plan, funding structure, and financial modelling can be found in Appendix V.

Part II: Regional Part provides an overview of regional strategies with respect to urban and territorial development. Furthermore, Part II provides information on experience in using FIs as of the end of August 2013 for each Region, including analysis of its key players on the FIs supply side. The demand side study is based on the analysis of results of a Questionnaire conducted by the Project Team as well as the review of key regional documents and interviews with the market participants. Finally, Part II gives recommendations and conclusions focusing on suggested FI structure for each Region separately as well as proposed implementation timescale relating to FIs for the next Programming Period.

The Final Report contains **six Appendixes** as follows:

I. Glossary

II. Study Methodology

III. Presentation of the Long List of projects identified in the Regions

IV. Presentation of the Interim List of projects identified in the Regions

V. Case Study Analysis

VI. Literature Review

3 POLAND – GENERAL CONTEXT

3.1 EU Programming Period 2014-2020

3.1.1 Common Strategic Framework & Partnership Agreement

The Common Strategic Framework ("CSF") was published to assist Member States in preparing their 'Partnership Agreements' with the European Commission for the 2014-2020 Programming Period. The CSF sets out the investment priorities and allows for better integration of various EU funds in order to maximise impacts and outcomes, and thereby contribute to the *Europe 2020 strategy: smart, sustainable, and inclusive growth*.[15] The CSF will be the basis for developing the Partnership Agreement between the MS and the EC which outlines the specific intervention needs, and how an integrated approach to the use of European Structural and Investment funds[16] can be used to support various policy objectives, including urban development. Additionally, the Partnership Agreement will also set out the integrated approach to territorial development and the specific arrangements for sustainable urban development. The Operational Programmes will then specify the detailed allocation for thematic objectives through each Priority Axis and the approach for sustainable urban development.

As part of the new framework for the Programming Period 2014-2020, the ESIF can be used to support the following **11 Thematic Objectives,** linked directly to the *Europe 2020 strategy: Smart, Sustainable, and Inclusive growth*, outlined below:

1. Strengthening research, technological development and innovation;
2. Enhancing access to, and use and quality of, information and communication technologies;
3. Enhancing the competitiveness of small- and medium-sized enterprises, of the agricultural sector (with regard to EAFRD) and of the fisheries and aquaculture sector (with regard to EMFF);
4. Supporting the shift towards a low-carbon economy in all sectors;
5. Promoting climate change adaptation, risk prevention and risk management;
6. Preserving and protecting the environment and promoting resource efficiency;
7. Promoting sustainable transport and removing bottlenecks in key network infrastructures;
8. Promoting sustainable and quality employment and supporting labour mobility;
9. Promoting social inclusion, combating poverty and any discrimination;
10. Investing in education, training and vocational training for skills and life-long learning; and
11. Enhancing institutional capacity of public authorities and stakeholders and efficient public administration.

In regards to the Polish context, the Ministry of Regional Development has put together a preliminary Partnership Agreement[17] ("draft Partnership Agreement"), outlining the priority areas for investment through ESIF for the Programming Period 2014-2020, as well as other policy objectives as outlined in the Polish National Development Strategy.

[15] Europe 2020 Strategy: http://ec.europa.eu/europe2020

[16] According to the CPR, the European Structural and Investment (ESI) Funds include: the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF).

[17] As the Partnership Agreement is not finalised, for the purpose of this Study, the Project Team will refer to the draft Partnership Agreement of 7th June 2013.

The draft Partnership Agreement also proposes the responsibility and accountability of the management of the funding between the national government and the regional governments, and outlines a proposed implementation scheme. At a regional level, support will be focused on areas identified under smart specialisations. For example, in the R&D area support will be directed on the national level to the best scientific and educational units and enterprises in the country. Regions, in turn, will focus on enhancing scientific and teaching potential of universities and vocational schools, based on specific social, economic, and geographic conditionality and demand for specific professions.[18] The draft Partnership Agreement provide the conceptual basis for the appropriation of EU ESIF that is subject to changes during the negotiation process between the Polish national government and the EC.

Two out of five Areas of Strategic Intervention ("ASI") are linked directly to the development of cities (in bold)[19]:

- **Voivodeship Cities and their Functional Areas;**
- **Cities and Districts Requiring Revitalisation;**
- Rural areas with the lowest accessibility to goods and services conditioning the development possibilities;
- Eastern Poland;
- Border areas.

Areas of Strategic Intervention	Direction of intervention
Voivodeship Cities and their Functional Areas	Enhancement of metropolitan functions, mainly scientific, social, economic, tourist, and cultural functions
Cities and Districts Requiring the Revitalisation	Integrated revitalisation activities

Source: Draft Partnership Agreement for the Programming Period 2014-2020

The Assumptions to the Partnership Agreement for the Programming Period 2014-2020 have been accepted by the Council of Ministers in January 2013. The draft Partnership Agreement was submitted to the European Commision in July 2013 and is now subject of negotiations between the EC and the Polish government.

3.1.2 2007 – 2013 Programming Period vs. 2014 – 2020 Programming Period

There are a number of changes in the new framework for the Programming Period 2014-2020,[20] compared to the Programming Period 2007-2013 aimed to support the *Europe 2020* strategy, focus on results, and maximise impact of EU funding. It will also have a greater focus on reinforcing territorial cohesion by focusing on sustainable development supported through ITIs, creation of urban development platform, and actions for sustainable development.

The table below summarizes the key approach and models / solutions envisaged in the Programming Period 2007-2013 and 2014-2020 respectively, highlighting its potential impact on financing urban development through FIs. According to Article 37 of the Common Provisions Regulation ("CPR") Financial Instruments may be combined with grants, interest rate subsidies and guarantee fee subsidies. FIs and other forms of support directly related to FIs (including interest rate subsidies, guarantee fee subsidies, technical support) targeting the same final recipients may be combined in a single operation. Final recipients receiving support from FIs may also receive grants or other assistance from programmes / instruments supported by the EU budget whether or not through European Structural and Investment Funds ("ESIF") programmes.

[18] Draft Partnership Agreement of 7 June 2013.
[19] Chapter V of the draft Partnership Agreement.
[20] EU Cohesion Policy 2014-2020: legislative proposals: http://ec.europa.eu/regional_policy/what/future/proposals_2014_2020_en.cfm

Figure 8: Key Changes in the new Programming Period, 2014-2020

	2007-2013 Programming Period	2014-2020 Programming Period
Partnership Agreement	Key EU guidelines for EU support were supposed to promote 3 priorities: 1. Increase attractiveness of Europe and regions in area of investment and employment, in particular improvement in transportation and technical infrastructure 2. Improvement in knowledge and innovation level, in particular investment in R&D, entrepreneurship and IT infrastructure 3. Increase in employment *Source: European Commission, Community strategic guidelines on cohesion, 2006/702/EC , Official Journal of the European Union, 06.10.2006; www.eur-lex.europa.eu*	Need for thematic focus on 11 thematic objectives of Europe 2020 Strategy as described above. *Source: European Commission, Europe 2020 – A strategy for smart, sustainable and inclusive growth, COM (2010) 2020, Brussels, 03.03.2010; www.ec.europa.eu.*
	Key national document in context of EU funding was the National Cohesion Strategy (***Narodowa Strategia Spójności, NSS***) that identified key strategic goal as increase in competiveness of Polish economy via six horizontal objectives: 1. Improving the quality of public institutions and the development of partnership mechanisms - to create favourable conditions socio-economic development; 2. Improving the quality of human capital and social cohesion; 3. Construction and modernization of technical and social infrastructure of key importance to competitiveness of Polish economy; 4. Increasing the competitiveness and innovation of enterprises, especially in the manufacturing sector with high added value and development of the services sector; 5. Increasing competitiveness of Polish regions and preventing their social, economic and spatial exclusion; 6. Improving growth opportunities and supporting structural changes in rural areas. *Source: Ministry of Regional Development, National Cohesion Strategy, Warsaw, 05.2007; www.mrr.gov.pl*	Key national document in context of EU funding is the National Development Strategy 2020 (***Strategia Rozwoju Kraju 2020, SRK 2020***), that identifies **three key objectives** to be supported via EU funding: 1. Increasing the competitiveness of the economy (most funds will be allocated for this purpose); 2. Improving social and territorial cohesion; 3. Efficient and effective state. *Source: Ministry of Regional Development, National Development Strategy 2020, Warsaw, 22.10.2012; www.mrr.gov.pl*
	Objectives for EU cohesion policy: • Convergence (ERDF, ESF, CF) • Regional competitiveness and employment (ERDF, ESF) • European territorial cooperation (ERDF)	**Objectives for EU cohesion policy:** • Investing in growth and employment (ERDF, ESF, CF) • European territorial cooperation (ERDF)
Terms of use of the Structural Funds	**Different eligibility criteria for several funds** The various funds included in the Common Strategic Framework used different eligibility criteria for similar projects. This meant that the potential beneficiaries applying for funding from different sources need to refer to the different sets of rules that required additional time and effort and increased risk level. *Source: European Commission website: www.ec.europa.eu*	**Common eligibility criteria for all funds** Draft Partnership Agreement for 2014-2020 foresee common regulations on eligibility for all funds under the same strategic frameworks. It means that regulations on EU level should be complemented by national regulations using the same priorities. *Source: European Commission website: www.ec.europa.eu*
	Separate programmes for ESF and ERDF The regulations for 2007-2013 required separate programs for the ESF and ERDF, which in some regions complicated coherent investment planning. *Source: European Commission website: www.ec.europa.eu*	**Multi-fund programs** In the Programming Period 2014-2020, Member States will be able to decide on the planning and implementation via one and/or multi-fund programs (combining ESF, ERDF and the Cohesion Fund as per local approach). This should facilitate joint planning and integrated

	2007-2013 Programming Period	2014-2020 Programming Period
		approach to implementation of cohesion policy. *Source: European Commission website: www.ec.europa.eu*
Operational Programmes	The funding from the Structural Funds and the Cohesion Fund is expended under several national and regional operational programmes. Programmes implemented at the national level were: • **Operational Programme Infrastructure and Environment** • **Operational Programme Human Capital** • **Operational Programme Innovative Economy** • Operational Programme Development of Eastern Poland • Operational Programme Technical Assistance • European Territorial Cooperation • **Regional Operational Programmes** • **Development Programme for Rural Areas** • **Operational Programme Sustainable development of the fisheries sector and coastal fishing areas** **ROPs were** an example of a significant decentralization of the management of funding processes. Measures included in each ROP could be crafted to meet development plans of each region separately. *Source: Ministry of Regional Development website; www.mrr.gov.pl*	EU funds will be implemented 8 central programs (including 1 supra-regional program for the Eastern Poland) and 16 regional programs. **The regional programs are planned to „multi-funding"**, i.e. they can fund both „soft projects" (e.g. training) and investment in infrastructure. There will also be programs to support territorial cooperation. **Planned operational programs** will be dedicated to areas as described above, including in particular in context of urban development: • innovation and scientific research, and their links to the enterprise sector; • Territorial Cooperation; • environmental protection, counteracting and adaptation to climate change, transport and energy security; • 16 Regional Operational Programmes. Most important changes result from **wider use of FIs**, especially for support of enterprises. The draft Partnership Agreement proposes to concentrate a large part of the funds on areas of key importance for the development of the country (ASI) as described in point 3.1.2 Common Strategic Framework & Partnership Agreement. *Source: Ministry of Regional Development website;* www.mrr.gov.pl
Integrated Territorial Investments	**No specific regulations addressing ITIs.** *Source: European Commission, Integrated Territorial Investment - Cohesion Policy 2014-2020, The European Commission adopted legislative proposals for cohesion policy for 2014-2020; www.ec.europa.eu*	The main tool dedicated to the support of cities and their functional areas and to **increase the involvement of cities and urban areas in the management of EU structural funds.** • Promotion of co-operation and integrated implementation of joint projects. • Implementation primarily through the multi-thematic priority axes and measures foreseen in RPOs. • Assumed **delegation of management / implementation functions to municipalities**. **At least 5% of ERDF funds to be ring-fenced for implementation of ITIs.**[21] *Source: European Commission, Integrated Territorial Investment - Cohesion Policy 2014-2020, The European Commission adopted legislative proposals for cohesion policy for 2014-2020; www.ec.europa.eu*

[21] Assumptions to the Partnership Agreement for the Programming Period 2014-2020, p.51

	2007-2013 Programming Period	2014-2020 Programming Period
Community-led Local Development	No specific regulations or initiatives to address CLLD. Several previous initiatives, including pilot project **URBAN** (1994-1999), URBAN II (2000-2006) and as well as **EQUAL** (2000-2006) and **LEADER** were addressing local cooperation and might provide valuable know-how. *Source: European Commission, Community-led Local Development - Cohesion Policy 2014-2020, The European Commission adopted legislative proposals for cohesion policy for 2014-2020; www.ec.europa.eu*	**CLLD** will be explicitly introduced as an instrument to promote interventions that can or should be implemented by local communities via **development and implementation of Local Development Strategies (LDS).** The major change to previous instruments (e.g. LEADER) will be increased engagement of cohesion policy funds (ESF and ERDF). **Priority to be given for projects developed jointly by public and private partners** and encompassing large functional areas. *Source: European Commission, Community-led Local Development - Cohesion Policy 2014-2020, The European Commission adopted legislative proposals for cohesion policy for 2014-2020; www.ec.europa.eu*

3.1.3 Integrated Territorial Investments (ITIs)

The territorial dimension of Cohesion Policy will play a crucial role in the next Programming Period at the EU and national levels. ITIs are expected to be the main instrument dedicated to the support of cities and their functional areas. It is assumed that ITIs will be a tool to help increase the engagement of cities and urbanised areas in the management of ESIF: cities and their functional urban areas ("FUAs").

In the case of Poland, ITIs are to be implemented on a mandatory basis in functional areas of 18 voivodeship cities.[22] MAs may also define on a voluntary basis territories of other cities (or their functional areas) of regional and sub-regional status that will qualify for using the ITI approach to urban development. ITIs will be implemented within the ROPs through more than one priority axis. It will be also possible to finance ITI from more than one Operational Programme[23]. **At least 5% of the ERDF funds will be earmarked for integrated actions for sustainable urban development implemented through the Integrated Territorial Investment tool.**[24]

Organisational Arrangements

Pursuant to Article 37 of the CPR, it will be possible to combine grants with FIs under ITIs whenever such solution is appropriate to deliver actions defined in the development strategy.

In terms of operational arrangements, ITIs will delegate management and implementation to cities, with the minimum scope of delegation that should be vested with the city authorities to be the selection of projects for implementation. It is currently envisaged that the tasks of Managing Authority will be delegated to establish municipal associations (at *gmina* and/or *powiat* level) or to other forms of partnerships between the local authorities. Activity of municipal associations should facilitate the implementation of a large number of smaller projects in urbanised areas. The programme of interventions for an ITI must include details of the envisaged tasks covering the thematic areas and issues to be covered under the ITI. Such a programme will require acceptance by the municipal association or another form of partnership and be binding exclusively to the entities forming part of that association. It is expected that integrated portfolios of small projects will be implemented within the framework of ITI.[25]

Figure 9: Proposed directions of intervention under ITI

Directions of intervention	Thematic Objectives
• Sustainable and efficient transport connecting the city with its functional area	4, 7
• Comprehensive revitalisation of selected (degraded) functional urban areas, understood in integrated manner, combining infrastructural, economic, and social actions	6, 8, 9
• Protection of the environment	6
• Energy	4
• Fostering development of symbolic functions, building international character and super-regional city status	6, 8, 9

Source: draft Partnership Agreement, Ministry of Regional Development

[22] Poland has 16 voivodeships, each having its own capital city plus two cities serving as site of *sejmik* (local parliament) for a total of 18 voivodeship cities.
[23] The rules of implementation of the Integrated Territorial Investment in Poland, Ministry of Regional Development, July 2013.
[24] Article 7(4) of the ERDF regulation.
25 Ministry of Regional Development, Programming 2014-2020 Framework - Integrated Territorial Investments, 16.10.2012; www.mrr.gov.pl.

The most important condition for implementation of ITI is an elaboration of ITI Action Plan discussed below.

Figure 10: Attributions of ITI Action Plan

1. The Action Plan of an ITI will be a necessary basis for providing a financial support from a relevant ROP actions/priority axes.
2. ITI defines the territorial vision (strategy from Article 7 ERDF) and indicates the aims and the most important actions/undertakings to be implemented.
3. It is a tool to implement policies in the urban functional area, but it covers those Territorial Self-Governmental Units that expressed their interest in cooperation (the Action Plan should consider the objectives of the regional strategies and work on delimiting functional areas of voivodeship capital cities).
4. ITI should reflect and at the later stage indicate the degree of implementation of the ROP's objectives (intervention in line with the programming logic expected by the EC, including assigning investment priorities, their implementation indicators and monitoring).
5. ITI defines the implementation system (incl. the ITI organisational structure, project selection procedures).
6. It documents the processes and procedures including an engagement of partners in the area it refers to (the process should be transparent).
7. It indicates a list of undertakings (to be implemented under the ITI and complementary undertakings).

Source: Ministry of Regional Development, presentation at the conference City 2013 (18-19 April 2013)

Nationwide Assumption on Implementation of Integrated Territorial Investments

As the Partnership Agreement has not yet been finalised, it is not possible to precisely predict how ITIs will be implemented, what thematic areas will be covered by them, and what institutional entities or what territories will qualify to be involved in the ITI design, development and implementation other than it will be implemented on a mandatory basis in functional areas of 18 voivodeship cities. However, according to the "Guidelines for the Partnership Agreement"[26] it is assumed that the ITIs will be defined as an instrument used and implemented under the ROPs and the management responsibilities for ITI will be located at the regional level (with the Marshall offices).

It is envisaged that tasks and responsibilities related to ITI development and implementation will be transferred to the lower tiers of self-government administration, in particular to the cities, whilst the selection of projects to be implemented under the ITI will be delegated to the municipalities. Therefore, close collaboration between municipalities, regional government, and cities will be a critical success factor for implementation of ITIs. Delegation of tasks to regional or city level enables preparation and implementation of integrated projects that bring together activities financed by ERDF and ESF. It might be expected, that in the next phases of ITI implementation delegation of tasks and responsibilities will become a commonly accepted rule.

Experience gathered so far from different regions indicates that their approaches differ depending on their approaches to territorial cooperation altogether. This issue has important political aspects due to the decentralization of authority and attributed to the rule of subsidiarity. In the cases that the draft ROP for 2014-2020 is already in place, it leaves the ITI management responsibilities at the regional level within institutional arrangements and organizational structures open and to be established at the ROP management phase. Many stakeholders expressed their concerns of potential success of ITIs taking into account generally poor track record of territorial cooperation of Polish self-government units.

[26] This document contains propositions concerning solutions for ITI to be used.

Financing ITIs

The current version of the Partnership Agreement states that ITI will be financed within the ROPs. The allocation for ITI in relation to the total allocation for respective funds for Poland will be at least 5,2% of ERDF and 2,4% of ESF[27].
The allocation between the ITIs implemented in the capital voivodeship cities will be made according to the algorithm taking into account the population living in the mentioned cities and their functional areas[28]. The allocated funds will be transferred to a given region provided that efficient and effective system of implementation of ITI in a voivodeship city (voivodeship cities) is implemented. Programme Reserve Facility resources will serve two purposes:

a) Supporting the implementation of ITIs in the functional areas of voivodeship cities (4,5% of Programme Reserve Facility resources, including ERDF and ESF for financing of the 16 ROPs will be transferred form national to regional level and activated conditionally based on the number of citizens);

b) Supporting the territorial focus of interventions on Areas of Strategic Intervention (3.5% of Programme Reserve Facility resources will be earmarked in the 16 ROPs for implementing integrated regeneration plans (ASI 2) and actions leading to increasing access to basic public services (ASI 3)[29].

In case of regional and sub-regional cities, the funds will come from the allocation under specific OPs (on both national as well as regional levels) and will be classified based on priority axes and actions[30]. ITIs may also take allocations from the ESF to support interventions that have specific social dimensions such as combating urban poverty or exclusion. The EC encourages combining ERDF and ESF in particular in sustainable urban development projects implemented under ITIs. The argument for such an approach is that combining ERDF, ESF and Cohesion Fund allows financing soft investments linked to the investment in physical infrastructure that is relevant to sustainable urban development.[31] According to the EC, the co-ordinated use of funds is important in areas, where complementarities of funds are critical to efficient investment: health, education, entrepreneurship, urban development and public administration reforms. The extent to which ESF funds will be used within the ITI will depend on the Partnership Agreement and each ROP as well as the intervention types for respective Functional Urban Areas.[32]

Organizational framework for ITI design and implementation

Activities that fit under ITI and are dedicated to 18 cities and their functional urban areas will be distinguished in the form of separate multi-thematic priority axes as the activities implemented under the ROPs. Selection of the ITI and financing of their implementation shall respond to Regions' needs and take into account specificity of development conditions and potential as seen by the MA.

As mentioned above, support for ITI will be focused on these thematic areas that are financed from ERDF and ESF. These are activities that, in accordance with the subsidiarity principle, will be implemented at the regional level.

Figure 11 provides the various approaches to ITI design and implementation, and current state of preparation to perform activities related to ITI design and implementation by Region.

[27] Partnership Agreement for the Programming Period 2014-2020, p. 156.
[28] The rules of implementation of the Integrated Territorial Investment in Poland, MID, July 2013.
[29] Ministry of Regional Development, presentation at a conference "City 2013", 18-19 April 2013.
[30] Draft Partnership Agreement, Ministry of Regional Development.
[31] European Commission, Cohesion Policy 2014-2020, Factsheets.
[32] European Commission's Factshhet on ITIs
(http://ec.europa.eu/regional_policy/sources/docgener/informat/2014/iti_en.pdf).

Figure 11: Approach to and status of ITIs implementation by Region

ITI concept implemen - tation / Region	Approach to implementation of territorial policies	General predominant nature / features of ITI / strategic importance	Types of areas for ITI implementation / ITI location	Planned types of projects under ITI
Kujawsko-Pomorskie	- Different territorial levels for ITI implementation considered: regional, sub-regional (powiat), and local levels; - different sources of funds distinguished; - ITI is addressed in assumptions to Regional Development Strategy	Common projects of Toruń and Bydgoszcz; metropolitan revitalisation; incentives for metropolitan cooperation and development of metropolitan futures in bi-pole of Toruń and Bydgoszcz	Main cities and regional urban centres	Not decided yet, probably: technical infrastructure, road infrastructure between Toruń and Bydgoszcz, urban regeneration, culture and cultural heritage protection, touristic attractiveness of Toruń
Lubelskie	ITI is addressed in the draft ROP 2014-2020	Investment under activities: - clean energy - regional mobility and sustainable low-impact transport	Main cities and regional urban centres	Investments in the heating systems in cities to promote energy friendly solutions; "passive building" – development of new trends in housing construction, environmental protection and sustainable transport
Łódzkie	No information available	Urban regeneration of strategic importance for the city of Łódź	No information available yet, City of Łódź (obligatory), Piotrków Trybunalski and Skierniewice still being discussed as potential regional urban centres to be supported	No information available
Małopolskie	The areas supported under ITI will be divided into sub-areas, covered by one sub-regional development programme	No information available	Main city - Kraków, probably other regional urban centres	Urban regeneration, other types of projects are being considered
Mazowieckie	ITI is addressed in the draft ROP 2014-2020	Implementation of ITI at the regional level, in co-operation with cities Project appraisal and selection at the city level, by the association founded for this purpose	Main city - Warsaw and regional urban centres (Radom, Skierniewice)	Wide range of projects: urban regeneration, energy, waste management, regional mobility, horizontal issues, employment

Śląskie	The areas supported under ITI will be divided into 4 sub-areas, each of them will be covered by a sub-regional strategy.	Selection of projects at the regional level.	Main cities and regional urban centres	Wide range of projects: integrated transport, urban regeneration, competitiveness of SMEs, environmental protection, vocational education, waste management, energy efficiency and renewable energy, social inclusion
Świętokrzyskie	ITI is addressed in the draft ROP 2014-2020	Implementation at the regional level (MA), the role of cities limited to project appraisal and selection	Main city – Kielce	Urban Regeneration, Transport, R&D, Energy
Wielkopolskie	Contribution to establishment of cooperative relationships between Poznań as centre of the Poznań Metropolitan Area and other municipalities from urban functional area.	No information available	The city of Poznań and Poznań Metropolitan Area.	Framework for activities strengthening development of Poznań Metropolitan Area, Projects encouraging the cooperation among municipalities from the urban functional area. Development of integrated parking system.
Zachodnio-pomorskie	Conceptual activities focused on delineation of the urban functional area. Identification of internal relationships within urban functional area.	The cities will be responsible for selection and implementation of projects. The list of projects selected by the cities will be subsequently accepted by MA.	Municipalities of the Szczecin Metropolitan Area Koszalin and Kołobrzeg as one joint functional area	Main focus of envisaged projects: - economy, - infrastructure.

3.1.4 Community-led Local Development (CLLD)

Based on the LEADER[33] approach, Community-led Local Development is a new instrument under in the Programming Period 2014-2020. CLLD is designed to facilitate the implementation of "bottom up" local development initiatives financed from the five ESIF. These initiatives are to be implemented by local communities, known as Local Action Groups ("LAG") who are responsible for the development and implementation of the Local Development Strategy. The LDS should clearly outline the objectives, development needs, geographical areas, targets/outputs, as well as an action plan and financial plan. The main types of interventions to be included in CLLDs are the following:

- stimulating local entrepreneurship through, among others, development of non-agricultural and processing activity;
- making use of information and communication technologies ("ICT") for the development of tourism;
- promotion and marketing of local products[34].

The instrument implementation design provides for preferences for projects implemented in co-operation with public and non-public partners and with the maximum possible outreach within the functional area.

As CLLD is a multi-fund tool, it is possible to use all the ESI Funds (except the Cohesion Fund) in order to address the main challenges, objectives and priorities. Support can be granted to areas with a population ranging from 10,000 to 150,000 inhabitants.

The main difference between CLLD and ITI is that the former is a "bottom up" approach implemented by the local action group that determines the content of the local development strategy and the operations financed under it. In the case of ITI, it is not important how decisions are taken – this process may be top down, or bottom up, or a combination of the two. CLLD can be one component of an integrated urban strategy implemented through an ITI[35]. CLLD is optional for the ERDF, the ESF, the EMFF, and it is compulsory for EAFRD. In Poland, CLLD will be supported by the ROPs, the operational program for rural development and the operational program for the development of marine and fishing. The MAs will determine areas in which they intend to support CLLD.

The Ministry of Infrastructure and Development is currently developing guidelines on detailed rules for financing CLLD under the ROPs and the Regions are awaiting these guidelines.

3.1.5 Demarcation Rules

Detailed regulations on the demarcation line between the ROPs and central level OPs are being currently developed by the Ministry of Infrastructure and Development. At this juncture, there is limited information available. There are four main sectors that will be subject to demarcation and that are most relevant to urban development:

- Transportation: The interventions in transport in the urban areas will have a complementary character to the projects supported on the central level. There will be probably no resources for the purchase of trains and buses but rather for such investments as intelligent transport systems, park & ride or bicycle routes that supports integrated urban and regional development.

33 LEADER: Liaison Entre Actions pour le Développement de l'Economie Rurale – Links between the rural economy and development actions.
34 Assumptions to the Partnership Agreement, Ministry of Regional Development, 2013, p.48.
35 European Commission, Cohesion Policy 2014-2020, Factsheets.

- Healthcare: The local intervention in the healthcare sector should be limited to institutions (hospitals) for which the local government unit (MA or municipality) is a funding body.
- Sustainable energy and energy efficiency: The investments in the sustainable energy and energy efficiency projects will be supported on the regional level up to a certain limit to be agreed later in 2013. Taking into account that most of projects submitted in response to the Questionnaire in this sector are of smaller value (besides larger-value WtE installation submitted by the municipality of Tarnów[36]), this should not create significant problem while preparing FIs interventions on regional levels.
- Business Environment and R&D: It is our understanding that in case of R&D, local interventions will be limited to support the cooperation between regional scientific institutions with local businesses to promote smart specialization of the region as well R&D commercialization.

Based on the initial discussions with the Regions these four sectors will be covered both on a central as well as on a regional level and the exact demarcation for the Programming Period 2014-2020 is to be decided later in the year. The main project types that could be implemented within FIs, on the regional level will presumably concentrate on following thematic objectives: 1, 2 ,3, 4, 6, 9 and 10.

3.1.6 Ex-ante evaluation of ROPs and Ex-Ante Assessment of FIs

At the completion date of this Study, the works on ROPs have still been in progress. The first versions of ROPs should have been prepared until the end of April 2013 and the final versions are to be presented to the Council of Ministers in December 2013. As of the end of September 2013, all nine Regions in this Study have prepared draft versions of their ROPs. The status of works performed on ROPs in all the Regions has been described in detail in Dedicated Regional Sections of this Study.

As of mid 2013, five regions have already started the ex-ante evaluation of their respective ROPs that is required by the Article 55 of the CPR.

Figure 12: Key features of ex- ante evaluation

1. Member States shall carry out *ex-ante* evaluations to improve the quality of the design of each programme.

2. Ex-ante evaluations shall be carried out under the responsibility of the authority responsible for the preparation of the programmes. They shall be submitted to the Commission at the same time as the programme, together with an executive summary. The Fund-specific rules may establish thresholds under which the *ex-ante* evaluation may be combined with the evaluation for another programme.

3. Ex-ante evaluations shall appraise:

(a) the contribution to the Union strategy for smart, sustainable and inclusive growth, having regard to the selected Thematic Objectives and priorities, taking into account national and regional needs and potential for development as well as lessons drawn from previous programming periods;

(b) the internal coherence of the proposed programme or activity and its relationship with other relevant instruments;

(c) the consistency of the allocation of budgetary resources with the objectives of the programme;

(d) the consistency of the selected Thematic Objectives, the priorities and corresponding objectives of the programmes with the Common Strategic Framework, the Partnership Agreement and the relevant country-specific recommendations adopted in accordance with Article 121(2) of the Treaty on the Functioning of the European Union and where appropriate at national level, the national reform programme;

[36] A PLN 500-650 M regional Waste-to-Energy plant submitted by the city of Tarnów in response to the Questionnaire.

(e) the relevance and clarity of the proposed programme indicators;

(f) how the expected outputs will contribute to results;

(g) whether the quantified target values for indicators are realistic, with regards to the support from the ESI Funds envisaged;

(h) the rationale for the form of support proposed;

(i) the adequacy of human resources and administrative capacity for management of the programme;

(j) the suitability of the procedures for monitoring the programme and for collecting the data necessary to carry out evaluations;

(k) the suitability of the milestones selected for the performance framework;

(l) the adequacy of measures planned to promote equal chances for men and women and to prevent any discrimination, in particular as regards the acccessibility for persons with disabilities;

(m) the adequacy of planned measures to promote sustainable development;

(n) measures planned to reduce the administrative burden of beneficiaries.

4. Ex-ante evaluations shall incorporate, where appropriate, the requirements for Strategic Environmental Assessment set out in implementation of Directive 2001/42/EC of the European Parliament and of the Council of 27 June 2001 on the assessment of the effects of certain plans and programmes on the environment, taking into account climate change mitigation needs.

Source: Article 55 of the CPR.

Ex-Ante Assessment of FIs has to be carried out before the MA decides to make a programme contribution to FI. Ex-Ante Assessment of a FI can follow closely the programming exercise (including the ex-ante evaluation of a programme).

Ex-Ante Assessment does not have to be carried out before the adoption of the programme; thus it does not need to be a part of the ex-ante evaluation of a programme. Since FI is in fact a mean to deliver OP support, the Ex-Ante Assessment of FI should take place only when the Thematic Objectives, target beneficiaries and key delivery structures are defined in the OP (i.e. programming and its ex-ante evaluation process should be advanced). It should also be noted that there is no formal deadline to submit the Ex-Ante Assessment and it shall be completed and submitted to the Monitoring Committee for information purposes before the MA decides to make contributions to FIs. It should be published within three months from its date of finalisation. Detailed description of Ex-Ante Assessment procedure has been presented in chapter 10.1. "Ex-Ante Assessment for Financial Instruments".

Figure 13: Key features to be covered through ex- ante assessment for FI

Support of financial instruments shall be based on an ex-ante assessment which has established evidence of market failures or sub-optimal investment situations, and the estimated level and scope of public investment needs, including types of financial instruments to be supported. Such ex ante assessment shall include:

(a) An analysis of market failures, suboptimal investment situations, and investment needs for policy areas and thematic objectives or investment priorities to be addressed with a view to contribute to the achievement of specific objectives set out under a priority and to be supported through financial instruments. This analysis shall be based on available good practice methodology.

(b) An assessment of the value added of the financial instruments considered to be supported by the European Structural and Investment Funds, consistency with other forms of public intervention addressing the same market,

possible state aid implications, the proportionality of the envisaged intervention and measures to minimise market distortion.

(c) An estimate of additional public and private resources to be potentially raised by the financial instrument down to the level of the final recipient (expected leverage effect), including as appropriate an assessment of the need for, and level of, preferential remuneration to attract counterpart resources from private investors and/or a description of the mechanisms which will be used to establish the need for, and extent of, such preferential remuneration, such as a competitive or appropriately independent assessment process.

(d) An assessment of lessons learnt from similar instruments and ex ante assessments carried out by the Member State in the past, and how these lessons will be applied going forward.

(e) The proposed investment strategy, including an examination of options for implementation arrangements within the meaning of Article 38, financial products to be offered, final recipients targeted, envisaged combination with grant support as appropriate.

(f) A specification of the expected results and how the financial instrument concerned is expected to contribute to the achievement of the specific objectives set out under the relevant priority including indicators for this contribution.

(g) Provisions allowing for the ex-ante assessment to be reviewed and updated as required during the implementation of any financial instrument which has been implemented based upon such assessment, where during the implementation phase, the managing authority considers that the ex-ante assessment may no longer accurately represent the market conditions existing at the time of implementation.

The ex-ante assessment may be performed in stages. It shall, in any event, be completed before the managing authority decides to make programme contributions to a financial instrument.

The summary findings and conclusions of ex-ante assessments in relation to financial instruments shall be published within three months from their date of finalisation. The ex-ante assessment shall be submitted to the monitoring committee for information purposes in accordance with Fund-specific rules.

Source: Article 37(2) and (3) of the CPR.

This Study can be used as a source of information for the Ex-Ante Assessment but should not be used as a substitution for the Ex-Ante Assessment. MAs can use the findings in this Study whilst carrying out the Ex-Ante Assessments in line with Article 37 of the Common Provisions Regulation.

3.2 Poland National Context

This section provides an overview of the national strategies relevant to this Study. It begins with a descriptive overview of the National Development Strategy, mapping the key policy objectives to the 11 Thematic Objectives where possible. It also provides a background on the National Urban Policy as well as the National Spatial Development Concept. Together, these national level strategies will feed into the broader discussions in the Dedicated Regional Sections.

3.2.1 National Development Strategy 2020

The starting point for preparing the Partnership Agreements for the Programming Period 2014-2020 in Poland is the **National Development Strategy 2020 ("NDS 2020")**[37] which outlines the three key policy themes:

1. Increasing economic competitiveness (the objective will be allocated proportionately the highest amount of funds);

[37] National Development Strategy, MID, Poland: http://www.mrr.gov.pl/english/regional_development/development_policy/nds_2020/strony/default.aspx

2. Enhancing social and territorial cohesion; and
3. Efficient and effective state.

The NDS 2020 has been adopted by the Council of Ministers on 25 September 2012, and an updated NDS for 2007-2015 was adopted on 29 November 2012, in order to address the changing economic conditions as well as to provide strong alignment to other strategic documents under development.

In the table below, the aims under each policy themes within the NDS 2020 are mapped to the 11 Thematic Objectives discussed in 4.1: *Common Strategic Framework & Partnership Agreement, 2014-2020.*

Figure 14: Mapping National Development Objective to the 11 Thematic Objectives

Polish National Development Strategy 2020	2014-2020 11 Thematic Objectives
1. Improving Economic Competitiveness	
• Innovation and links between R&D and enterprises (e.g. through increased concentration of research; support of intellectual property rights)	1. Supporting scientific research, technological development and innovation
• Digital development (e.g. provision of access to high-speed broadband Internet; development of e-economy; development of digital competences, in particular with children and youth).	2. Increasing accessibility, scale of utilisation and quality of information and communication technologies
• Increasing energy efficiency; diversification of energy sources, development and modernisation of transmission and distribution networks	4. Supporting transition to low-emission economy in all sectors
• Road and rail connection	7. Promotion of sustainable transport and improvement of network infrastructures
• Development of human capital, (e.g. life-long learning and improving university education)	10. Investing in education, skills and life-long learning
• Corporate investment (involving greater than before utilisation of non-grant FIs)	11. Strengthening institutional capacity and performance of public administration
2. Enhancing Social and Territorial Cohesion	
• Digital inclusion (e.g. at risk of exclusion)	2. Increasing accessibility, scale of utilisation and quality of information and communication technologies 9. Supporting social inclusion and combating poverty
• Economic development of rural areas (e.g. through facilitating opportunities for undertaking employment outside agriculture; increasing vocational mobility of the inhabitants; increasing accessibility and quality of education, health care and culture in those areas)	3. Enhancing the competitiveness of small- and medium-sized enterprises of the agricultural sector (with regard to EAFRD) and fisheries and aquaculture sector (with regard to EMFF)
• Improving the quality of the natural environment	6. Protection of the natural environment and supporting efficient resource use
• Increasing transport accessibility by connecting the smaller transportation hubs with the TEN-T infrastructure (target of max. 60 minutes travel time to any voivodeship city)	7. Promotion of sustainable transport and improvement of network infrastructures
• Increasing accessibility and quality of education at various levels (including preschool education) and increasing vocational activity (e.g. adjustment to labour market needs)	8. Supporting employment and labour mobility
• Regeneration/renewal programmes and prevention of socio-economic decline in urban areas and selected city districts	9. Supporting social inclusion and combating poverty
• Increasing the level of employment, and particularly among the groups disfavoured in the labour market (e.g. young, with disabilities, aged 50+); and aiming to reduce the threats of poverty and social exclusion	9. Supporting social inclusion and combating poverty 10. Investing in education, skills and life-long learning
3. Improving the efficiency and effectiveness of the state	
• Improving the quality of law-making	11. Strengthening institutional capacity and performance of public administration
• Partnership of public, social and private entities	
• Opening up of public resources (e.g. digitisation of cultural, scientific and education heritage; public information access)	
• Public e-services	

The NDS 2020 proposes concentration of funding support in key strategic areas that are important to the overall economic development of Poland, known as Areas of Strategic Intervention and described in point 3.1.2 Common Strategic Framework & Partnership Agreement. ASIs will be specified in national and regional programmes, for example within separate priority axes or interventions dedicated such areas. A separate programme will be designed for Eastern Poland.

3.2.2 Operational Programmes

EU Cohesion Policy in Poland is expected to be implemented through 8 operational programmes implemented at national level, one supra-regional operational programme covering the voivodeships of Eastern Poland and 16 regional operational programmes. The regional operational programmes will be "dual-funded" programmes (ERDF and ESF), meaning that the funds are available for financing of both "soft costs" (e.g. training, feasibility studies) and "hard investments" in the infrastructure and other major urban projects. The plan also provides for implementation of territorial co-operation programmes.

The planned OPs for the Programming Period 2014-2020 include:

- Programme for innovation and scientific research, and their links to the enterprise sector;
- Digital development programme;
- Programme for Eastern Poland;
- Technical assistance programme;
- Territorial co-operation programmes;
- Programme for environmental protection, counteracting and adaptation to climate change, transport and energy security;
- Operational programme for development of competencies and skills, social inclusion and good governance;
- Programme for development of rural areas; and
- Programme for development of maritime and fisheries areas (EMFF);
- 16 Regional Operational Programmes.

The most significant changes proposed in the new legislative framework for 2014-2020 as discussed earlier in point 3.1.3. 2007 – 2013 Programming Period vs. 2014 – 2020 Programming Period is the greater use of FIs in all 11 Thematic Objectives where feasible and subject to an Ex-Ante Assessment; as well as the new territorial instruments, such as the ITIs and CLLDs. Both will have implications on how the ROPs are structured and designed for the next Programming Period.

3.2.3 National Urban Policy 2020

The **National Urban Policy 2020** is concerned with Poland's functional urban areas in accordance with the classification proposed by the National Spatial Development Concept 2030[38]. These FUAs include voivodeship centres (including metropolitan centres), regional centres, sub-regional centres and local centres. Instruments and actions undertaken in relation to the respective types of FUAs are differentiated in such a way to take into account the specific needs and development potential of such areas.

[38] National Spatial Development Concept 2030: http://www.mrr.gov.pl/english/Regional_Development/Spatial_Policy/NSDC_2030/Strony/default.aspx

The National Urban Policy 2020 is implemented in accordance with the following principles:

I. The integrity principle: subordination of national urban policy to development policy;

II. The integrated territorial approach principle; and

III. The multi-level governance principle.

In accordance with the integrity principle, the national urban policy forms part of the development policy, and objectives, tasks and instruments are closely linked to the national development policy objectives, as outlined in the Medium-term NDS and the Long-term NDS.

The integrated territorial approach principle aims to improve the coordination of resources to achieve greater impacts, including human resources, and specialisation of the respective types of urban centres.

The multi-level governance principle involves: close co-operation and coordination of measures between the national government, the voivodeship regional governments, and the local self-governments; as well as horizontal cooperation between territorial government units and other entities in a FUA.

Figure 15: The key urban policy challenges in context of the National Urban Policy 2020

The key urban policy challenges		**Assumptions to the National Urban Policy 2020**
Utilising the potential of major urban centres and of their functional areas for growth and employment creation and boosting national development	⇦	Increasing the capabilities of cities for creation of development, growth and employment
Utilising the potential of cities in regional development processes in the problem areas of national importance	⇦	Supporting the development of the problem areas (including some rural areas) in regional policy through supporting the functions of small- and medium-sized cities and preventing their economic decline
Improving land management in urban areas and restraining spontaneous suburbanisation;	⇦	Supporting sustainable development of urban centres, including restraining suburbanisation;
Improving the quality of management and co-operation in urban areas, including FUAs;	⇦	Creating conditions for efficient, effective and partner-based management of the urban areas development, in particular the metropolitan areas.
Transport infrastructure, including public transport in urban areas, in particular integrated public transport system, which satisfies the energy conservation and low-emission requirements.		
		Rebuilding urban development capacity through regeneration of socially, economically and physically degraded urban areas

Source: Study on the basis of materials published by the Ministry of Infrastructure and Development, National Urban Policy 2020.

3.2.4 National Strategy of Regional Development, 2010-2020

The **National Strategy of Regional Development ("NSRD")** aims to promote economic competitiveness in Poland's major urban centres, i.e. voivodeship cities. Capitalising on each voivodeship city's economic advantages, the NSRD outlines ways in which to support and promote investments in key areas such as for example SME development, infrastructure development, education, and R&D. Major urban centres can play a greater role in attracting investments and be a major player in the European market if they undertake appropriate organisational and investment measures.

All the voivodeships have well developed and relatively even distribution networks of medium-sized cities (above 20,000 inhabitants) performing essential functions of sub-regional and regional scale. These are of major importance in regional economies as well as in the provision of public services. The regional policy will act to increase the economic and social significance of such cities in order to ensure more efficient use of the region's potential. Such geographically targeted support for medium-sized cities will involve:

- Projects supporting spatial, social and economic integration of medium-sized urban centres and of their surrounding areas (mainly rural) through expansion and modernisation of transport infrastructure and public transport systems;
- Supporting comprehensive plans to increase availability and operational efficiency of institutions supporting the labour market, development of human and social capital, provision of finance for businesses, improving the quality and scope of business-related services, as well as development of economic functions of supra-local impact, including administration, tourism, and environmental protection;
- Development and enhancement of high quality public services, involving primarily: secondary and higher vocational education; health care (particularly in the area of specialist medical services); and culture services addressed to the local population; and
- Development and modernisation of technical infrastructure to improve location attractiveness to enterprises utilising the unique local potential of particular specialisation and drawing on human, environmental, cultural or other resources.

The support for development of sub-regional cities covers the entire territory of Poland, but it is of greatest significance in sparsely populated areas, with majority of rural populations and weak networks of medium-sized cities, such as the North-Eastern Poland or the Central Pomerania.

More information on the specific regional issues regarding the Nine Regions can be found in Part II of this Study.

3.2.5 National Spatial Development Concept 2030

National Spatial Development Concept ("NSDC") 2030 incorporates the provisions to increase the competitiveness of Poland's major urban centres through their functional integration and spatial organisation. In view of the identified development issues and opportunities, the spatial policy measures supporting competitiveness Poland's major cities include:

- Supporting development of the metropolitan functions of major urban centres;
- Intensifying functional links between the main nodes of the settlement network in the national and international dimension; and
- Integration of the functional areas of the country's major urban centres.

The measures supporting the development of metropolitan functions will be adjusted to the baseline situation of respective urban centres. At present, metropolitan functions are best developed in ten centres, of which Warsaw stands out. Within the framework of the spatial policy, voivodeship cities will be provided on priority basis with improved quality public services and with scientific, economic (particularly in the area of knowledge-based economy) and symbolic functions of national and international importance[39]. Therefore, measures will support strengthening the knowledge and innovation based economy, with focus on R&D, information and communication technology, and facilitating co-operation between higher education and industry. Promoting urban centres with historical and cultural significance will also be supported under the strategy.

The spatial policy measures supporting the economic development objectives will be focused on the capital city Warsaw in order to promote Poland as a major player in Europe. The measures supporting the development of the metropolitan functions of the other voivodeship cities include: strengthening and diversification of their economic functions through creation of conditions to locate investments in high value-added sectors.

NSDC provides for intensification of functional links between the growth centres in the country. Also, particular attention will be paid to intensification of links between metropolitan centres and regional centres, which are to complement the polycentric network of the metropolitan areas in the future. One challenge with the contemporary urbanisation processes in Poland is **the incoherent development of the functional areas of the major urban centres**. The suburban zones of those centres experience escalating spontaneous suburbanisation, which can lead to for instance: degradation of natural environment; loss of settlement and investment attractiveness; and increased flooding risk.

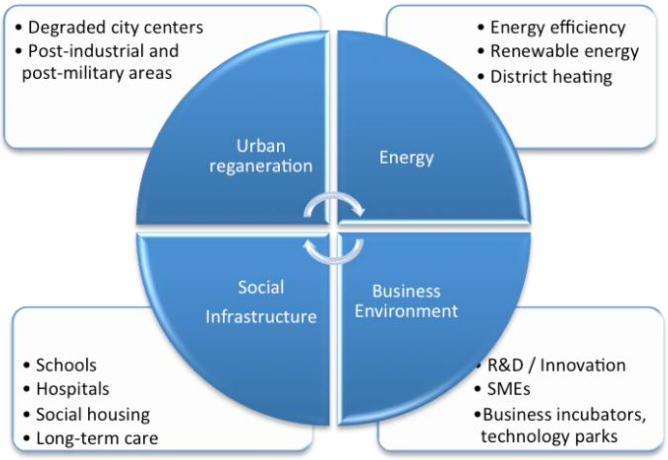
In case of FUAs, the integrative measures will concentrate on adoption of regulations enabling implementation of integrated spatial policy in those areas. It is expected that solving urban governance issues and the development of public transport will have a positive impact on the growth of economically strongest centres and their functional areas, i.e. the main population concentration areas as Warsaw metropolitan area, the Upper Silesian metropolitan area and the Tri-City metropolitan area. The development plans and strategies of FUAs should take into account in particular: the need for sustainable mobility within those areas; the need for protection of environmentally valuable areas; the need for controlled and integrated sustainable development; as well as the need for preservation of public access areas.

3.3 Sectors Relevant to Urban Development

The Project Team took a sectoral approach to identify urban projects that might be relevant to the Regions and focused on four strategic areas of significant importance to urban development in Poland, namely: urban regeneration, social infrastructure, energy and business environment. This sectoral approach was followed in the Questionnaire to identify and classify projects to one of the following areas.

[39] Ministry of Regional Development, *The National Spatial Development Concept 2030*, 13.12.2011; www.mrr.gov.pl.

Figure 16: Sectoral approach to identify projects in Regions



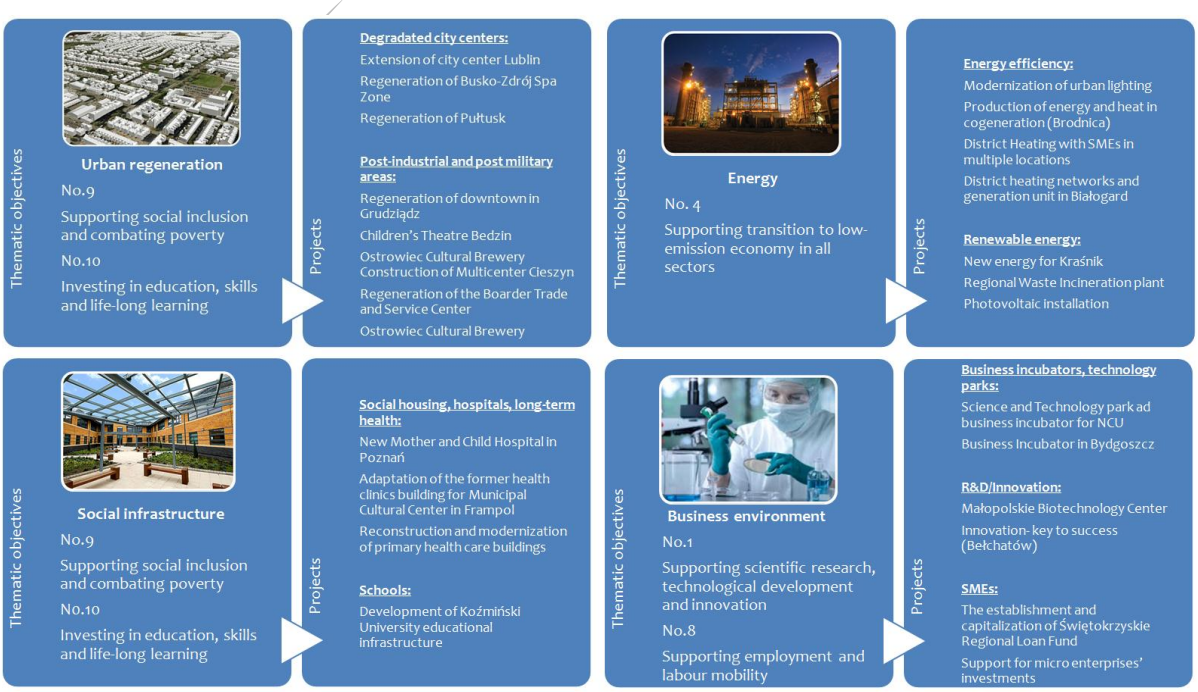
3.3.1 Mapping Sectors Relevant to Urban Development with Thematic Objectives

The need to use FIs to increase investment level to cover all 11 Thematic Objectives is explicitly mentioned in the key EU policy documents, including *Europe 2020*. Hence it is of key importance to link the potential use of FIs across the sectors in a way that covers 11 Thematic Objectives.

The four sectors and 11 Thematic Objectives can be linked as follows:

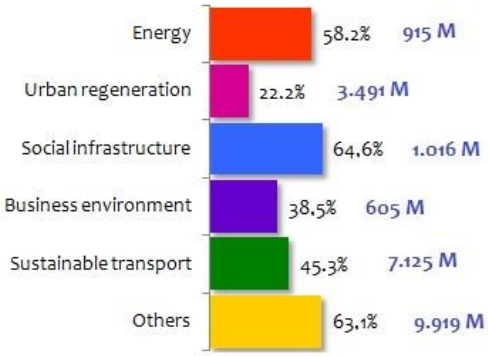
- urban regeneration is related as a cross-cutting theme to various Thematic Objectives as for instance: Objective no. 4, 7, 8 and 9;
- social infrastructure is related to the Objectives no. 8, 9 and 10;
- energy is related to the Objective no. 4; and
- business environment is related to the Objectives 1 and 3.

Figure 17: Link between the four strategic areas and 11 Thematic Objectives with sample projects submitted



The sectoral approach to identification of potential projects adopted by the Project Team proved to fit the purpose of diversity and focus on thematic objectives and the projects submitted by respondents have good coverage across all strategic areas.

Figure 18: Distribution of projects across sectors by value of projects submitted (% of projects in each sector in entire project population)*



** Note: some projects submitted represent complex regeneration effort and fall within more than one sector category, e.g. a complex building refurbishment (urban regeneration) with thermomodernisation (energy) or a regeneration of degraded city area (urban regeneration) with subsequent use as a technology park and R&D centre (business environment).*

The Project Team identified potentially viable projects with significant potential in urban development in each of four strategic areas and most of identified sub-sectors.

Figure 19: Number of project applications in each sector in the Questionnaire

98	Urban regeneration	Energy	23
28	Regeneration of post-industrial and post-military areas	Energy efficiency	13
		Waste-to-energy	2
		Photovoltaic	11
43	Complex modernisation of devastated buildings	Other renewables	8
		District heating	9
48	Others	Others	3
49	**Social infrastructure**	**Business environment**	**24**
14	Schools/ kindergartens	B&R / innovation	7
1	Hospitals / long-term care	SME	8
11	Social housing	Business incubators / business parks	16
23	Public buildings		
15	Others	Others	7
20	**Sustainable transportation**	**Others**	**58**

Note: Some projects have been classified into more than one category, and hence the sum of projects after counting all categories exceeds the total number of 225 projects submitted.

3.3.2 Key characteristics of several sub-sectors in the context of potential market needs

Energy efficiency: None of Polish UDFs has been structured as a classic renewable/energy efficiency fund despite a large potential in this market segment, although it is worth mentioning that energy efficiency was an area of intervention in two Regions (Mazowieckie and Pomorskie) and in Mazowieckie a part of funds entrusted to the UDF was dedicated exclusively to energy investments. Taking into account the significant challenges faced by Polish municipalities as a result of the need to reduce the carbon footprint, the Study covered extensively use of FIs in energy efficiency projects, including initiatives such as energy saving companies / energy service companies ("ESCOs"), PPPs and other transaction structures that allow for an off-balance sheet treatment of investments. Several Polish municipalities expressed interest in the models to be used particularly for public buildings and street lighting, subject to off-balance sheet structure of solutions adopted. The sector creates also potential for larger-scale comprehensive projects as an energy efficiency PPP project for public schools in the city of Radzionków developed in cooperation with Siemens[40]. Many projects in this category represent revenue generating projects with healthy economic rationale and some of them need only mild intervention to help them unlock. In some cases, a mere contribution of initial phase equity (along with the project developer) and FIs mitigating to certain extent the construction and market risks mostly feared by commercial lenders (especially electricity price and changes in the support system) can make these projects bankable. One of challenges in implementation of thermomodernization projects through JESSICA in Poland in the current Programming Period resulted from limitations of the State Aid regulations. The block exemption approach adopted in Poland is applicable only to new investments whereas thermomodernization project do not qualify. This area should be taken into consideration while planning the use of FIs in the Programming Period 2014-2020 as thermomodernisation of both public and private buildings represents a project type with significant potential to use FIs.

Possible link to Thematic Objectives: 1, 4, 5, 6, and 11.

Renewable energy: The scope of support to be introduced by a new Renewable Energy Law still in 2013 remains unknown. After influx of wind projects over the last couple of years, the new law might promote also: Waste-to-Energy, biomass and solar / photovoltaic installations. These areas might play an important role for towns and cities by:

- giving access to green energy at competitive prices,
- creating entrepreneurship direct and indirect (including SMEs) and employment in the area,
- helping revitalising unused urban areas, including sites requiring clearance and decontamination as well as post-military and post-industrial areas,
- helping address community problems as treatment of household organic waste and sludge,
- creating public revenue from local taxes.

Besides opportunities arising from support system to be introduced by the government, waste management in itself creates a challenge for most of regional and local governments that in accordance to the new Municipal waste law of July 2011[41] are responsible for effective implementation of integrated waste management plans including modern collecting, sorting and recycling facilities as well as waste incinerators / gasification installations. Taking into account Poland's current obligations

[40] Complex Thermomodernisation of education buildings in the city of Radzionków. a 10-year PPP agreement signed with the City of Radzionków, for CAPEX of approximately PLN 9M developed by Siemens.

[41] Law of 1 July 2011 amending the Act on maintaining cleanliness and order in municipalities, Dz.U. of 2011 no. 152, item 897.

resulting from the Directive 2008/98/EC on waste, and in particular obligation to significantly reduce the amount of waste sent to landfills, both regional as well as local governments need to look for ways to fund required installations.

There is diversified interest in renewable energy projects from private investors, including potential cooperation with local municipalities (e.g. offering a municipality shares in project company in exchange for land for biogas plant). While larger cities will most probably find interested private parties (e.g. PPP project for PPP WtE plant in Poznań that reached successful Financial Close recently), especially smaller local authorities would benefit from tailor made FIs. Local authorities are scrutinising the investment opportunities and there have been several projects submitted through the Questionnaire, with the Waste-to-Energy incinerator plant in Tarnów being analysed in detail as one of the Case Studies.

Possible link to Thematic Objectives: 1, 3, 4, 5, 6, 8, and 9.

Refurbishment of district heating networks: There are district heating networks in over 300 cities and towns in Poland, most of them coal-fired post-Soviet installations which, due to increased costs of emissions, lead to sharp increases in heat bills for local communities and businesses and create environmental burden. Most of smaller local governments cannot afford capital investment in repowering existing installations in more environmental friendly models as, for example, high-efficient gas co-generation units or biomass installations and there is moderate interest from global private investors as Dalkia or Fortum, present on the local market but focused on larger cities. There is an urgent need to support smaller municipalities in the refurbishment and repowering of their district heating systems, with tailor made FIs in place. There have been approximately 10 projects in district heating submitted through the Questionnaire, with three of them analysed in detail as three separate Case Studies in Wielkopolskie, Zachodniopomorskie and Kujawsko-Pomorskie.

Possible link to Thematic Objectives: 4, 5, 6, and 11.

Schools: Schools are the responsibility of local governments and most premises need complex refurbishment and upgrade. Facing limited public funding, several towns launched PPP procedures (including Niepołomice and Zawoja in Małopolskie region) with limited interest from private investors. As many regions face demographic changes, local authorities need to set up integrated plans that include closure / restructuring of some schools that might enable commercial use of existing and/or refurbished premises, as well as complex refurbishment (including thermomodernization) of schools continuing operations. There have been several school and kindergarten projects (including refurbishment and thermomodernization of old buildings and submitted through the Questionnaire).

Possible link to Thematic Objectives: 1, 2, and 10. In case of thermomodernization: 4, 5, and 6.

Hospitals / Long-term care: Most public hospitals in Poland are under the responsibility of local governments (either of Marshal's offices or cities / towns). The asset base of local hospitals is generally obsolete with needs for complex refurbishment as liquidity problems have hindered public hospital's ability to make long-term capital investments. In addition, Polish hospitals need to meet requirements to upgrade their asset base in line with EU regulations. Taking into account public funds constraints, potential financial burden resulting from capital outlays and covering operating costs in a public healthcare sector has been identified as the single most serious financial risk for financial standing for public entities (both cities as well as regions) which has been expressed in comments to credit ratings for many regions / cities given by independent credit rating agencies. Several authorities have shown reasonable interest in engaging private investment, including most prominent example of new-built hospital in Żywiec (Śląskie) to be procured via PPP structure, and most recently also Children's and Mother Hospital in Poznań or hospitals in Warsaw or Mińsk Mazowiecki. Taking into

account an increasing role of private healthcare providers, the sector create potential for different modes of cooperation with private financing, including generation of commercial revenue. However, the limitations on long-term contracting with the National Health Fund ("NFZ") created additional barrier to private financing of infrastructure needs due to potential unpredictability of future revenues.

Poland is also one of the worst EU countries with respect to long-term care and elderly care. Generally, long-term care services are funded by mixture of local government funds and patients' own funds. The total number of long-term beds in Poland in 2010 amounted to 75 beds per ten thousand people on average. This number is significantly lower than in other countries, especially when compared with EU15 (e.g. over 800 per ten thousand in Germany and 700 per ten thousand in the UK). The number of dependent / disabled people in Poland has lately reached 1.3 million, with families providing long-term care for 83% of them[42]. Due to profound changes in family patterns, economic migration and low birth rate it is estimated that this form of care will become more and more important over next 10 to 20 years, which is of key importance to local governments, especially in urban areas, due to dynamic social changes. These developments create an increased demand for long-term care facilities of the certain standard, which are not sufficient currently. The sector itself provides for wide cooperation of municipalities and private partners and could in theory benefit from FIs.

There have been two large-scale hospital projects (in Wielkopolskie and in Kujawsko-Pomorskie) submitted through the Questionnaire, with several smaller scale real-estate projects in healthcare. None of these projects have been selected for further investigation, in particular in case of large-scale projects, due to lack of clarity on demarcation between regional and central funds available for this sector. However, broad-defined healthcare or long-term care projects, in particular combined with refurbishment and thermomodernization of old buildings in degraded areas could potentially benefit from FIs.

Possible link to Thematic Objectives: 1, 8, and 9. In case of thermomodernization: 4, 5, and 6.

Social housing: A few municipalities have demonstrated significant interest in social housing, with several cities launching PPP procedures (incl. Kraków – Małopolskie that was cancelled in summer 2013). Social housing projects have been analysed in the context of refurbishment and thermomodernisation of existing buildings, with several projects submitted through the Questionnaire, also including TBS (social housing associations).

Possible link to Thematic Objectives: 8, 9. In case of thermomodernization: 4, 5, and 6.

R&D / Innovation and cooperation with business: In accordance to The Global Competitiveness Report 2011-2012 produced by the World Economic Forum, Poland ranked as 41st most competitive economy in the world. The authors praised the country's comparative strengths including its large market size (20th), high educational standards (17th) and increased trustworthiness (16th). However, regarding innovation and technological readiness factors Poland ranked significantly lower, as 57th country in the world[43].

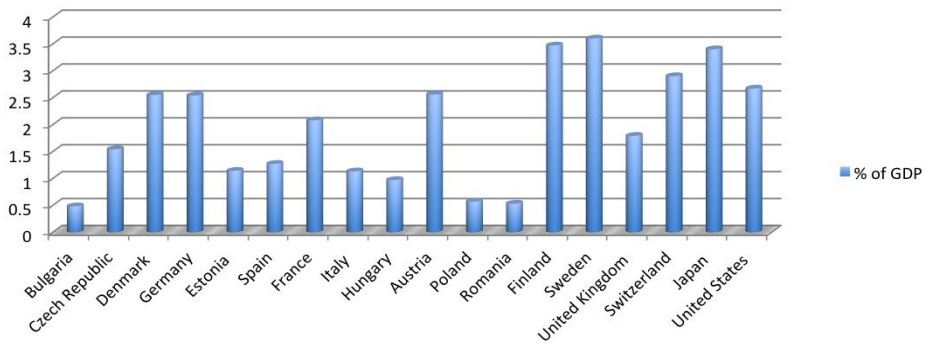
[42] *"Long-term care in Poland. Descirption, diagnosis, recommendations. Opieka długoterminowa w Polsce. Opis, diagnoza, rekomendacje"*, Grupa Robocza ds. Przygotowania Ustawy o Ubezpieczeniu od Ryzyka Niesamodzielności, Warsaw 2010.
[43] The Global Competitiveness Report 2011-2012, World Economic Forum.

Figure 20: Position of Polish economy in innovation and technological readiness (ranking 2011)

Source: The Global Competitiveness Report 2011-2012, World Economic Forum

Low innovation and insufficient level of investment in the R&D sector has been generally perceived as one of the weakest areas and the key barriers to further development of Polish economy and its effective transfer to innovation-driven economies. The Polish economy demonstrates one of the lowest spending on R&D in the EU, both on public as well as private sector level. With circa 0.57% of GDP spending on R&D in 2007, Poland ranked well behind European and world leaders, but also behind most of other CEE countries[44]. The figures have improved since then but Poland still lags behind most of the EU countries. According to the MID, the targeted use of EU funding should facilitate an increase from 0.74% R&D expenditures as percentage of GDP in reference year 2010 up to 1.7% by 2020.[45]

Figure 21: Domestic spending on R&D as % of GDP (2007)



Source: Europe in figures, Eurostat Yearbook 2010

On top of the relatively low R&D expenditures, there is not sufficient cooperation between R&D units and private commercial sector. One of the measures undertaken on regional level was establishment of technology parks in the regions that intended to promote R&D and its practical implementation in the industry. One of the projects funded by UDFs in Poland so far is a development of Poznan Science and Industrial Park - Phase II in Wielkopolskie region that should support expansion of R&D / technology in the region. Nonetheless, most of Polish regions perceive support for R&D / innovation as crucial element of regional development.

The Questionnaire has seen significant interest in financing projects in the R&D / Innovation and cooperation with business sector. Several Regions specifically requested analysis of potential use of various FIs in this sector in the next Programming Period and several projects were subject to detailed Case Studies. The unrivalled leader in this sector was Małopolskie Region that submitted 7 projects in this category, with two of them being subject to detailed analysis in the Case Studies. This resulted in

[44] "Europe in figures", Eurostat Yearbook 2010

[45] "Programowanie perspektywy finansowej 2014-2020. Założenia do Umowy Partnerstwa, MID", draft from 16 November 2012, p.19.

the Project Team's recommendation to set-up a sector-specific UDF that will respond to the market need, development potential and smart specialisation of the Region.

Possible link to Thematic Objectives: 1, 2, 3, 8, 9, and 10.

Support for SMEs: SMEs play a paramount role in the Polish economy. There are 1.67 million companies in Poland out of which 99.8% qualify as SMEs. The SMEs sector accounts for 48.4% of Polish GDP and provides for 70% of jobs across the country.[46] A strong position of SMEs as well as its entrepreneurial approach is believed to be one of significant shields that protected Polish economy, and also regions from repercussions of global financial crises and helped avoid the recession. The SMEs play particular role in developments of regions as a significant source of local taxes and job creation. The local governments generally promote development of SMEs and several national and EU initiatives have been created to support them. Recent developments in international financial markets have resulted in deteriorating position of Polish SMEs, in particular in the area of drastic cuts in capital expenditures. Furthermore, despite relatively high entrepreneurship ratio, Poland has one of the largest business failure ratios in the EU (over 14% of Polish entrepreneurs have quitted their efforts, in comparison to 9% EU-average). Only 3 out of 4 companies survive the first business year and only 54% first two and only 31% first five years of operation.[47]

Taking the above into account, most of regions considers support for SMEs to be one of key actions to promote sustainable development, in particular in certain subsectors as: self-employment of young people / graduates, women, unemployed or people in a +55 group.

Use of FIs in this sector seems to be of key importance as access to attractive form of financing is believed to be one of major obstacles to sustainable growth of these companies. In accordance to the report prepared by Bank Pekao S.A., only 24% of Polish SMEs use any form of external financing[48]. Whereas low level of leverage gives SMEs more stability in times of lower economic performance and reduces risks of payment defaults in case of lower revenue generation, it also creates a significant barrier for SMEs planning to expand their activity. This applies in particular to companies planning innovation-related and R&D investments that require significant capital outlays and cannot be financed by own means only. Only 7% of all investments made by Polish SMEs are made for intangible assets.[49]

Recognising this shortfall, several initiatives have been activated on a regional level, with e.g. JEREMIE implemented in seven regions (Dolnośląskie, Kujawsko-Pomorskie, Łódzkie, Mazowieckie, Pomorskie, Wielkopolskie and Zachodniopomorskie). Also, most of FIs on regional level (debt / guarantee and equity funds, business angels, etc.) are focused on SMEs. Experience in implementation of FIs for SMEs has been analysed in detail in Regional studies.

Support for the SMEs has been in particularly analysed in this Study in the context of providing SMEs with affordable business infrastructure and business development opportunities and services, mainly through the technology parks and industry clusters. Several Case Studies analysed in detail were focused on refurbishment on existing premises for SMEs activity and one Case Study in Łódzkie Region presented creation of an integrated technology park to develop innovative SMEs.

Possible links to Thematic Objectives: 1, 2, 3, 8, 9, and 10.

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[46] *„Raport o stanie sektora małych i średnich przedsiębiorstw w Polsce"*, Polska Agencja Rozwoju Przedsiębiorczości 2011.
[47] op. cit.
[48] *"Raport o sytuacji mikro i małych firm w 2011 roku"*, Bank Pekao S.A., Warszawa, 2012, p. 65.
[49] op. cit.

4 AREAS RELEVANT TO USE OF FINANCIAL INSTRUMENTS IN THE CONTEXT OF URBAN DEVELOPMENT

There have been several areas that proved critical in the implementation of JESSICA in the current Programming Period and that need to be addressed while implementing FIs in the new Programming Period 2014-2020. They have been summarized at the inception phase of this Study in four categories:

- Policy level
- Fund level
- Beneficiary level
- Project / Pipeline level

as described in chapter 5.1.2 *Lessons learnt from implementation of JESSICA in Poland*.

This Study provided recommendations in all four categories. This section focuses on public debt and budgetary constraints that proved to be one of critical points for potential use of FIs by municipalities (that are the dominant group of respondents in the Questionnaire) and PPPs as one of potential options to increase the level of private financing for urban development.

4.1 Impact of the budgetary constraints

Budgetary constraints play a significant role for the municipalities (self-government units, (*jednostki samorządu terytorialnego* or "JSTs") in their decision-making process when selecting a model of financing their infrastructure / urban development projects.

4.1.1 Financial ratios

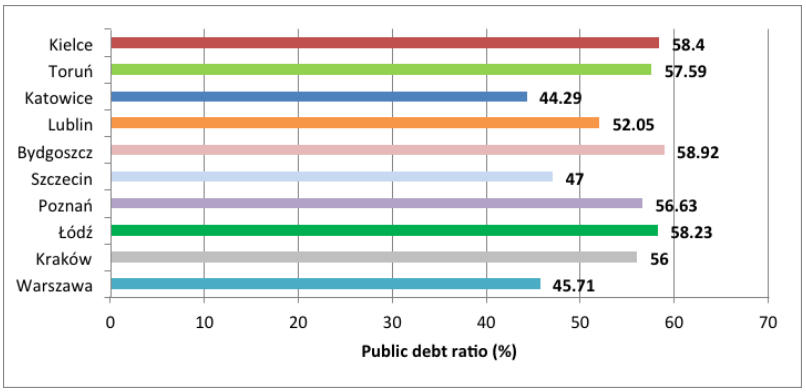
Polish legislation on public finance has introduced a number of financial ratios that need to be met by JSTs when conducting their activities. Although JSTs are legally independent from central government, there are certain levels of supervisory authorities that oversees the JSTs' fulfilment of those financial ratios. Although the law on public finance of 2005 ("Public Finance Act 2005")[50] was replaced with the new law on public finance of 2009 ("Public Finance Act 2009")[51] in 2009, its provisions concerning financial ratios applicable to JSTs will apply until 31 December 2013. As from 1 January 2014, they will be replaced with a new financial ratio set out in the Public Finance Act 2009. As the budgetary constraints quantified with applicable financial ratios play the key role for the municipalities deciding upon financing their capital investments they are of significance to potential use of FIs.

Debt Level Financial Ratio

Pursuant to the current regulations, an aggregate amount of debt of a JST as at the end of a budgetary year may not be higher than 60% of such JST's total revenues generated in such budgetary year ("Debt Level Financial Ratio"). As it can be seen from the Figure below, most of the largest cities in Poland have approached maximum debt levels that might undermine their further potential for funding much needed infrastructure and urban development investments.

[50] Law on public finances of 30 June 2005 (Dz.U. of 2005, no. 249, item 2104, as amended).
[51] Law on public finances of 27 August 2009 (Dz.U. of 2009, no. 157, item 1240, as amended).

Figure 22: Debt Level Financial Ratio of Polish municipalities (planned for 2013)



Source: Cities' Budgets, Long-term Financial Forecasts (Biuletyn Informacji Publicznej of respective city)

In respect of the Debt Level Financial Ratio, the Public Finances Act 2009 specifies that public debt includes liabilities of, amongst others, JSTs incurred under loans (*pożyczka*) and credit facilities (*kredyt*), debt securities (including bonds), accepted deposits as well as due and payable liabilities. In addition, the Minister of Finance has issued a regulation (*rozporządzenie*) specifying in more detail which liabilities are included into the relevant categories of the public debt listed above.

The first regulation was issued in 2010 (the "Public Debt Regulation 2010")[52] and subsequently it was replaced by a new regulation of 2011 on the classification of public debt titles (the "Public Debt Regulation 2011")[53]. Pursuant to the Public Debt Regulation 2011, the category of loans and credit facilities included in the public debt should be construed in a broader sense and it should include not only loans and credit facilities in their strict legal meaning but also additional types of agreements. They embrace (i) PPP contracts that have an impact on the level of public debt, (ii) securities with limited transferability, (iii) hire-purchase agreements, (iv) financial leasing and (v) other non-defined agreements (*umowy nienazwane*), with a payment date longer than one year which are concluded in connection with financing services, deliveries or construction works, and which have the economic effect of a loan or credit facility.

In respect of the PPP contracts and pursuant to a regulation issued by the Minister of Finance in 2014 on budgetary reporting ("Reporting Regulation")[54], in order to determine whether a PPP contract should be classified as part of the public debt, it was necessary to carry out an assessment on a case-by-case basis of the risk-sharing provisions contained in a PPP contract in the context of the decision issued by Eurostat[55] in 2004 on the treatment of Public-Private Partnerships ("Eurostat Decision")[56]. The Eurostat Decision provides for accounting rules of PPPs and in general assumes that no obligations under a PPP contract should have an impact on the public debt if a private partner bears most of the construction risk and most of the availability or demand risk, taking also into account any

[52] Regulation of the Ministry of Finance of the Republic of Poland of 23 December 2010 on the detailed classification of debt liabilities included into national public debt including debt of the State Treasury (Dz.U. of 2010, no. 252, item 1692).

[53] Regulation of the Minister of Finance of 28 December 2011 on the detailed classification of debt liabilities included into national public debt (Dz.U. of 2011, no. 298, item 1767).

[54] Regulation of the Minister of Finance of 16 January 2014 on budgetary reporting (Dz.U. of 2014, no. 0 item 119).

[55] Eurostat is a statistical office of the European Union and it is a part of the European Commission as a Directorate-General located in Luxembourg.

[56] Eurostat's decision no. 11/2004 of 11 February 2004 on deficit and debt – treatment of public – private partnerships, Eurostat News Releases on the Internet: http://europa.eu.int/comm/eurostat/

potential guarantees and/or financing provided by a public partner and provisions concerning allocation of assets following termination of the PPP contract. Subsequently to the Reporting Regulation and pursuant to an act on the reduction of certain administrative burdens in the economy of 2012 (the "Administrative Burdens Act")[57], the law on Public-Private Partnership of 2008[58] ("PPP Law") has implemented into Polish law the rules set out in the Eurostat Decision in respect of the PPP contracts in an act of Parliament rather than a regulation of the Minister of Finance.

Consequently, when selecting a specific FI to fund an JST's project, it will be necessary to carry out classification of the associated agreements under the Public Debt Regulation 2011 and, if applicable, the amended PPP Law. If such classification indicates that a specific agreement falls into the public debt category, it will need to be taken into account when calculating the Debt Level Financial Ratio.

Debt Service Financial Ratio

Pursuant to the current regulations, debt service of an JST in a given budgetary year (including repayments of capital and payments of interests) may not be higher that 15% of such JST's total revenues planned to be generated in such budgetary year ("Debt Service Financial Ratio"). The Debt Service Financial Ratio does not only refer to the pure debt service meaning repayment of capital and payment of interests under a loan/credit facility granted to or debt securities issued by an JST but it also includes potential payments under sureties (*poręczenia*) and guarantees (*gwarancje*) issued by such JST.

As such, the ability of JSTs to support infrastructure projects carried out by their subsidiaries (such as e.g. water and sewage companies or local transport companies) or by private investors that require a surety or guarantee from an JST is limited. In order to address this issues, the market has developed different types of support agreements which in the strict legal terms do not constitute a surety or guarantee, however, which are recognised by credit institutions and holders of the debt securities as sufficient level of support to the specific projects. Potential use of such instruments should be subject of analysis while agreeing an investment strategy for any UDF.

Financial ratio under Public Finance Act 2009

As from 1 January 2014, the Debt Level Financial Ratio and the Debt Service Financial Ratio will be replaced with a new financial ratio set out in Public Finance Act 2009 (the "New Financial Ratio"). Pursuant to the New Financial Ratio, the aggregate amount of debt service and potential payments under sureties and guarantees envisaged by an JST for a financial year and divided by the planned total revenues of the JST for that financial year need to be equal or lower than an arithmetic mean of a sum of the current revenues and revenues from the sale of assets decreased by the current expenditures, and divided by the total revenues, calculated for each of the preceding three years.

The New Financial Ratio is designed to address differences between financial condition and size of different JSTs rather than to impose a strict level of 15% as in the case of the Debt Service Financial Ratio. At this stage, it is difficult to assess an influence of the New Financial Ratio on the JSTs' appetite for new projects that could be financed directly by JSTs. However, in a predominant view presented by the JSTs, there is a risk that a significant number of JSTs will not be able to meet the New Financial Ratio in the coming years. This will further force JSTs to seek more innovative and indirect models of financing of their infrastructure projects without having a direct impact on their financial ratios.

[57] Act on the reduction of certain administrative burdens in the economy of 16 November 2012 (Dz.U. of 2012, item 1342).
[58] Law on public-private partnerships of 19 December 2008 (Dz.U. of 2009, no. 19, item 100, as amended).

4.1.2 Different models of financing in the context of the budgetary constraints

As set out in section 4.1.1. above, JSTs are subject to different budgetary legal constraints, in particular to different financial ratios which they need to meet when planning their investment expenditures. As such, before a final decision on the financing model of a specific project is made by a JST, it is important to analyse an impact of such financing model on the budgetary constraints to which the JST is subject. These rules need to be understood and properly addressed on the UDF level in order to accommodate municipalities' budgetary constraints and enable them funding the projects given these constraints. In respect of the potential use of FIs, following models need to be taken into account.

Direct loan, credit facility or debt securities

Municipalities may finance their investment needs with a direct loan/credit facility extended to such municipality by a credit institution (including UDF) or with debt securities issued by the municipality and subscribed for by different types of investors. This financing model is currently prevailing for financing municipal projects by UDFs in Poland.

Although there are usually different considerations to be made as to whether a loan/credit facility or debt securities should be selected by a municipality (such as e.g. appetite of potential lenders, public procurement, currency, amount to be borrowed, etc.), they are generally treated in the same way in respect of the budgetary constraints. Any debt service in respect of such loans/credit facilities and debt securities will be taken into account for a purpose of the Debt Service Financial Ratio and the New Financial Ratio as well as the amount of such loan/credit facility or debt securities will constitute public debt and it will have an impact on the Public Debt Financial Ratio.

Financing through the municipal companies

Within the limits prescribed by law, municipalities can found subsidiaries that could be entrusted with certain tasks for which such municipalities are responsible (e.g. local transport companies, local water and sewage companies or local waste collection companies). Often, such companies require additional financing to finance their investment needs (as e.g. extension of the sewage infrastructure or purchase of the new rolling stock).

If not financed directly by a JST, such companies can obtain a loan/credit facility from a credit institution or issue debt securities to their investors. Often, the lenders or holders of the debt securities require certain level of collateral to secure repayment of such loans/credit facilities or debt securities. Such collateral may include establishment of different sorts of security interest over the assets of such companies (as e.g. pledge over assets, mortgage, pledge over bank accounts, assignment of certain contracts, etc.). In addition, it is a common practice that the lenders and holders of debt securities expect certain level of support from an JST that owns shares in a borrowing company. Such support may be provided in a form of a surety or guarantee. This option constitutes a preferred option by the lenders, as in the case of non-payment of the loan/credit facility they will have a direct legal claim against a JST for such payment to be made. However, such surety or guarantee would have an impact on the Debt Service Financial Ratio and the New Financial Ratio and as such, it is often rejected by the JSTs.

As mentioned in section 4.1.1. above, in order to address this issue, the market has developed different types of support agreements. They are non-defined contracts (*umowy nienazwane*) under Polish law, i.e. contracts that are not specifically defined in the binding provisions of Polish law. As such, in the strict legal terms they do not constitute a surety or guarantee but at the same time, they are often recognised by the lenders and holders of debt securities as sufficient level of support. Such support may have different forms as e.g. (i) an obligation to raise share capital in a borrowing company either

in line with an agreed time-table or in the case when a specific financial covenant set out in a loan agreement or terms and conditions of the debt securities is breached (ii) an obligation to repurchase debt securities issued by a borrowing company (*put option*) if certain financial covenants set out in the terms and conditions of such debt securities are breached, or (iii) an obligation not to terminate a public service contract between a JST and its subsidiary (e.g. public service contracts with the local transport companies). Although, the support agreements do not constitute sureties or guarantees in a purely legal meaning, they often provide for a financial obligation on a part of a JST and as such, there have been on-going discussions on a case-by-case-basis between JSTs and supervision authorities (including Regional Audit Authorities, Regionalne Izby Obrachunkowe, RIO) as to whether specific obligations set out in the support agreements should not be treated as guarantees and as such, whether they should not be taken into account in calculating of the Debt Service Financial Ratio or the New Financial Ratio. Potential use of such instruments should be subject of analysis while agreeing an investment strategy for any UDF. Taking into account the importance of this area for ability to finance certain urban development project by the municipality, the know-how and experience of potential UDF fund manager will play a key role in municipalities' potential interest in using FIs.

The revenue bonds governed by the law on bonds of 1995 ("Bonds Law") [59] constitute an exemption from the above rule. In general, they may be issued directly by JSTs or by their subsidiaries. The revenue bonds provide the bondholders with a right of priority in respect of repayment of their claims under the revenue bonds from the revenues or assets of certain investments that were financed by an issuer from the revenue bonds. The issuer may also ascribe the right of priority in respect of the revenues generated by a different pool of assets of the issuer (a so-called "*undertaking*"). The right of priority of the bondholders is also preserved upon bankruptcy of the issuer (in particular, relevant for the subsidiaries of JSTs) and in the enforcement proceedings against the issuer's assets. As such, the revenue bonds enable ring-fencing of certain revenues and assets of the issuer without a need to transfer those revenues and assets to a separate legal entity. In addition, pursuant to the Bonds Law, debt service under the revenue bonds does not need to be taken into account for the purpose of calculation of the New Financial Ratio. As such, the revenue bonds could be contemplated as an alternative source of funding of separate investments that generate certain cash-flows and form a solution for off-balance sheet treatment and are FIs to be considered as one of potential options of funding municipal needs. It needs to be highlighted that potential off-balance sheet treatment of investment should not be treated by municipalities as their key goal in project structuring. In particular, the project structure adopted should in the first place accommodate needs and competences of respective project parties and municipalities should by no means undermine most efficient risk transfer for the sake of off-balance sheet treatment.

4.2 Public-Private Partnerships

Public-Private Partnerships offer additional source of private finance for public investments needs. Besides co-financing, PPPs offer series of benefits to public entities including expedite development of much needed infrastructure, whole-life costing as well as potentially higher quality of services rendered by private partners that all offer Value-for-Money benefits for public partners and the community. Although Poland does not have a long experience with PPPs yet, there is currently more visible openness in the market to include private capital in financing of the infrastructure and urban development projects of municipalities. As such, municipalities are often exploring as to whether their investment plans could be financed by the private partners or concessionaires.

[59] Law on bonds of 29 June 1995 (Dz.U. of 2001, no. 120, item 1300, as amended).

The PPP Law governs the PPP contracts under which a private partner undertakes to implement a project against remuneration and to incur expenditures for its implementation (including funding capital expenditures for infrastructure required). At the same time, a public partner undertakes to cooperate in achieving the aim of the project. The remuneration of the private partner should depend on the actual use or availability of an infrastructure asset subject to the PPP contract.

As mentioned in section 4.1.1. above, the PPP contracts may fall into public debt if they do not meet criteria of the Eurostat Decision. As such, in order for a PPP contract to be classified outside the public debt, a municipality will need to negotiate with a private partner an appropriate risk sharing structure in line with the Eurostat Decision. In brief, the construction risk and one of the availability or demand risk should lay with a private partner. In addition, a JST should pay attention to the provisions concerning termination of a PPP contract, its participation in financing of a project subject to the PPP contract as well as any guarantees provided by such JST. Additional guidance can be found in the Eurostat's Manual on Government Deficit and Debt ("MGDD")[60]. If a PPP contract falls into public debt, it will have an impact on the Debt Level Financial Ratio.

Project Team proposed PPP models as a potential model of financing of several Case Studies analysed as part of this Study. This Study does not advise on specific treatment of FIs under the Polish regulations but one of the examples of addressing municipalities concerns could be as follows. Under a PPP contract, remuneration of a private partner is periodically payable by a public partner (an JST) as availability fee. Such availability fee can be split into two main parts: (i) one part which covers cost of operation of a specific asset constructed or renovated by a private partner ("Operational Part"), and (ii) the other part which covers investment costs incurred by the private partner to build or renovate this asset ("CAPEX Part"). Under the Public Finances Act 2009, the Operational Part will be classified as current expenditure. In addition, based on the assumption that at the end of a specific PPP contract, the relevant asset will be transferred to a municipality, the CAPEX Part could be classified as investment expenditure. Such classification would be favourable to the municipality; as such investment expenditure would not be taken into account for the calculation of the New Financial Ratio.

In addition to PPP contracts, Polish law provides for the concession contracts. Pursuant to the law on concessions for construction works and services of 2009[61] ("Concession Law") under a concession contract, a concessionaire undertakes to implement a project set out in such contract against remuneration. Generally, such remuneration consists of a right to use and charge the end-users for the use of an asset or services provided by the concessionaire. In a "pure" model, a municipality will make no payments to a concessionaire under a concession contract. If this was the case, such concession contract should not have any impact on the budgetary constraints of the municipality. It is however, necessary to underline that not all projects are suitable for a private partner/concessionaire to take a demand risk and to be remunerated solely by the end-users of a specific part of infrastructure constructed or operated by a private partner/concessionaire. As such, often a hybrid model will be used where a concessionaire will rely on the payments from the end-users, however, it will also be entitled to payments from a JST should the prospective demand for services be below forecasted values. In such the case, a budgetary impact of each such concession contract will need to be assessed on a case-by-case basis.

PPP models (including concessions) present a desirable form of cooperation between public and private entities that reaches beyond solely benefits of funding. These models allowed worldwide for a

[60] Manual on Government Deficit and Debt, Eurostat Methodologies and Working Papers, March 2013.

[61] Law on concessions for construction works or services of 9 January 2009 (Dz.U. of 2009, no. 19, item 101, as amended).

transfer of know-how and optimal allocation of risks and it is also encouraged by the EC. Therefore, these models should be in particular taken into account when devising and agreeing investment strategy of a UDF. As PPPs require high-level competence, the relevant know-how and experience of potential UDF fund manager will play a key role in municipalities' potential interest in using PPPs along FIs for urban development.

Despite PPPs' potential, various benefits to the public entity and the community, the model has been implemented in Poland with limited success and many false starts. However, there have been several projects under procurement and some successful financial closings, with the most notable transaction of the Waste-to-Energy plant in Poznań. JESSICA led the way in a hybrid PPP for the redevelopment of the railway station in Sopot. This Study also proposed several PPP transaction structures to be used while analysing the Case Studies. These structures should be supported by FIs, both in equity as well as debt capacity. In particular, the MAs should seek relevant know-how and experience from potential UDF managers to assist potential beneficiaries with efficient structuring and development of transactions.

5 EXPERIENCE IN IMPLEMENTING FINANCIAL INSTRUMENTS IN POLAND

There are several FIs that can support financing of urban related projects, available on both central as well as regional level, with JESSICA being the most relevant. This section describes the nature and the track record of existing FIs, including JEREMIE and JESSICA distributed on regional level as well as those available centrally that might apply to energy and energy efficiency projects that substitute a large part of potential projects portfolio. This section also presents demonstrated potential interest in using FIs based on the Questionnaire, conducted as part of this Study. In addition to this section, this Study analysed in detail experience of each Region in implementing FIs, in particular in the urban development areas that can be found in Part II of this Study in Region dedicated sections.

5.1 Regionally distributed Financial Instruments

Based on the DG REGIO Summary Report 2013, as at 31 December 2012 there were 247 financial instruments (including JESSICA and JEREMIE) across Poland.[62] This includes EUR 1,237.99M from OP contributions, of which EUR 1,042.03M come from Structural Funds. Approximately, one-fifth of these resources are reserved for municipal projects under the JESSICA initiative, while the remaining funds were transferred as loans and guarantees for enterprises using the JEREMIE initiative – either by signing contracts with Bank Gospodarstwa Krajowego as a JEREMIE Holding Fund (except for Kujawsko-Pomorskie Region where the holding fund is a regional loan fund) or directly with the financial intermediaries, but not necessarily have been disbursed to final recipients.

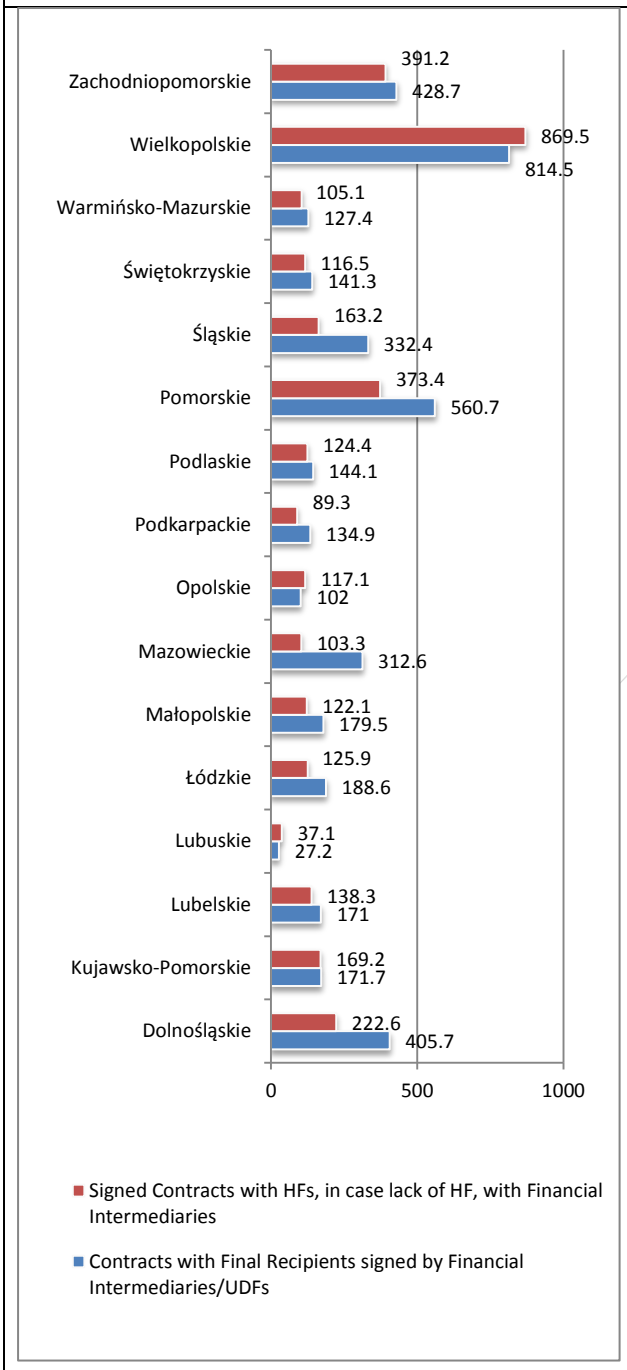
All ROPs use revolving instruments; however, the amount of funds that the voivodeships decided to use for the FIs in the current perspective varies in various regions. The contracts of highest values were signed in Wielkopolskie Voivodeship (PLN 814.5 M) and Pomorskie Voivodeship (PLN 560.7 M), where both JEREMIE and JESSICA initiatives are being implemented. In those voivodeships the amounts contracted under revolving instruments constitute over 11 per cent of their programme allocations.

By the end of August 2013, Managing Authorities have signed 96 contracts in total (including contracts signed between Managing Authorities and the Holding Funds or Financial Intermediaries (if the Holding Fund has not been established))[63]. The total value of contracts signed amounted to PLN 4,242.5M, including PLN 3,511.1 M funded from the EU funds. By the end of August 2013, 23,825 agreements with final beneficiaries were signed, amounting to PLN 3,268.2 M[64].

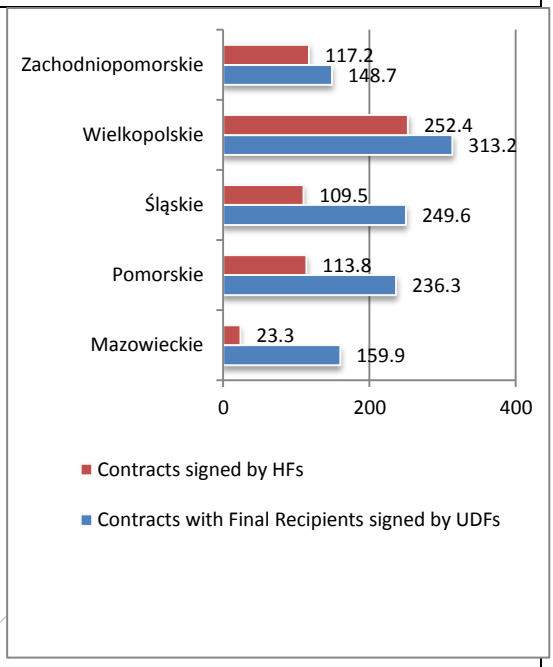
[62] Based on the DG REGIO Summary Report 2013 on the situation as of 31 December 2012 http://ec.europa.eu/regional_policy/thefunds/instruments/doc/summary_data_fei_2012.pdf
[63] Ministry of Regional Development, information published on the website http://www.funduszeeuropejskie.gov.pl/AnalizyRaportyPodsumowania/Documents/RPO_stanwdrazania_8102013.pdf 30.09.2013
[64] ibidem

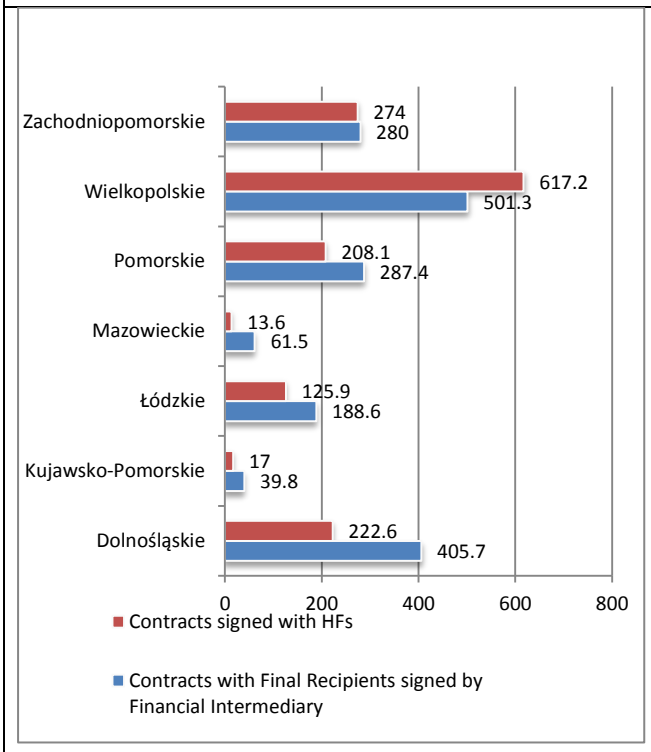
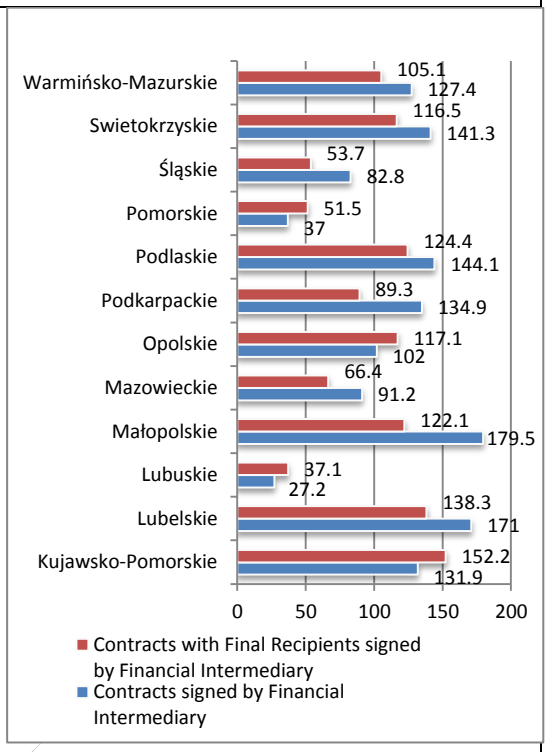
Figure 24: FIs implemented by the Regions as of end of August 2013

Total value of contracts for FIs concluded (M PLN)



Contracts concluded under JESSICA Programme (M PLN)



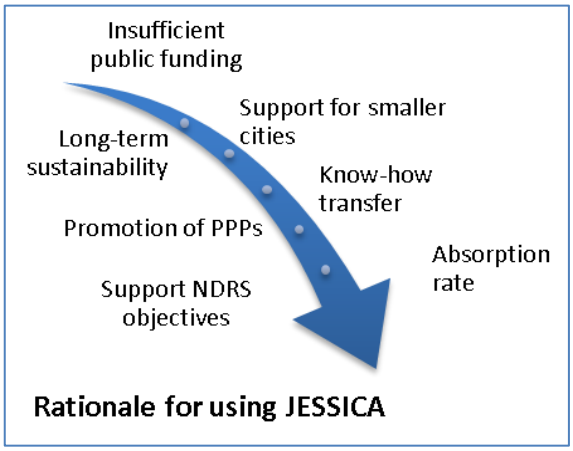
Contracts concluded, signed under JEREMIE implemented with a Holding Fund (M PLN)	Contracts concluded, signed under JEREMIE implemented without a Holding Fund (M PLN)
	

Source: Ministry of Regional Development, 30.09.2013, information published on the website http://www.funduszeeuropejskie.gov.pl/AnalizyRaportyPodsumowania/Documents/RPO_stanwdrazania_8102013.pdf.

5.2 JESSICA - Experience to date

Poland was one of the first countries to implement JESSICA as a tool for urban regeneration. At the initial preparation stage, several Polish regions demonstrated interest in adopting JESSICA as part of their Regional Operational Programmes, with five voivodeships effectively implementing JESSICA, including **Wielkopolskie, Zachodniopomorskie, Śląskie, Pomorskie** and **Mazowieckie**. Together, the total amount of the programme was EUR 256.3 M. Other regions that were interested in JESSICA included: Małopolskie, Dolnośląskie and Łódzkie, but decided not to implement JESSICA for various reasons, mainly the limited time that remained for the JESSICA implementation in the 2007-13 Programming Period, limited financial sources available under the ROPs already at the time as well as limited experience of the Managing Authorities in using FIs.

Based on the knowledge and understanding of Polish Regions and discussions with various stakeholders, including the MAs, the Project Team believes that the **key rationale underpinning the Polish regional governments' decisions to adopt JESSICA** in the 2007-2013 Programming Period were one or more of the following reasons, which were also indicated during the consultations:



- The need to support sustainable urban transformation of Polish cities;
- The attractiveness of solution that ensures long-term sustainability through the revolving character of the FIs, in which repayments are then reinvested into new urban development projects;
- The shortage of public funds on local level that might be used to fund urban development on large scale that might be at least partially addressed by use of FIs, especially taking into account public debt constraints applicable in Poland;
- Concerns about urban development in smaller cities that do not attract the interest of potential investors as large cities;
- Perceived need to learn new FIs that will be used more widely in the new Programming Period 2014-2020 and that might to some extent replace the traditional grant-funding model;
- Incentives to utilise UDFs due to adopted payment certification model that stipulates funds absorbed after they are allocated to the UDF;
- Benefit from expertise of the private sector specialising in investing for urban development;
- Desire to promote private sector involvement in urban regeneration projects, especially in investment through PPPs that have been actively supported by most Polish local governments, with limited success in most of cases; and
- Support to the regional development policy objectives outlined in the NSRD 2010-2020.

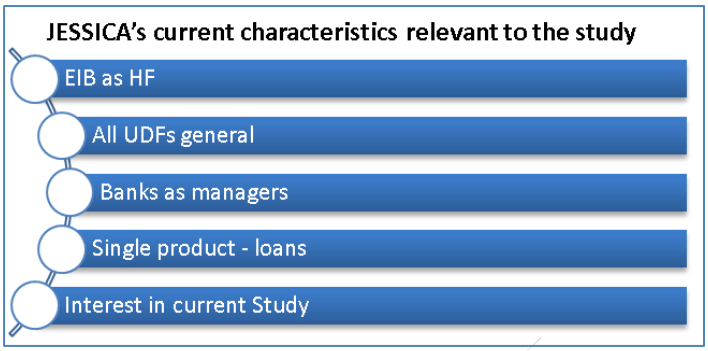
Wielkopolskie Voivodeship was the first region in the European Union to establish the Holding Fund ("HF") with the EIB. As of Q4 2013, with 7 out of 43 UDFs, and 5 out of 18 HFs, Poland is a forerunner in setting up JESSICA operations to support sustainable urban development in Europe.

Figure 25: Urban Development Funds in Poland, 2007-2013

Region	UDF Fund Manager	Size EUR (M)	Main urban project types Projects financed
Wielkopolskie	Urban Development Fund Wielkopolska - BGK	EUR 66.3 M	Urban regeneration Support for BE institutions 22 projects financed
Zachodnio - pomorskie	UDF for the Szczecin Metropolitan Area – BZ WBK (in cooperation with a local development agency ZARR S.A.) UDF for the areas outside the SMA - BOŚ(in cooperation with a local development agency KARR S.A)	EUR 33.1 M	Urban regeneration Urban infrastructure 14 projects financed
Pomorskie	UDF for the cities with county rights – BGK (in cooperation with a local development agency ARP S.A) UDF for other cities – BOŚ (in cooperation with a local partner AMT Partner S.A)	EUR 56.8 M	Urban regeneration EE and renewable energy Public transport 12 projects financed
Śląskie	UDF for JESSICA in Silesia – BOŚ (in cooperation with Centrum Projektów Rewitalizacji S.A.)	EUR 60 M	Urban regeneration Revitalization of post-industrial and post-military areas 10 projects financed
Mazowieckie	UDF for JESSICA in Mazovia – BGK (in cooperation with Masovian Energy Agency and Mazovian Development Agency)	EUR 40 M	Urban regeneration EE and renewable energy Cluster development initiatives 5 projects financed

There are some **common characteristics of implementing JESSICA in Poland** that reflect specific situation of Polish regional governments as well as market reality. This will, to some extent, be relevant in the next Programming Period 2014-2020, and therefore of significance to this Study:

- All 5 Polish MAs have signed agreements with EIB that acts as the Manager of the respective HFs and manages the JESSICA operations on behalf of the MAs.
- All UDFs have been established by Polish-based banks: BGK, BZ WBK and BOŚ with the market dominated by BGK which manages over 60% of funds;
- Loans are the only financial product used through the UDFs – this results mainly from regulations concerning State Aid that limits block exemptions to loans and guarantees for micro-companies and SMEs (in case of the latter instrument no interest on final recipients side has been reported to the UDFs up to date);



- Polish UDFs have tailored investment strategies to accommodate current development stage of Polish financial market;
- With the ROPs signed and agreed well before the adoption of JESSICA in the current Programming Period, the implementation proved to be challenging for MAs and required additional measures to be undertaken to address region-specific needs within given structures and solutions;
- Pomorskie and Zachodniopomorskie regions explicitly differentiated their UDFs between larger cities (agglomerations) and smaller cities, and Mazowieckie and Wielkopolskie required their UDFs for certain allocation of funds (cities below and above 50 thousand inhabitants or special areas of intervention as energy efficiency, regeneration or clusters).

5.2.1. Implementation progress of JESSICA as of the end of September 2013

As of September 30th 2013, Polish UDFs have signed 63 loan agreements for total amount of PLN 733.1 M:

- 22 in Wielkopolskie for total amount of PLN 255.5 M;
- 12 in Pomorskie for total amount of PLN 194.1 M;
- 10 in Śląskie for total amount of PLN 139.2 M;
- 14 in Zachodniopomorskie for an amount of PLN 117.3 M; and
- 5 in Mazowieckie for an amount of PLN 27 M.

Figure 26: Contracts signed by Polish UDFs as of September 30th 2013[65]

No.	Name of the Project	Size (PLN)
	UDF for Wielkopolskie – UDF Fund Manager: BGK	
1	Revitalisation of post-industrial areas in the city centre in Leszno	50.0 M
2	Business incubator in Poznań	18.5 M
3	Revitalisation of degraded area and development of an office centre in Poznań	27.0 M

[65] Information presented in this table is based on data provided by EIB.

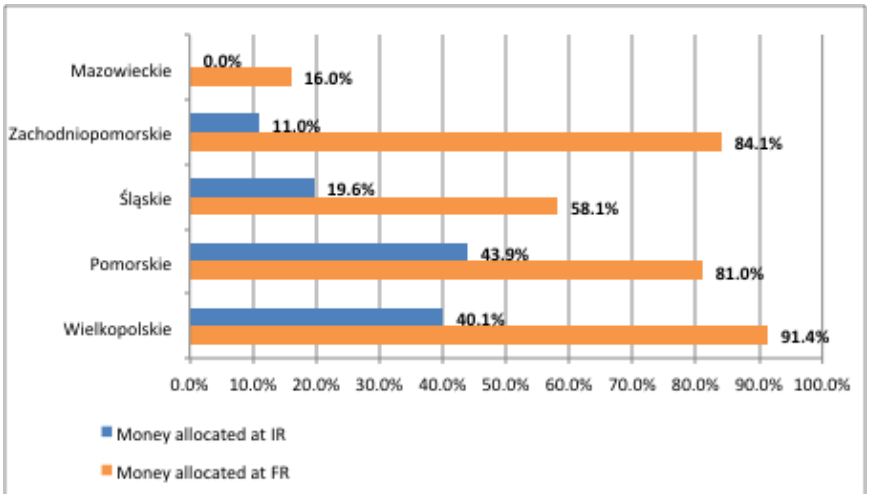
No.	Name of the Project	Size (PLN)
4	Adaptation of an old building and creation of a cultural and educational centre in Koźmin Wielkopolski	1.0 M
5	Adaptation of a former pump station for cultural purposes in Ostrów Wielkopolski	4.2 M
6	Extension and redevelopment of a hotel building and a sports hall in Szamotuły	5.5 M
7	Development of a multimedia communication centre in Jarocin	1.5 M
8	Revitalisation of a market square in Gniezno	5.6 M
9	Revitalisation of the city centre in Krotoszyn	9.3 M
10	Revitalisation of an industrial area along with business infrastructure in Ostrów Wielkopolski	1.7 M
11	Enlargement and modernisation of hospital buildings in Międzychód	13.9 M
12	Renovation of the front-view of a junior high school in Ostrów Wielkopolski	1.4 M
13	Redevelopment of the former library building in Ostrów Wielkopolski	2.5 M
14	Renovation of post-hospital buildings and development of a local kindergarten in Poniec	6.8 M
15	Modernisation and further development of hospital facilities in Piła	29.9 M
16	Adaptation of the former farm buildings into residential hotel for elderly in Leszno	21.4 M
17	Complex thermomodernisation of a school in Oborniki	0.7 M
18	Revitalisation of the market square in Kórnik	7.8 M
19	Development of an office and commercial space building and a parking lot in Poznań	37.5 M
20	Development of a sports hall in Pleszew	6.2 M
21	Creation of a mini-centre of entrepreneurship in Leszno	2.6 M
22	Development of a skate park and a car wash in Jarocin	0.5 M
UDF for Pomorskie (cities with county rights) – UDF Fund Manager: BGK		
1	Garrison of Culture – new centre for culture and art promotion in Gdańsk	19.2 M
2	Development of emigration museum in Gdynia	23.8 M
3	Development of the railway station area in Sopot	41.9 M
4	Complex termomodernisation of Medical University of Gdańsk's infrastructure	1.9 M
5	Development of a recreation and sports centre on the grounds of the PGE Arena stadium in Gdańsk	6.8 M
6	Development of premises for Gdynia Film School and improvement of transportation system in the adjacent area	21.9 M
7	Development of a conference and training centre on the grounds of the palace and park complex in Gdynia	15.6 M
8	Development of an administration and service facility within the Pomorskie Logistics Centre in Gdańsk	20.0 M
UDF for Pomorskie (cities without county rights) – UDF Fund Manager: BOŚ		
1	Revitalisation of a former brewery and its adaptation to commercial functions in Kościerzyna	7.7 M
2	Development of a swimming pool at a primary school in Pruszcz Gdański	12.6 M
3	Development of a recreation and services building in Reda	20.0 M
4	Creation of a cardiology ward in a specialist hospital in Chojnice	2.7 M
UDF for Śląskie – UDF Fund Manager: BOŚ		
1	Cultural passage Andromeda in Tychy	4.6 M
2	Creation of a services and cultural space in Czechowice-Dziedzice	30.7 M
3	Revitalisation of sports and leisure facilities of the housing association in Jastrzębie-Zdrój	0.9 M
4	Revitalisation of a municipal swimming site in Świętochłowice	10.8 M
5	Renovation of a building located in the centre of Katowice and giving it new functions	6.4 M
6	Revitalisation of a group of buildings through development of office and service space in Gliwice	1.8 M

No.	Name of the Project	Size (PLN)
7	Creation of a modern library in a former municipal school building in Tychy	20.3 M
8	Revitalisation of three children's playgrounds in Jastrzębie-Zdrój	1.1 M
9	Development of a hotel and conference centre in Dąbrowa Górnicza	33.0 M
10	Redevelopment of a medical centre building in Chorzów	29.6 M
UDF for Zachodniopomorskie (Szczecin Metropolitan Area) – UDF Fund Manager: BZWBK		
1	Restoration and revitalisation of a former paper factory in Szczecin	4.6 M
2	Renovation and adaptation of a building in the shipyard area in Szczecin	7.8 M
3	Revitalisation of a former emergency services building in Stargard Szczeciński	1.9 M
4	Redevelopment of a former power station in Szczecin	19.3 M
5	Redevelopment of a former cinema building into cultural centre and development of an energy efficient office building in Szczecin	16.4 M
UDF for Zachodniopomorskie (outside the Szczecin Metropolitan Area) – UDF Fund Manager: BOŚ		
1	Redevelopment and transformation of a service building in Kołobrzeg	5.0 M
2	Revitalisation of a former hospital building in Świnoujście	4.0 M
3	Revitalisation of a complex of tenement houses in Kamień Pomorski	6.3 M
4	Construction of a marketplace in Świnoujście	2.5 M
5	Revitalisation of a seaside district in Świnoujście through the development of the Baltic Park Molo complex	25.0 M
6	Construction of a hotel complex and landscaping of adjacent area in Świnoujście	12.0 M
7	Redevelopment of a former cinema into cultural centre in Połczyn-Zdrój	3.7 M
8	Redevelopment and enlargement of treatment facilities and canteen in a health resort in Połczyn-Zdrój	3.5 M
9	Modernisation and enlargement of a hotel building along with creation of a sports and recreation centre in Wałcz	5.3 M
UDF for JESSICA in Mazowieckie – UDF Fund Manager: BGK		
1	Revitalisation of a former combine harvester factory in Płock	15.0 M
2	Revitalisation of the city centre in Sochaczew	1.7 M
3	Redevelopment of a boiler house and the energy system of two housing estates in Warka	1.9 M
4	Improvement of energy efficiency of a heat network in Piaseczno	4.6 M
5	Refurbishment and redevelopment of tenement houses in Radom	3.8 M

The track record of signing the loan agreements over the last months shows slow starts after the UDF is established and a strong learning curve. It could be well illustrated by comparison of loan values signed as of the completion date of the Inception Report (February 2013) and the Final Report (September 2013). Over seven months the proportion of funds already allocated into projects (loan agreements signed) to funds available in UDFs has risen significantly, with Wielkopolska with the highest allocation reaching over 90%[66].

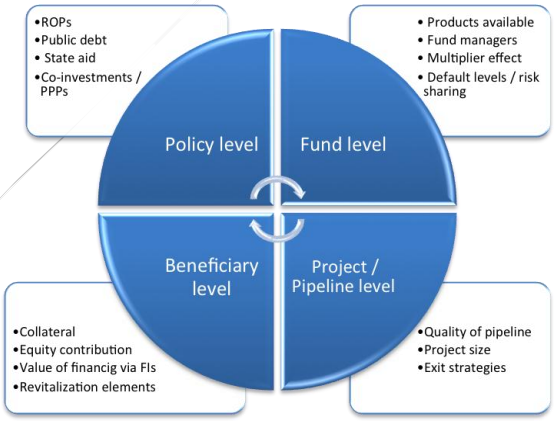
[66] Allocation calculated using currency PLN/EUR currancy rate as of 30.09.2013.

Figure 27: Financial means allocated as % of total UDF value at the completion date of the Inception (18.01.2013) and the Final Report (03.09.2013)



5.2.2. Lessons learned from implementation of JESSICA in Poland

There are numerous **lessons learned based on the experience of implementing FIs through the JESSICA initiative** that could be used to inform the investment policy, strategy, and the architecture of FIs to support investments in urban policy in the 2014-20 Programming Period. The Project Team grouped these lessons and areas of potential key concerns relevant to implementation of FIs in the new Programming Period 2014-2020 into four categories as below.



These lessons have been taken into account while formulating recommendations on general and regional level for the Programming Period 2014-2020.

Regional Operational Programmes: Under the Programming Period 2007-2013, JESSICA FIs were implemented under the existing ROPs that limited implementation solutions available (in terms of areas of interventions in the context of urban development and types of projects to be financed). This Study formulated some recommendations as of certain provisions in new ROPs that should promote use of FIs, including clear definition of areas of intervention and types of projects eligible for grant funding and combination of FIs and grants under one priority axis and one project[67].

Public debt and involvement of municipalities: Due to public debt constraints, as well as obligations to limit deficit and current spending imposed on the local authorities (municipalities, and regions) all potential solutions concerning FIs must take into account their possible impact on public debt and their accounting treatment in public accounts. This Study identified several transaction structures with limited impact on public debt levels that have been described in general in Section 4 Areas relevant to

[67] It should be noted that ROP provisions are quite general and project types eligible for investment are indicated only in ROP Complements, which can be amended on the basis of a decision of the Management board of the Region (new project types were introduced in accordance to this mechanism in certain cases in the 2007-13 Programming Period).

use of FIs in the context of Urban Development and presented on the case-by-case basis in the Case Studies.

Public-Private Partnerships and Co-investment: One of rationales behind MAs introducing FIs through the JESSICA initiative during the 2007-2013 Programming Period was promotion of PPPs as a method to address urban development needs. As general, this target has not been achieved by JESSICA so far and modest PPP development in Poland has been achieved during that Period. The first PPP project to be financed through the JESSICA initiative (complex redevelopment of railway station in Sopot) was signed in January 2013. The Study covered potential use of FIs to attract private co-investors and presented several PPP structures that might be used in the future, in particular in relation to large-scale urban regeneration projects.

State Aid: This area is of particular importance in context of any wider use of FIs at all levels: MAs, HFs, UDFs as well as the project level. State Aid has been addressed for the purposes of implementing FIs through JESSICA in Poland based on the Commission Regulation (EC) No 800/2008 (so called General Block Exemption Regulation), on a Final Recipient level. While this approach proved to be practical and working in practice, it has its limitations. For example, a requirement for FIs to be used only for new investments created problems for their use in certain sectors, e.g. thermomodernization. This subject is of particular importance in the view of the 800/2008 Regulation that expired on 31 December 2013 and was amended by the Commission Regulation No 1224/2013 of 29 November 2013 that has extended the period of application till 30 June 2014[68]. The possible approach to State Aid issues has been discussed in detail in Section 10.5 of this Study.

Products available: In the current Programming Period, all projects financed through FIs so far have used preferential loans exclusively. Whereas the Project Team believes this to be a well-founded approach given the time constraints in the current Programming Period and State Aid regulations adopted that allowed exemptions only for loans and guarantees to micro- and SMEs, the Study proved the necessity of using a wider range of FIs, including equity, mezzanine and different types of guarantees that would help bridge the market gaps for potential urban development projects, and thus be able to leverage additional private sector co-investment. The Study presented several financial structures that utilize various FIs. The FIs architecture proposed multi-product UDFs to be implemented by the Regions.

Fund managers: all Polish UDFs have been managed by banks that offered certain benefits but also created limitations, including strict Polish banking regulations. UDF managers being banks need to apply regulations of the Polish financial regulator (Komisja Nadzoru Finansowego, "KNF") relevant to bank products, in particular on value of collateral and requirements on equity. Taking into account the character of urban development projects this might create a barrier for potential Final Recipients and limit attractiveness of FIs through JESSICA to reduced cost of financing, longer tenors and grace periods. In the view of expansion of products available in the Programming Period 2014-2020, the Study proposed series of other instruments including equity and mezzanine finance that should be managed by specialised fund managers.

Leverage effect: the leverage effect of using FIs through JESSICA is Poland is relatively low, which most probably results from the fact that under GBER up to 75% of the total eligible costs of an investment may be financed, thus high co-financing rates are not required under the existing regulations, even though they are promoted in the tender procedures for UDFs' selection where on of the evaluation criteria is declared level of co-financing. Achieving maximum leverage on HF/UDF and/or project level might not have been the key objective of the instrument in the current Programming

[68] Commission Regulation (EU) No 1224/2013 of 29 November 2013 amending Regulation (EC) No 800/2008 as regards its period of application (O.J. of EU, L 320/22, 30.11.2013)

Period with more focus placed on financing pilot projects and educating market participants. In the Programming Period 2014-2020, it is expected that FIs will offer higher leverage both on HFs (named as "Funds of Funds") and well as UDFs level. The leverage effect (including external participation of 3rd party equity investors) should remain one of assessment criteria while selecting UDF fund managers in the Programming Period 2014-2020. The higher multiplier effect could be also achieved with use of guarantees, subject to recognition of Holding Fund as guarantor by the financing institutions as in the case of the JEREMIE initiative.

Default level / risk sharing: While assessing attractiveness of FIs and possible limitations to more effective use of FIs in Poland, financial institutions and other stakeholders have referred to default levels accepted by UDFs. Potential acceptance of higher than standard market default levels and / or risk sharing mechanisms that would offer higher potential loss guarantees to commercial banks should be taken into account, in particular in the view of expansion of FIs into sectors and projects with different risk profiles (e.g. R&D or start-ups).

Insufficient collateral and equity contribution: Experience gained in implementation of FIs thus far has shown insufficient collateral and/or level of equity contribution to be one of key barriers for applying for funding. This problem was mainly detrimental to smaller developers with obsolete and limited asset base and companies at the early stage of developments and Special Purpose Vehicles. As described above, these elements might create also a serious barrier for wider use of FIs by municipalities. More flexible approach is needed in this respect in the new Programming Period 2014-2020. The problem of insufficient collateral needs to be addressed in cooperation with the banking sector. The MAs should also address the issue of insufficient own contribution in case of municipalities (e.g. by extending the list of eligible collateral by inter alia municipal promissory notes and allowing for in-kind contributions as a form of own contribution and/or substitute of cash equity contribution). Under Article 37(10) of the CPR, contributions in kind in the form of land or real estate may also be considered as eligible expenditure in respect of investments with the objective of supporting rural development, urban development or urban regeneration.

Amount of financing available: Studies conducted among potential beneficiaries of FIs showed that the amount of financing available via FIs is one of key decision factors in application process. In order for the FIs to become attractive alternative to commercial financing and in particular to grants, the amount of financing available needs to justify the effort and risk involved in application process as well as to address financing needs of integrated urban development projects.

Revitalisation element of investment: On several occasions, UDFs' managers have signalled insufficient cooperation of private investors with city authorities on revitalisation elements of investments that hampered possible use of JESSICA instruments. Better understanding of the need of revitalisation / social-economic effects to be generated by JESSICA eligible projects by private investors needs to be assured to ensure effective implementation of FIs.

Quality of pipeline: UDF managers highlighted lower than expected response levels to calls for projects announced by UDFs, especially at the initial stage of JESSICA implementation. For example, the number of applications submitted to BGK in tenders till the end of 2012 in Wielkopolska was 29 (with 8 contracts for PLN 100 M signed) and 9 in Pomorskie (with 2 projects of total value of PLN 100M signed).[69.] The tendency improved with time but the quality of pipeline remained the problem at the beginning. This may be partly explained by novelty of the JESSICA instrument as well as the limited time frame for preparation of Business Plan by UDF candidates at the stage of tender procedures. Most of the MAs implementing JESSICA in the current Programming Period wanted the tenders to be

[69] Interview conducted with Mr. Marek Szczepański from BGK, on 11.01.2013.

finalised as soon as possible and requested the EIB to proceed accordingly. This however resulted with very tight deadlines for identification of eligible projects to be presented in the portfolios and their pre-assessment. This Study reviewed 225 projects that demonstrated interest in FIs through the Questionnaire and over 60 further projects in the Local Development Plans. The projects present diverse preparedness levels, with majority of them being at the conceptual stage with very little information available or preparatory works completed. Successful completion of projects will require proactive support to the project promoters. This statement is in line with market needs expressed during the interviews by several stakeholders that indicated approach of current UDF managers to support in financial structuring as one of major areas for improvement. The MAs might consider implementation of incentive mechanisms to induce UDFs to actively look for opportunities of external financing from private sector as well as encouraging project promoters to apply for financing through these FIs. The role of technical assistance in preparing and structuring projects so that they can successfully use FIs will be of paramount importance to successful implementation of FIs in the new Programming Period 2014-2020.

Project size: Many projects currently financed via JESSICA instrument in Poland are of quite low values. In this context, the UDFs might adopt a portfolio approach to uniformed projects of same nature and risk profile that might be recommended for certain sectors as e.g. energy efficiency.

Exit strategies: To assure revolving character of FIs, there must be well-defined exit strategies on project level as one of key investment criteria to be adopted by UDFs. Exit strategies will have to be established and discussed as part of the overall investment strategy for each Region. This Study has adopted exit strategies for FIs along with assumed exit strategies of initial project developer (in most cases "buy-and-hold"). The Regions while preparing their Ex-Ante Assessment and later at the investment strategy definition for a UDF might adopt different exit strategies (e.g. after the development stage and the ramp-up period and risks associated thereof elapse) to optimise the multiplier revolving effect and ensure the use of FIs for other eligible projects.

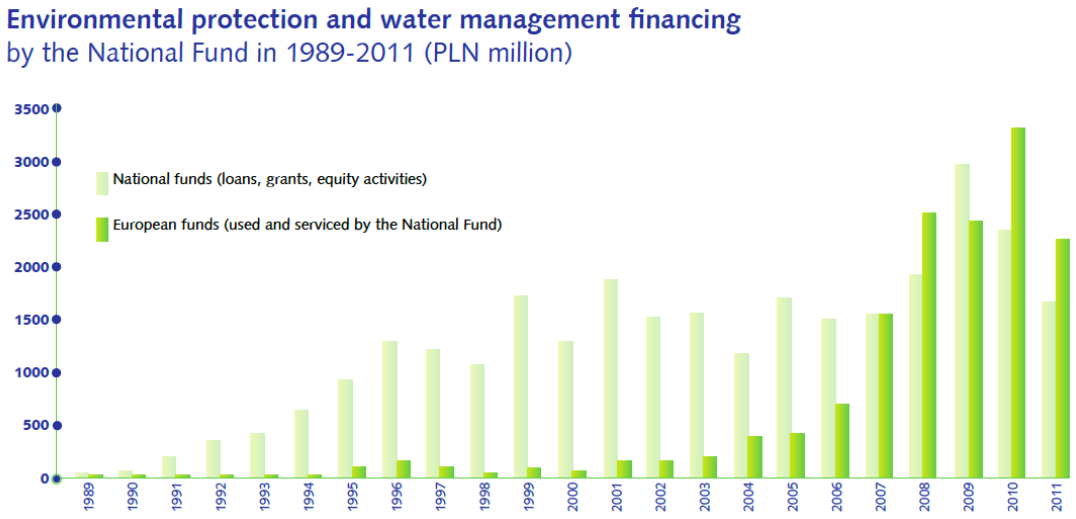
5.2.3. FIs implemented centrally

Besides urban-development relevant financial products available on the regional level as has been described in the region-specific sections in Part II of this Study, there are several initiatives on a central level that offer financing, especially in the energy and energy efficiency sector. Two main sources of funding these projects have been made available by the National Fund for Environmental Protection and Water Management ("NFOŚiGW") and the BGK Bank. The financial products offered by them are available to both private and public beneficiaries (including municipalities, universities, tenants of public buildings) and can address the financial needs of projects in the energy and energy efficiency sector, along with the FIs proposed in this Study. This fact has been taken into account while assessing potential demand for FIs in each Region by introducing so called "Competition Factor" as explained in detail in Section 8 "General definition of Financial Gap".

5.2.4. GIS - Green Investment Scheme ("GIS")

Polish Green Investment Scheme is managed by the National Fund for Environmental Protection and Water Management. NFOŚiGW is a well-established institution in Poland that in the period 1989-2011 co-funded environment initiatives with the amount of PLN 42.4 Bn (including foreign grants managed by the National Fund). The most funds were allocated for water protection and water management as well as for reduction of air pollution (see table below).

Figure 28: NFOŚiGW financing in Poland



Source: *Renewable source of financing, National Fund for Environmental Protection and Water Management, Warsaw 2012*

The most relevant program to this Study is GIS. GIS has been designed for management of resources from the sales of Assigned Amount Units ("AAUs") as part of Poland's participation in the Kyoto Protocol, and to monitor the environmental effects achieved upon. According to the *Polish Act on management of GHG emissions and emissions of other substances* adopted on July 17, 2009, the operating entity for the National GIS is NFOŚiGW that provides for a separate account to gather the resources originating from the AAUs sales transactions. The resources generated from the sales of AAUs might only be used to implement emission-reducing programmes and projects in, among others, the following areas:

- improving energy efficiency in the various sectors of the national economy;
- avoiding or reducing greenhouse gas emissions in the transport sector; and
- using renewable energy sources.

GIS runs several priority programmes, some of which are relevant to urban development and in particular to public entities (including municipalities and their units and companies) as potential beneficiaries. In particular, the following parts of GIS are relevant to this Study:

- Part 1 Energy management in public buildings (including local governments hospitals);
- Part 3 CHP installations and biomass heating generators – so far only focused on small-scale biomass;
- Part 5 Energy management in certain types of public buildings (including local units of central governments, theatres, research units);
- Part 6 SOWA programme - Energy-efficient street lighting; and
- Part 7 GAZELA programme - Low-emission public transport.

The table below presents key features of Part 1 of GIS programme – *Energy management in public buildings*.

GIS Part 1 Energy management in public buildings[70]

- Budget
  - PLN 3,165 M (incl. PLN 1,055 M as subsidies and PLN 2,110 M as loans)
- Forms of co-financing
  - Subsidy (amounting to 30% of eligible project costs)
  - Preferential loan (amounting to 60% of eligible project costs)
- Minimum total cost of the project: PLN 10 M.
- Conditions of loan co-financing
  - floating rate: WIBOR 3 M + 50 basis points (annually)
  - loan tenor: up to 15 years counting from the first projected disbursement of loan tranche
  - grace period: no longer than 18 months from the completion date of the project implementation
- Beneficiaries, i.e.:
  - territorial self-government units and associations thereof
  - independent public and non-public health care institutions
  - non-governmental organisations
- Types of investments eligible:
  - thermomodernisation of public buildings
  - replacement of internal lighting for energy-efficient systems

The other programmes offer either grant funding as Part 5 (Energy management in certain public buildings) and Part 7 GAZELA or a mix of grants and preferential loans (besides Part 1 described above, SOWA that offers up to 45% grant and up to 55% preferential loans).

Under the GIS programme, application procedures are being held on a regular basis. The table below presents the application submitted till April 2013.

Figure 29: Applications submitted under the GIS programme

		Application Round	Grants PLN M	Loans PLN M
Part 1	Energy management in public buildings	1. April 2010	176	233
		2. May 2012	71.7	115
		3. Jan 2013	19.4	22.9
		4. Jan 2013	53.3	52.2
		5. Jan 2013	34.3	33
Part 5	Energy management in certain public buildings	Jan 2012	69.1	n/a
Part 6	SOWA *	Apr 2013	118.3	90.4
Part 7	GAZELA **		643.6	n/a

Source: Priority lists published at http://www.nfosigw.gov.pl
** value of applications submitted (applications under review)*
*** value of applications submitted (applications under review)- all applications concerning acquisition of low-emission buses*

Lessons learned from the implementation of GIS in Poland show an upward learning curve of potential beneficiaries. The first application rounds did not find enough interest, with only parts of financial means allocated being effectively absorbed (e.g. the first round of Energy management in public buildings showed only PLN 176 M grant financing and PLN 233 M loans absorbed in comparison to PLN 260 M and PLN 520 M allocated). Current calls for projects enjoy increased interest. The GIS

[70] Green Investment Scheme (GIS) Programme, Part 1, Energy Management In Public Buildings, NFOSIGW

instruments form a competitive financing source to any potential energy efficiency UDF that has been taken into account while assessing potential demand for FIs on a local level.

5.2.5. Thermomodernization Fund

BGK manages state special funds to support i.e. development of social housing, infrastructure, innovation, by assisting local governments in using EU funds or supporting projects related to environmental protection. One of the state earmarked funds managed by the BGK is the Thermomodernization Fund ("TF").

The primary objective of the TF is the financial assistance to investors carrying out retrofitting, repair and renovation of residential buildings (including houses, tenement houses and block of flats). TF offers loans, including loans offered through cooperating commercial banks. In addition to granting the loan, the TF offers further incentives including:

- "thermomodernization premium",
- "repair premium",
- "compensation premium".

The funds from the TF may apply to local governments, businesses and individual clients.

Figure 30: Number of applications, allowances and premiums paid

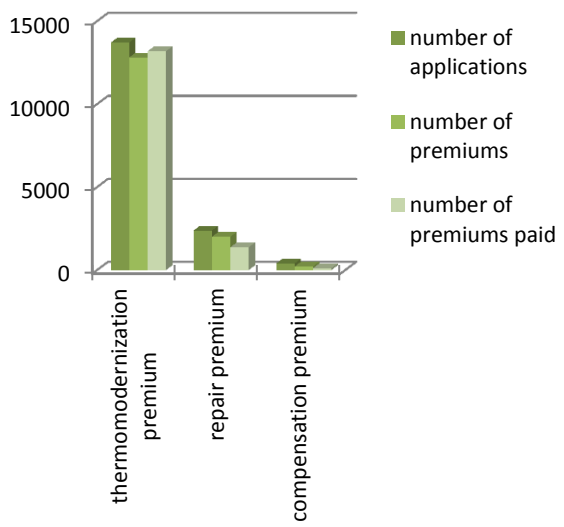
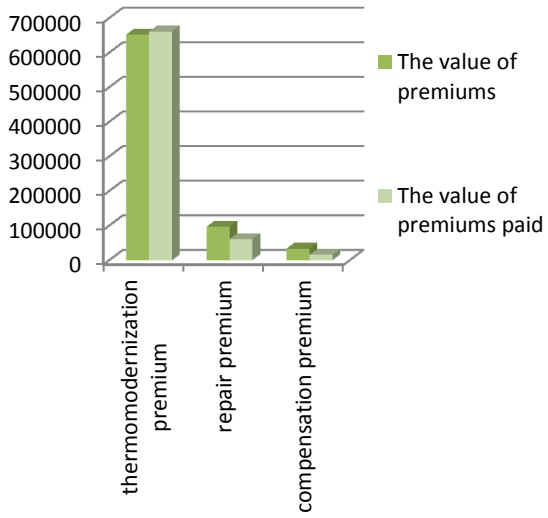


Figure 31: The amount of awarded and paid premiums



Source: Figures published by the Thermomodernisation Fund as of 07.05.2013; published www.bgk.gov.pl

The table below shows the key information on the beneficiaries, amount of funding and project scope that are eligible for certain incentives through the TF.

Figure 32: Key information on Thermomodernization Fund

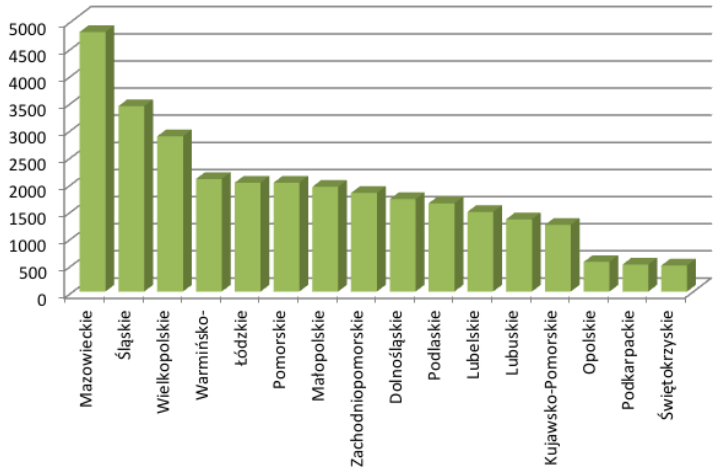
	Thermo-modernization premium	Repair premium	Compensation premium
Beneficiaries	Owners or managers of buildings[71]	Owners or managers of residential buildings, the use of which started before 14th August 1961. [72]	Individuals (owners, co-owners and heirs of residential), who were the owners of the buildings on 25th April 2005.
Type of investment / investment objective	- reduction of energy consumption for heating and hot water systems in the buildings - reduction of the costs of heat delivered to the building - reduction of transmission losses in district heating networks - total or partial replacement of traditional energy sources and the use of efficient cogeneration	Retrofitting of buildings, including: - renovation and/or reconstruction of buildings - replacement of windows - renovation of balconies Equipping buildings with adequate facilities and equipment [73]	Refinancing all or part of the eligible project costs, both financed with the loan as well as from investor's own sources
Eligibility of projects	- performing an energy audit and its positive verification - submitting a premium application to the crediting bank	- Performing a repair audit and its positive verification - Submitting a premium application to the crediting bank	
The amount of the premium granted	20% of loan used [74]	20% of the loan used for the repair project [75]	A bonus compensation relating to costs carried by the investor

Source: Study on the basis of materials provided by BGK

So far the TF provided loans amounting to PLN 1,422 M. The amount of the application varied from region to region. The following graph presents respective interest in TF funds across all voivodeships in Poland.

[71] The managers of residential buildings, accommodation buildings, public buildings owned by local government and used by them to perform public duties, district heating, local heat source.
[72] Individuals, community housing, housing associations, TBSs.
[73] Required to put into residential use, in accordance with the technical specification
[74] Not more than 16% of the costs incurred for the project thermo-modernization and twice the expected annual savings in energy costs, determined on the basis of an energy audit.
[75] Not more than 15% of the cost of the project.

Figure 33: The number of applications for premiums, by the regions (year 1999-2012).



Source: BGK

The TF is being distributed in cooperation with 14 commercial and cooperative banks, including:

1. Bank BPH S.A.
2. Bank DnB NORD Polska S.A.
3. Bank Millennium S.A.
4. Bank Ochrony Środowiska S.A.
5. Bank Pekao S.A.
6. Bank Pocztowy S.A.
7. Bank Polskiej Spółdzielczości S.A.
8. Bank Zachodni WBK S.A.
9. ING Bank Śląski S.A.
10. Krakowski Bank Spółdzielczy
11. Nordea Bank Polska S.A.
12. PKO BP S.A.
13. Spółdzielcza Grupa Bankowa - Bank S.A.
14. Getin Noble Bank

The TF is a well-established financial product in a Polish market and offers additional source of funding that might compete with any potential energy efficiency UDF on a local level and that has been taken into account while assessing potential demand for FIs. However, the scope of intervention of proposed UDFs would be broader and refer to broader group of potential beneficiaries.

6. FINANCIAL INSTRUMENTS – QUESTIONNAIRE SUMMARY

6.1. General Information

The Study used the purpose-built Questionnaire to identify and estimate demand for using FIs in the Programming Period 2014-2020. The Questionnaire was held from 8th February 2013 to 30th April 2013. In total, the invitations to respond to the Questionnaire were sent to more than 2,500 entities, both public and private. The Questionnaire conducted in the Regions identified 225 urban development projects in all 9 Regions. The average number of projects submitted is 25, with the Regions with the highest response rate as high as 36 (Śląskie) and the lowest of 17 (Świętokrzyskie).

Figure 34: Number of Projects submitted in each Region in the Questionnaire

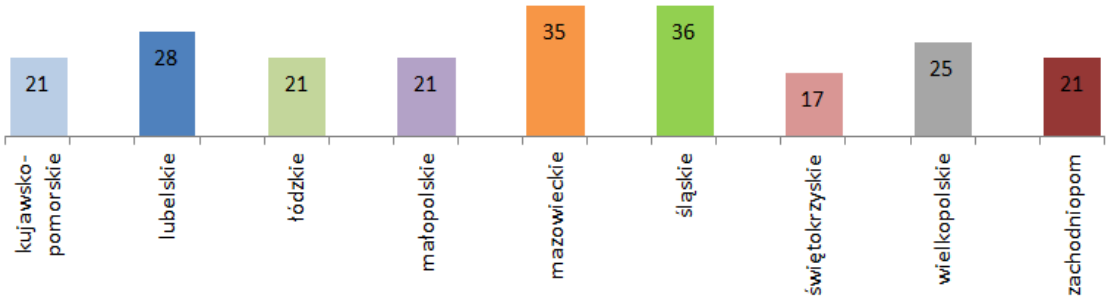
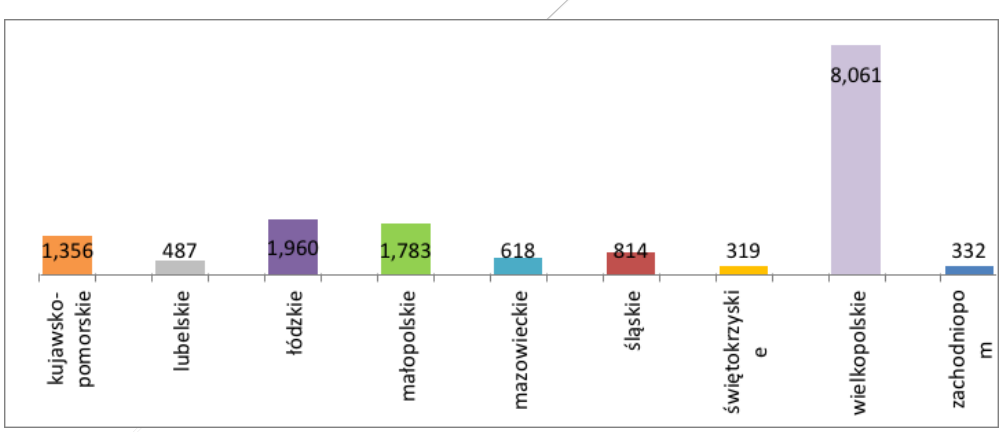


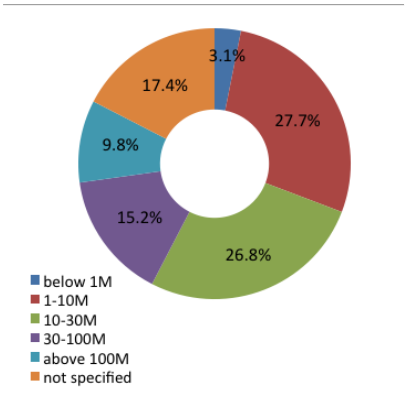
Figure 35: Total project value per Region (in PLN M)



Two of three Regions with the highest value: Wielkopolskie and Łódzkie registered high total project values due to mega-complex urban regeneration projects submitted by their capital cities, whereas the high score of Małopolskie results from general high project values submitted by public and private respondents in the Region, with no participation of Małopolskie's capital city Kraków.

Almost 55% of all projects submitted in the Regions fall in one of the following categories: PLN 1-10 M (27.7%) or PLN 10-30 M (26.8%). The largest difference among Regions is present in the category of projects above PLN 100 M. Across all Regions, almost 10% of projects fall within this category – there are, however, Regions that have no or limited number of projects in this category (e.g. Lubelskie and Mazowieckie) whereas in Małopolskie there are 9 such projects identified that constitutes over 40% of the regional sample.

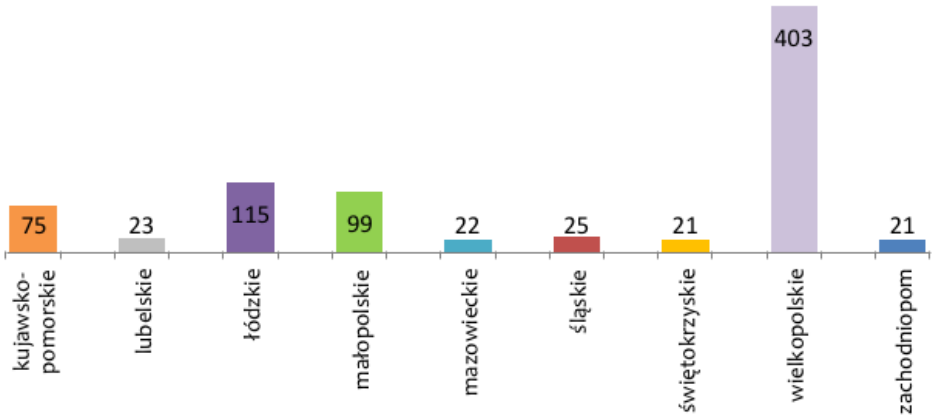
Figure 36: Distribution of projects across unitary project value



The largest project proposal of estimated value of PLN 7 Bn has been submitted by the City of Poznań, a complex proposal for city's real estate in the area in vicinity of planned ring-road as well as the financing for the construction of this road. Most of the largest projects have been generally submitted by the largest cities (mostly regional capital cities) and concerns complex regeneration of large integrated areas. The opposite category of projects submitted is the projects category below PLN 1 M. There were only 7 such projects submitted across all Regions, mostly concerning thermomodernisation or partly refurbishment of single buildings (replacements of windows or lighting system).

The average project value across all Regions was PLN 44 M. Whereas this number represents a mathematical average, the figure could be distorted by existence of a few mega-projects and does not represent an average project value potential. The more representative value for the analysed sample might be the median value for the entire population of PLN 15 M. There have been noted distinct differences in average project values between the Regions, where Łódzkie average project value of PLN 115 M is almost 5 times the value of the lowest average value in Świętokrzyskie and Zachodniopomorskie.

Figure 37: Average project value per Region (in PLN M)



As noted above, the major reason for such large differences is the presence of large-scale projects in several Regions, including:

- Wielkopolskie: *River in the city - development of riverside areas in Poznan* (PLN 500 M) and *Activation of areas around the key transportation infrastructure* (so called 3rd communication frame in Poznań (PLN 7.000 M);
- Łódzkie: *Regeneration of the urban area in the City of Łódź* (PLN 560 M);
- Małopolskie: *Waste Incineration Plant in Tarnów* (PLN 500-650 M);
- Kujawsko-Pomorskie: *Kujawsko-Pomorskie Medical Investments* (PLN 650 M).

6.2. Key Questionnaire Findings - Aggregate level

General Findings:

- **Generally high interest in urban development projects from respondents**: the Questionnaire conducted in the Regions allowed to **identify 225 urban development projects**. The projects have been **submitted by both private and public entities** (including municipalities and their companies as well as universities and others). The average number of projects submitted is 25 per Region, with the highest response rate of up to 36 (Śląskie) and 35 (Mazowieckie), and the lowest of 17 (Świętokrzyskie).
- The proposals submitted in the Questionnaire represent **various development and preparation stages**; from the project idea through more mature projects with completed or advanced feasibility studies to the projects with construction permits already in place. While the MAs and the Project Team prioritised more mature projects while selecting the final Case Studies to be further analysed, the majority of remaining projects should also make a solid base for the future pipeline. In particular, the Project Team presented the **Interim list of over 75 most suitable projects ("Interim-List").** The Project Team believes these to be the most relevant projects to the respective Regions based on their regional priorities (see Appendix IV for a complete list of projects identified in each Region).
- **Good coverage of projects across sectors:** projects submitted in the Questionnaire represent a **diversified mix of sectors**, with the majority being urban regeneration (43.6%), followed by social infrastructure (22.2%) and energy and business environment (each 10.2%). This is in line with the four strategic areas of significant importance to urban development in Poland that link to 11 Thematic Objectives, identified initially by the Project Team i.e.: social infrastructure, urban regeneration, energy and business environment sectors. The projects have been mapped with 11 Thematic Objectives throughout the projects' assessment process. It is worth noting that the significant part of projects submitted represent complex regeneration effort and often fall within more than one category, e.g. a complex building refurbishment (Urban Regeneration) with thermomodernisation (Energy) or a regeneration of degraded city area (Urban Regeneration) with subsequent use as a technology park and an R&D centre (Business Environment).
- **Interest from different categories of project promoters:** the most active Questionnaire respondents were municipalities that accounted for 67% of all respondents together with public / municipal companies and/or other municipal entities (4.9%), followed by private companies (7.1%) and scientific entities (including universities) (4.9%). The remaining category "Others" (16.1%) was dominated by housing associations and Non-governmental Organisations ("NGOs"). The Project Team believes that the high interest on municipal level proves high level of needs coupled with a decreasing financing potential that to a certain extent might be addressed by use of FIs. The relatively lower response rate from private companies results in our opinion from the sample selection method for the Questionnaire (ca. 60% of invitations sent across the Regions were sent to public entities, while 40% were sent to other entities). In addition, based on the experience from several surveys conducted by the Project Team for assignments in Poland, there is generally a higher willingness of public bodies in comparison to private entrepreneurs to participate in surveys at the early stage that might have influenced the response rate.

Potential Market Failure:

- Based on the portfolio of projects, the Project Team believes that a significant share of them represent potentially feasible projects that might effectively support achievement of policy objectives and at the same time good potential for utilizing FIs in the future, with the **majority of them representing revenue generating** projects.

- The analysis of the Questionnaire allowed the Project Team to identify **projects with a broad economic, social and environmental impact and suitable for FIs. Many of these projects have not been successful in securing financing (either through grants or commercial loans) for various reasons** (e.g. projects located in contaminated or deprived areas with high levels of risk and uncertainty). Both the Questionnaire respondents and the interviewees in the Regions outlined similar reasons for negative credit decisions from commercial banks for their projects, with major three of them being: 1) **insufficient equity contribution** and/or **inadequate collateral value** as well as 2) **uncovered early development** risk and in selected cases 3) **market risks** inherent in the project and unacceptable to commercial banks. Several respondents also noted that the potential tenors to be offered by commercial banks do not correspond with forecast payback periods of their projects. Also, the review of urban specific documents (including analysis of urban regeneration projects that were declined while applying for the EU grants) and the interviews conducted with the major market participants in the Regions proved the existence of possible market failures in the past.

The analysis of different sources proved the existence of repeating market failures in the past in case of urban projects.

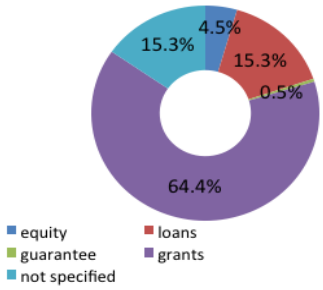
Potential use of Financial Instruments

The information gathered as part of the Questionnaire has shown certain preferences of different group of stakeholders demonstrating interest in use of FIs in the future.

- **Predominant interest in grants** as the most desirable method of finance - on average, almost 65% of all respondents named grants as the preferred form of financing. As the sample size of the Questionnaire comprised mostly of municipalities, this phenomenon represents the natural preference of respondents for "free money", especially taking into account last years of intensive use of grants in Poland. The Project Team also believes that some respondents indicated grants as the most favourable source of finance for their projects in an attempt to influence MAs to continue grant-funding to the largest possible extent. Interesting observation is to be made in those Regions who already implemented JESSICA in the current Programming Period. **The preference for grants is in these Regions significantly lower than average,** with the two Regions with the longest tradition in implementing JESSICA demonstrating the lowest rates under 50% (Wielkopolskie 48% and Zachodniopomorskie 44%). The example of the opposite situation can be observed in Świętokrzyskie, the Region with the least experience in the use of FIs where over 88% of all respondents are looking for grants as the best way of financing their projects, with the remaining giving no responses to the mode of finance, meaning that the project promoters in the Region did not consider the use of FIs at this stage.

Successful implementation of FIs (including JESSICA) helps with the cultural shift from grants-only towards more diversified market for financing urban development.

Figure 38: Which form of financing you would find most interesting for your project?



MAs and other market participants with whom interviews have been conducted have also observed the natural preference for grants. The interviewees underlined therefore the **need for clear division between types of projects eligible for grants** from other projects that could potentially use FIs in order **not to create counterproductive competition** that might negatively influence interest in the FIs.

- **General openness towards FIs** – there is considerable interest amongst project promoters in using FIs should they represent the only method of financing (as opposite to availability of grant financing). **Almost 53% respondents already confirmed their interest in FIs**, with additional 26% not being able to decide at this stage. Over 20% of respondents excluded financing through FIs. Most of those who do not see FIs as the way of funding their projects refer to the lack of revenue potential and future inability to repay the FIs from project's cash-flow. Again, an analysis of responses from the Regions that already implemented JESSICA in the 2007-13 Programming Period leads to a clear conclusion that the readiness to use FIs is in these Regions generally higher. For example, in **Śląskie, almost 70% of respondents confirmed their interest in FIs already at this stage**. This finding is in line with interviews conducted in the Regions that have already implemented JESSICA – the MAs and beneficiaries interviewed assess the JESSICA initiative generally positively. Additionally, the analysis of projects closed under JESSICA so far also show that the beneficiaries often did not envisage FIs as the possible model of funding their projects at the early stages. Several stakeholder interviewees stated that they had considered grants as the only way to fund their projects before realising that "JESSICA-type" FIs could be used. It allows for an assumption that there exists a **potential for using FIs, even in case of respondents who at this stage excluded using them.** In particular, the Project Team believes this situation is relevant to several projects submitted in the Questionnaire, especially those where the project promoters denied possibility of use of FIs due to lack of sufficient own means that could be addressed by targeted third-party equity contribution.

65% of all respondents prefer grants but more than 50% already confirmed their interest in using FIs should grants not be available for their projects. There is higher readiness for FIs in the Regions already implementing JESSICA.

- **Still not sufficient recognition of FIs other than loans –** the Questionnaire showed generally low understanding of FIs other than loans. The overall interest in potential equity contribution was as low as 4.5% of all respondents, with only one respondent expressing interest in guarantees. On many occasions, the FIs proposed by project promoters were not fit for purpose. This finding was analysed in detail within the Case Studies that proved that project promoters expressed interest in loans whereas the **analysis demonstrated that the use of equity contribution** / mezzanine instrument or covering certain project specific risk with a **guarantee would address the major cause of potential or experienced market failure**. The Study demonstrated that availability of loans (irrespective of their potentially attractive terms and conditions) helps the projects' economics (i.e. increasing potential project's and investors' returns to the levels acceptable to potential investors) but often does not allow for projects to "unlock" (i.e. to obtain required financing). The Project Team believes that **a limited understanding of FIs' character and potential use by respondents as well as generally bank oriented financial market in Poland** require

educational and promotional measures to be undertaken to increase understanding the benefits of equity and guarantee FIs among project promoters.

- **Limited experience in using FIs so far** – most of interviewees representing all categories of project promoters declare no or very limited experience in using FIs. The only exceptions are public / municipal companies that used corporate loans and the Regions currently implementing FIs via the JESSICA or JEREMIE initiatives. The experience from utilising region specific local FIs providers and intermediaries (including regional guarantee and debt funds as well as equity providers) is focused on SMEs sector and is very fragmented.

- **Positive experience in using JESSICA** - interviewees representing both actual beneficiaries as well as MAs who already implemented FIs via JESSICA consider the instrument to be positive. Current beneficiaries of JESSICA FIs mentioned the value-added of such instruments, in particular: 1) lower interest rates; 2) longer tenors and grace periods that available in the commercial market and 3) no additional costs and extra fees. Private beneficiaries have indicated additional benefit of FIs that allows for financing of significantly larger urban development projects that would have been the case had they relied on grants.

Most of beneficiaries and MAs who already implemented JESSICA assess it very positive due to its clear benefits.

Municipalities as a potential beneficiary class

- **Increased interest on municipalities' side** – Municipalities together with their companies or related entities constitute almost 72% of all respondents to the Questionnaire that submitted projects. This interest together with appealing regeneration needs in larger and smaller cities requires closer investigation of this beneficiary class. This is in particular the case due to specific budgetary constraints the municipalities face nowadays described in detail in Section 4.1. of this Study that might limit their potential to fund complex and capital intensive regeneration projects.

Rapidly growing interest in FIs on municipal side, as well as issues and constraints relevant to them require specific approach of this beneficiary class.

- **Limited revenue generation potential** – a considerable group of projects submitted by the municipalities have a limited revenue generation potential. This in particular applies to larger and more complex revitalisation programmes where the amount of initial capital expenditure required does not correspond with the revenue to be potentially generated as a result of the capital investment planned. These projects will experience problems with financing, irrespective of potential source of financing. Even if grants were available for these types of projects, significant part of municipalities would face difficulties in finding financial resources to cover own contribution, given the limitation on their indebtedness level.

7. CASE STUDY EXPERIENCE

7.1 Case Study selection – Interim and Short-List

7.1.1 Interim List

The Long-List of 225 projects was assessed and scored by the Project Team in order to develop the Short-List of 6 to 12 projects per each Region. The Short-Lists of projects were discussed in detail with respective MAs during regional meetings that took place in February and March 2013.

The Long-List of projects in the Questionnaire have been assessed against the predefined criteria to identify the most viable urban development projects for further analysis as the Case Studies. The projects have been assessed for each Region separately to reflect the Regions' objectives, in particular in relation to the sectors of key importance for the regional development and the regional smart specialisation. The MAs took part in defining the criteria and their importance in quantitative assessment. Besides the relevance of project sectors for respective Regions, the scores were based also on other merits as in particular:

- revenue generation potential and reliability of revenue streams;
- project's coherence with the Local Revitalisation Plan or other plan/programme of this type;
- project's development in the degraded areas;
- project's maturity;
- failure to attract external finance in the past.

After completing the quantitative assessment, the Project Team undertook a high-level discussion as part of an internal workshop where the projects underwent qualitative scrutiny, in particular assessment of the information availability for each high-ranked project and the ability of projects' promoters to make realistic assumptions for financial data required to build a Case Study. The Project Team also took a bottom-up approach to the project selected to the Interim-List to ascertain that all Case Studies across all Regions will cover all four strategic areas as well as all potential FIs (equity, debt and guarantees).

The Interim-Lists consist of 6-12 projects per Region (75 projects in total) and each project was described in more detail using customised project fiche, including basic information for each identified project:

Figure 39: Customised project fiche for an Interim Project List

	Project name		
Respondent			
Project description			
Sector:	Sector - subsector	**Total Project value (PLN M)**	
		Total CAPEX (PLN M)	
Location			
Short Project characteristics			
Preparation stage		**Time required for Project implementation**	
Financing			
Form of financing		**Funding provided by sponsor (%):**	
Expectations on financing	Key parameters of FIs expected by the Respondent		
Others			
Why would the Project require support with FIs?			
Availability of information	Financial data and assumptions to build a business plan/feasibility study	**Cohesion in the Region**	Will the Project be coherent with other projects in the Region?
Experience with FIs	Previous experience with FIs (Programming Period 2007-2013)		
Willingness to use FIs			
Selection rationale			
· Project scoring · Other rationale			

All 75 projects' fiches from all Regions have been summarized as Interim-List and **presented in Appendix IV.**

7.1.2 Short-List

Each Region received all project fiches for their selected projects from the Interim-List as part of a preparation to the Region's specific workshop carried out by the Project Team.

The Project Team organised a workshop with each Region with the MA (from inside and outside of the Managing Authority office, including representatives of the largest cities in the Regions and regional development agencies). The main purpose of these workshops was the presentation of the Questionnaire results together with an Interim-List of 6-12 projects and the selection of two Case Studies for a detailed analysis. While selecting the Case Studies, the MAs took into account:

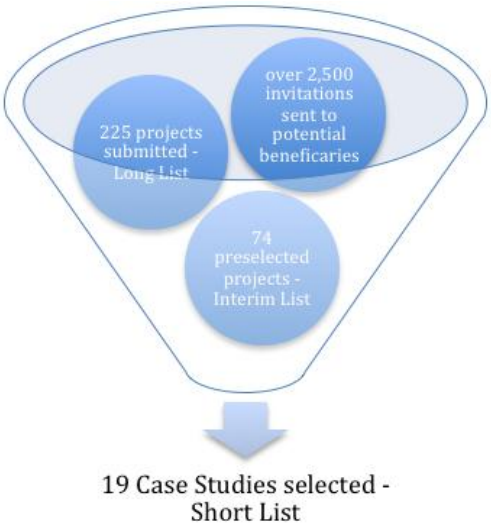
- sector and subsector to be in line with Regional priorities,
- location, e.g. degraded or post-industrial/post military areas,
- project influence on the Region/City (e.g. revitalisation effect, project significance),
- ability to generate revenue,
- current status and stage of preparation, incl. documentation prepared and data available,
- form of financing preferred by project promoter,
- project promoter's experience in development of projects in the past, as well as
- potential to combine FI with grants.

As a result, 19 projects were selected to be subject of detailed Case Studies. The majority of the projects represent complex urban regeneration, energy, social infrastructure and business

environment / R&D. The total value of the projects analysed under the Case Studies is approximately PLN 3.4-3.5 Bn (depending on the final values of capital investments required in several cases, and assuming the value of regeneration project in Poznań at PLN 500M which presents only a fragment of the entire project), with the "Revitalisation within the Inner City of Łódź" being the largest project selected (PLN 650 M). The project "Renovation and Upgrade of Buildings in City Centre of Szczecin" (Zachodniopomorskie) is the project of the lowest value (PLN 10.5 M) among all 19 Case Studies selected.

The sample represents a good coverage of projects across the sectors as well as a required diversification of FIs to potentially be used (loans, guarantees and equity instruments).

Figure 40: Case Study selection process



In the due course, three out of 19 Case Studies initially selected needed to be replaced by other projects due to insufficient information base to prepare the financial model and propose a suitable financial structure as the case of the "Extension of the city centre of Lublin" project or reformulated or limited in scope and value as the case in Grudziądz downtown regeneration project or Poznań riverside area regeneration project.

7.2 Case Studies Methodology

A financial analysis on each of the Case Studies has been performed in order to demonstrate the potential impact which the inclusion of multiple FIs has on selected key performance indicators both on project and multiple stakeholder levels (including developers, 3rd party equity investors and lenders). The main objective of this exercise was to illustrate the potential benefits of utilising FIs as part of the funding structure of projects, thereby finding an optimal funding solution. The Case Studies demonstrate how the use of FIs can help unlock financing provided by private investors for projects they would not have otherwise been funded due to perceived project or market risks.

The projects have been examined at an individual basis, and have seen that there are certain commonalities in terms of the challenges each project faces depending on project type and sector. However, each project has been additionally cross-checked on these general assumptions to refer to possible project-specific risks.

Each project's financial analysis follows a similar methodology and approach in order to provide a financial simulation of various funding scenarios. The key analysis includes: operations, funding structure, base case scenario, and optimisation scenario.

1. Project Operations Analysis:
    a. Capital expenditure – the cost incurred to complete the project including but not limited to: development, construction, labour, planning permission, infrastructure, and other relevant works associated with the project completion and the timings i.e. when and where are these costs incurred through the lifecycle of the project;
    b. Sources of revenue - project's potential sources of revenue and quantification of these revenue streams. Analysis of the potential revenue streams is critical in order to determine appropriate timings in which incomes are realised. There is also an assessment of how realistic these revenue streams are where information from project promoter is not readily available or limited;
    c. Operating costs - project's main operating costs drivers (labour, maintenance, etc.) and quantification of these cost streams. Analysis of the nature of operating costs in order to establish plausible cost timings. Similar to the analysis of revenue potential, there is an assessment of how realistic these cost streams are where information from project promoter is not readily available or limited.
2. Project Funding Structure Analysis:
    a. Identification of financial products suggested by both project promoters and the Project Team which would be potentially available as a form of financing;
    b. Analysis of the identified financial products in terms of their key characteristic features and suitability as potential forms of financing.
3. Project Base Case Analysis:
    a. Identification and analysis of project promoter's expected funding structure – understanding the different types of potential equity and debt investors that the promoter has or would like to approach;
    b. Understanding the potential project commercial structure in terms of stakeholders' potential involvement in the project;
    c. Identification and analysis of how obtainable and realistic the project promoter's proposed funding structure is and what are the main weaknesses, obstacles and challenges for the implementation of this funding structure;
    d. Analysis of the returns and funding requirements for project's stakeholders in the base case funding structure – understanding the gap between what would be required versus what could be achieved in the project base case in terms of risk and return requirements for each potential investor and lender.
4. Project Optimisation Scenario Analysis:
    a. Analysis of how FIs could be implemented into the project's funding structure in order to allow for broadening of the scope of potential financing options;
    b. Running multiple scenarios with different project funding structures, each of which includes different types or mix of different FIs such as equity, loan, or financial guarantee taking into account eligibility criteria for different categories of project costs. Potential project scenarios include but are not limited to:

i. BASE CASE: A case showing the funding structure proposed by the project promoter (without FIs) or a possible funding structure of the project without FIs assumed by the Project Team where information from project promoter is not readily available;

ii. EQUITY: A case showing participation with equity;

iii. LOAN: A case showing participation with loans;

iv. GUARANTEE: A case showing participation with guarantees;

v. EQUITY/LOAN: A case showing participation with a mix of equity and loan financing.

c. Where relevant, additional project scenarios using various combination of FIs will be included in the financial simulation, including but not limited to:

i. EQUITY/GUARANTEE: A case showing participation with a mix of equity and financial guarantee products.

ii. LOAN/GUARANTEE: A case showing participation with a mix of loan and financial guarantee products.

d. Analysis of the potential incentives and benefits offered to perspective investors that FIs provide to the multiple project stakeholders. The aim is to demonstrate how FIs would improve the project's viability and help the project meet the requirements of the multiple stakeholders in terms of (1) mitigating project risks, (2) providing acceptable return levels, (3) lowering financing costs.

e. For each project, two financial analysis levels are distinguished:

i. The operational project level, demonstrating project's costs and revenues and returns thereon;

ii. The level related to its financial structure referring to project's operational level and the model of financing adopted, with returns to be generated by different groups of projects' investors (debt and equity).

f. Analysis of the chosen project funding structure:

i. Rationale for choosing certain FIs;

ii. Account of any financial and non-financial benefits provided by FIs (such as market incentives to invest in a market segment);

iii. Sizing and proposed conditions of FIs recommended.

7.2.1 Project Assumptions for Case Studies

General project assumptions have been adopted separately for three main sectors: 1.Energy / Energy Efficiency ("EE"), 2. Urban Regeneration (including Social Infrastructure) ("UR") and 3. Business Environment ("BE") to reflect similarities across the projects within the same sector in terms of financial and commercial structures, the key project risks and market failures.

Project's construction and operational periods

For most Case Studies, information on project's construction and operational periods was extracted from the relevant financial and commercial information packages received from project promoters.

Where such level of detailed data was not available, reasonable assumptions based on the Project Team's experience in structuring and advising on similar deals in Poland and abroad for the project's timeline were made as follows:

1. For energy / energy efficiency projects:
    a. Construction period – 1.5 years (renewable / CHP) and 1 year (energy efficiency);
    b. Operations Period – 20 years (renewable / CHP) and 15 years (energy efficiency);
2. For urban regeneration/ social infrastructure projects:
    a. Construction period – up to 3 years;
    b. Operations Period – up to 20 years.
3. For business environment projects:
    a. Construction period – up to 2.5 years;
    b. Operations Period – up to 20 years.

The rationale behind the differentiation of construction period between the multiple project types is based on:

- Project scale – Typically urban regeneration, social infrastructure and potentially also business environment projects involve larger scale developments and design of more complex equipment/infrastructure;
- Legal and regulatory setup - Typically urban regeneration, social infrastructure and potentially also business environment projects involve longer planning and permitting procedures, due to multiple governing requirements that need to be satisfied;
- Commercial setup - Typically urban regeneration, social infrastructure and potentially also business environment projects comprise the participation of multiple project counterparties with various levels of involvement and incentivisation which prompts the creation of slightly more complex commercial structures (PPPs, JVs, etc.) extending project's setup timeframe.

In terms of the differentiation of projects' operations periods, the rationale is as follows:

- Life of developed equipment/infrastructure – Currently, the typical useful lifespan of an energy efficiency technology ranges from 15 to 18-20 years and that of newly developed urban infrastructure – much longer. As a precautionary measure and to keep forecasts to a reasonable timeframes, the operational periods of the latter projects have been limited to 20 years;
- Commercial setup – As with project's construction period, the fact that urban regeneration, social infrastructure and potentially also business environment projects involve the participation of multiple project stakeholders means that these various project counterparties would have different investment/involvement incentives which may stretch project's operational lifespan longer than the lifespan of an energy project.

Eligibility of project costs

In general, total eligible project costs include in particular:

- project–related preparatory and development costs,
- capital expenditure in tangible and intangible assets,
- staff costs,
- incremental working capital, and
- other operating costs.

The eligibility questions must be addressed project by project, relying mostly on the respective Operational Programmes, as well as the FI investment strategy, outlining the criteria for project

selection and eligibility rules approved by the MA, but also on other national regulations and policies applicable.

Each Case Study was analysed from an eligibility's perspective in line with existing EU regulations. Where costs were eligible it can be assumed that it was financed through FIs, and where it was not eligible under national and EU laws, the funding was sourced from private sources of finance, excluding the required co-financing from public/private sources. It should be reiterated that these Case Studies are for illustrative purposes only to demonstrate how FIs can get projects off the ground, which otherwise would not have been able to attract private finance alone. Therefore, careful due diligence should be carried out prior to investing in future projects.

7.2.2 Financial Assumptions for Case Studies

7.2.2.1 Project Debt-to-Equity (Gearing) Assumptions

As with project's construction and operational periods, information on project's gearing was extracted from the relevant financial and commercial information packages or confirmed by project promoters, and where such level of details was missing, reasonable assumptions (based on the Project Team's experience in structuring and advising on similar deals in Poland and abroad and soft market testing in the Polish banking sector) were made as follows:

1. For energy projects (including district heating and renewable projects) and energy efficiency (EE) projects;
    a. Debt vs. Equity – Typically 70:30;
2. For urban regeneration / social infrastructure (UR) projects:
    a. Debt vs. Equity – Typically 60:40;
3. For Business Environment (BE) projects:
    a. Debt vs. Equity – Typically 60:40

Gearing assumptions provided by project promoters have been implemented as a base case however we have commented on their reasonability in relation to conditions available in the market. Considerations in determining project gearing were (1) the variability of a project's cashflows - the greater the degree of riskiness in the cashflows, the greater the "cushion" lenders will need in the forecast of available cashflows beyond what will be needed for debt service; (2) project's type – energy and energy efficiency projects would generally be favoured by commercial loan providers due to the clarity around their revenue generating potential, whereas other sectors would require the greater "equity cushion" due to sector- specific risks discussed in detail in Section 7.3.1 *Sector Specific Conclusions* that are generally assessed high by potential commercial lenders; and (3) – project's operational life span – taken together with low/moderate cashflows variability and moderate/strong revenue generation potential, shorter length of project's operations, may act as another positive signal in attracting banks or other types of private capital financing and vice versa.

7.2.2.2 Financing Costs

Another important part of the model that greatly impacts the results of the analysis, is the estimate of projects' borrowing costs. To calculate the cost of borrowing from a UDF, the following methodology was used[76].

[76] Commission Notice on current State aid recovery interest rates and reference / discount rates for 27 Member States applicable as from 1 June 2012 (2012 / C 155/03).

The reference rate for a JESSICA loan facility was defined as the 6-month WIBOR rate plus a margin of 1% - 2% depending on project's: (1) scale, (2) cashflows variability, (3) type, all of which form the majority of project's risk profile. This assumption has been revised and adjusted for each Case Study and the margin has been reduced in case of projects with potential high social impact and / or limited capacity for revenue generation.

Additional borrowing costs associated with this type of financing are an Arrangement Fee, which represents a one-off administration fee for structuring of the financial instrument, and a Commitment Fee, which represents interest only charged on any undrawn loan amount. Also in this case, the assumption has been adjusted for each Case Study and the fees have been waived in case of projects with potential high social impact and / or limited capacity for revenue generation, with no Arrangement Fees charged, as it is the case in the current Programming Period.

Project Type	Risk Profile	Collateral	Base Rate	Construction Period Margin	Operations Period Margin	Arrangement Fees as % of Facility Size	Commitment Fees as % of loan Margin
Energy/Energy Efficiency Project	Low/Medium	Low	3.40%	1%-2%	1%-2%	0.00%	50.00%
Urban Regeneration (UR) Project	Low/Medium	Low	3.40%	1%-2%	1%-2%	0.00%	50.00%
Business Environment (BE) Projec	Medium/High	Low	3.40%	1%-2%	1%-2%	0.00%	50.00%

In terms of the commercial bank loan assumptions, these were deduced following a soft market testing with local and regional commercial banks and other debt investors. It should be noted that commercial rates apply under the assumed gearing ratios acceptable to commercial banks.

Taking into account their feedback and weighting multiple projects' risk profiles, the interest rate on a commercial loan is defined as 6-month WIBOR plus a margin of 2.5% - 4.5%, as follows:

Project Type	Risk Profile	Collateral	Base Rate	Construction Period Margin	Operations Period Margin	Arrangement Fees as % of Facility Size	Commitment Fees as % of loan Margin
Energy/Energy Efficiency Project	Low/Medium	Low	3.40%	2.5%-4.5%	2.5%-4.5%	1.20%	50.00%
Urban Regeneration (UR) Project	Low/Medium	Low	3.40%	2.5%-4.5%	2.5%-4.5%	1.20%	50.00%
Business Environment (BE) Projec	Medium/High	Low	3.40%	3.5%-5.5%	3.5%-5.5%	1.20%	50.00%

It should be noted that the above are initial debt market estimates and further investigations and considerations should be done to confirm their validity. No bank has provided any formal term sheets or letters of credit with the data selected for the estimated loan rates.

7.2.2.3 Inflation Assumptions

The rate of inflation in Poland used in the selected projects' financial analysis refers to the rate of inflation based on the consumer price index, or CPI, which shows the change in prices of a standard package of goods and services which Polish households purchase for consumption.

Inflation is subject of intense scrutiny by Polish monetary authorities (the National Bank of Poland) in their strategy of direct inflation target. Over the last 5 years (2007 – 2012) that target has been in the range of 3% - 4%, with average CPI over the period of 3.3%. Reflecting future planned decrease of National Bank of Poland's inflation target and putting more emphasis/weight on recent CPI inflation rates (04/2010 – 04/2013), this Study's estimate of future inflation expectations are fixed at 2.75% per annum.

7.3 Case Study Conclusions

7.3.1 Sector Specific Conclusions

7.3.1.1 Energy and Energy Efficiency Projects

Development Phase

The main risks associated with the selected portfolio energy and energy efficiency projects relate to project development and levels of market risks unacceptable to some investors and lenders.

On a more detailed level, development risks relate to elements specific to the project's pre-construction and construction period such as technology risks, delay in infrastructure completion, capital expenditure overruns, environmental, and management risks as defined in a table below for four key sub-sectors being: combined heat and power (district heating), Waste-to-Energy, energy efficiency and street lighting.

Subsector / Area	Risk Description	Combined Heat & Power (CHP)	Waste-to-Energy (WtE)	Energy Efficiency	Street lighting
Technology	Relates to the novelty level of the applied project technology and equipment.	Technology and concepts potentially fairly new to the local market, however extensively tested and applied in multiple geographies.	Technology and concepts fairly new to the market and not extensively tested and applied.	N/A. Well tested technologies in multiple geographies.	N/A. Well tested technologies in multiple geographies.
Construction Delays and Capital Expenditure Overruns	Relates to the availability of certain construction contracts such as an Engineering, Procurement, and Construction ("EPC") contract between the project developer and the construction company.	Construction contracts could be extended on a turnkey basis as EPC contracts with experienced construction companies.	Possible technology failure / delays in completion and cost over-runs in case of new / untested technologies	N/A. Brownfield projects[77], simplified procedure	N/A. Brownfield projects, simplified procedure
Environmental	Project failures or delays due to environmental problems.	N/A. The selected projects are brownfields or new build plants in industrial areas where environmental impact is well known and process is proven.	Environmental impact needs to be further assessed as there might be possible local protests and delays associated with project initiation.	N/A. Brownfield projects, simplified procedure	N/A. Brownfield projects, simplified procedure
Management	Developer's experience, expertise and capacity to deliver the specified infrastructure and manage the project implementation process to a high industry standard.	Limited experience in development of small-scale co-generation and WtE plants and although developers employ and/or cooperate with individuals and companies that provide them with necessary projects knowledge and experience, this lack of history with the energy market presents challenges in terms of availability and unlocking of private equity and/or debt financing solutions. This is not the case with larger WtE installations that can attract developers with extensive experience in developing complex installations across the world.		N/A. Most developers have previous experience in development of similar infrastructure, however potential insufficient management experience on public project grantors	Potential insufficient management experience on public project grantors

There are number of ways to mitigate these types of development risk, including insurance, or local legal and regulatory incentives such as simplified environmental procedures for energy projects smaller than 25MW in the CHP sector.

[77] Brownfield projects mean in this context new capital investments performed on existing assets in order to improve their features or extend their scope, size, feasibility or useful life.

However, smaller developers and construction companies assess the costs of these risk-mitigating measures as high, especially in the ramp-up period that does not relate to general business economics. In addition, although the existence of certain incentives does limit some of the development risks to an extent, it does not eliminate them completely.

Operational Phase

In terms of operational phase risks, across the selected portfolio of energy and energy efficiency projects, these risks relate to the market uncertainty around commodity pricing (prices of heat (according to the heat tariff), electricity, and natural gas), regulations around the availability of certain project incentives (such as Green and Yellow / Orange Certificates), and in the case of the Waste-to-Energy subsector – the availability and reliability of feedstock supply.

Subsector / Area	Risk Description	Combined Heat & Power (CHP)	Waste to Energy	Energy Efficiency	Street lighting
Commodity Market Pricing - Electricity	Certainty and predictability of the sale price of generated electricity	Practically, all project developers are exposed to changes in electricity market prices. The on-going Polish electricity market trend for replacement of old, mostly coal-based generation installations with new, more efficient and environmentally friendly facilities acts as a catalyst for increase in the system price due to of the implicit cost of capacity additions and change in the system fuel mix. Market participants therefore anticipate that power prices in Poland will increase in real terms and have framed their business plans accordingly. However, the recent trends in the electricity price in Poland that indicated ca. 20% drop in market prices might question these assumptions, at least in a short term that makes the market environment less stable and puts additional strain on project funding. If price increases do not materialise this may cause reductions in shareholder returns, and/or ability to repay bank loans.			
Heat – demand side	Certainty and predictability of the sale price of produced heat.	Increased capital outlays for improved insulation of buildings supported by the government and EU EE initiatives may result in lower demand for heat from existing customers.		N/A	N/A
Commodity Market Pricing - Gas	Certainty and predictability of the cost of natural gas.	In the selected CHP projects, gas is the developer's single largest operating cost. Current pricing levels assumed in the financial models reflect current market tariffs. They do not reflect any potential changes in pricing, which might be triggered by the liberalisation of the Polish gas market.		N/A	N/A
Regulatory Risks	Legal and regulatory changes in regards to the form, level, and timings of any project relevant renewable energy / energy efficiency incentive schemes.	Taking into account Poland's energy mix dominated by coal-fired production, potential legal and regulatory changes in the energy efficiency and renewable energy incentive schemes will have only limited influence on electric energy prices; therefore unfavourable changes in the support system would cause reductions in shareholders returns and/or ability to repay senior debt. In addition, any recovery of increased fuel or other costs, or the loss of subsidies are subject to regulatory approval and market capacity. Current insecurity of the regulatory environment across Europe (with Spain, Portugal, Czech Republic and Bulgaria to name only a few) and the lagging completion of works on the new incentive system in Poland create additional challenge to project financing.			
Feedstock Supply	Level and overall availability of relevant feedstock required for appropriate project operations.	N/A	Significant, however new law on municipal waste (1st July 2013), addresses risk by transferring the waste "ownership" to the municipalities that made the long-term supply agreements with municipality possible. If long-term agreement with the municipality is not possible, other risk mitigation measures are required.	N/A	N/A

Market Failure / Suboptimal Investment

The financing for the selected energy projects is currently blocked due to the lack of partners (especially equity providers and/or banks) who are willing to assume the projects' operational and market risks and some of the development risks. In many cases, the local developers for the renewable energy, CHP, Waste-to-Energy, and energy efficiency projects have injected seed-capital to cover initial expenses but have reached the limit on further funding. The project promoter for the selected street lighting project has implemented the new technology on a sample area, but has been

unable to produce sufficient technical, commercial, or financial track record that could feed a project business plan.

Whilst most of the selected energy projects offer balanced risk profiles during the development and operational phases, the risks described above, pose significant project challenges:

- Lack of interest from larger non-cash constrained entities – while larger municipalities can attract interest from larger players (contractors/developers), smaller communities / projects need to rely on smaller scale developers;
- Limited interest from commercial debt providers at the development stage due to certain level of development risk and exposure to the market risks (gas, electricity and heat prices as well as regulatory changes and pricing of Green and Yellow / Orange Certificates)[78].

Private Investor Return Requirements

Energy efficiency projects are generally perceived to have a moderate risk profiles with equally low-medium amount of risk involved in their development and operational phases because the development risk is assessed as lower and the revenue sources are generally easier to quantify. These risks are generally well balanced between the project phases, and as is the case with the selected energy efficiency projects, majority of these risks are already moderately mitigated by the current projects' commercial structures and set-up. As a result, this Study works on the assumption that a generally acceptable required rate of private equity investor be in the 13%-15% range, measured as equity Internal Rate of Return ("IRR").

With a similar commercial structure and set-up, the selected other energy projects (eg. Waste-to Energy, biomass, solar, wind power plants) fall into a similar realm in regards to private equity investor required return expectations. Due to their extra level of complexity and exposure to additional sources of development and operational risks (such as technology risk, energy price risk, changes in green energy support system and feedstock supply risks) these projects are characterised by a slightly higher level of expected private equity capital return in the area of 15% – 20% measured in the form of equity IRR. These assumptions on equity returns are based on the Project Team's experience in structuring and advising on similar deal in Poland and abroad and soft market testing among key equity players in the market.

7.3.1.2 Urban Regeneration Projects (including Social Infrastructure)

The main risks associated with the selected portfolio of urban regeneration and social infrastructure projects relate to project development risks (during the development phase) and their limited revenue generation potential (during the operational phase).

Development Phase

Urban regeneration and social infrastructure development risks are of different types and nature as described in this section. On a more detailed level, these development risks include investors' perceptions of the following issues:

(1) inefficient local or regional planning procedures that create risk of time delays, potential cancellations and/or development cost increase;

[78] Poland has established a specific incentive system based on certificates to promote the development of clean energy. The Polish energy regulator provides plant operators with certificates for each unit of green electricity produced. The colour of certificates differs on the type of fuel and technology used, with Yellow Certificates being extended to high-efficient co-generation.

(2) cumbersome, time-consuming, and bureaucratic permitting / grant regimes;

(3) potentially difficult to predict nature and amount of construction and land costs; and

(4) management problems and local inexperience with effective commercial and financial structures to reduce development risk for stakeholders;

Subsector / Area	Risk Description	Urban Regeneration
Planning	Efficiency of local and regional planning procedures.	The concept of a "sustainable city" is still a novel one in the context of Poland. Although progress in that regard has been made and there are examples of successful planning procedures, over the last 20 years the municipal planning policy has shown only limited improvement. Majority of the selected urban regeneration projects are in highly conceptual phases that might cause moderate interest of private investors. Use of European funds on complex regeneration projects has been limited and although there are successful examples of revitalisation, most of the major Polish cities cannot recognise their full urban and cultural potential due to lack of clarity surrounding urban planning processes. This lack of sound practices, local policies, and public awareness might have a negative impact not only on potential projects' social outlook, but also constrains them in terms of the availability of funding instruments and solutions offered by potential investors.
Permitting / Licensing	Efficiency, timings, legislation and regulation procedures involved in the local and regional permitting regimes.	As many other countries, Poland employs cumbersome permitting procedures, involving multiple licenses and permits, and the completion of required notifications and inspections. Some examples of such documentation include but are not limited to (1) Fire Department Approvals, (2) Work Safety and Hygiene Permits, (3) Public Roads Approvals, (4) Building Permits, (5) land ownership matters and entries in the Land Register, (6) Utilities, Sewage, Telecommunications Connection Approvals, (7) Environmental Approvals, (8) Occupancy Permits, etc. Although majority of the selected urban regeneration projects are owned by the local municipalities which in effect mitigates some risks of the complex permitting procedures in Poland, it does not eliminate these risks completely and potential project investors would still have a significant level of risk exposure to this type of development risk.
Capital Expenditure Overruns	Certainty of construction costs, contamination remediation in the case of brownfields, standard of built infrastructure, level of land prices.	As the majority of the selected urban regeneration projects are still in conceptual phase, construction contracts on a turnkey basis with certain completion dates and prices are still not available to the local investors. Additionally, topics such as contamination remediation are not covered by the information provided by most of the project promoters. As the latter is considered by investors in urban regeneration to be a major barrier in unlocking the flow of private sector finance, the lack of clarity on the topic can hinder the availability of project funding options. Other measures perceived to be important for the provision of private finance include an expected minimum standard of infrastructure to be taken over / purchased that can push the required project capital expenditure to an unacceptably high level. In contrast to the permitting procedures, the fact that municipalities own majority of these projects does not mitigate the risks associated with capital expenditure overruns, contamination remediation, and pricing, and is therefore highly relevant for the obtainability of any form of private finance.
Project Structure and Management	Developers and public bodies' experience and expertise to manage and deliver the complex infrastructure and effective commercial and financial structures (such as PPPs, JVs, or other partnership forms).	Local developers and public bodies have limited experience in delivering complex infrastructure / regeneration projects. PPP model has been implemented in Poland with limited success and many false starts. Hence, the limited level of involvement into, experience, and understanding of more sophisticated financial structures there might create additional risk to Polish urban regeneration projects.

Operational Phase

In terms of operational phase risks, across the selected portfolio of urban regeneration projects, these risks relate to (1) lack of or low rates of capital appreciation; (2) rental growth; and (3) long-term project sustainability.

Subsector / Area	Risk Description	Urban Regeneration
Capital appreciation	Probability of rise in the value of the regenerated infrastructure based on a rise in market prices.	Perceived total return is the primary factor influencing investment decisions. Those companies that retain their investments within urban regeneration locations do so in expectation of achieving expected rates of returns and capital appreciation is a major factor in the determination of these returns. Together with the presence of transparent exit strategies for the private finance investors, capital appreciation enhances project's attractiveness to private investors and broadens the scope of funding solutions and options available to the project. Due to their early development stage (mainly, conceptual phase), majority of the urban regeneration projects do not offer sufficient clarity on potential prospects of capital appreciation. Additionally, the lack of concrete and specified commercial structures might hinder the transparency of potential exit options available to private investors, which significantly limits the variety of investment solutions accessible by the project.
Rental Increase	Potential of projected upward trend of the market rental rates over a particular period of analysis.	Rental growth arising from occupier demand and capital appreciation reflecting investor demand are the primary factors by which new urban regeneration projects are evaluated. In addition to the level and growth potential of rental income, its mix is another factor highly scrutinised by every potential private investor. Multiple rental income sources provide for a level of investor diversification and act as natural hedges against potential rental income declines (i.e. commercial vs. residential rental streams). Most of selected urban regeneration projects involve the regeneration of infrastructure with mainly social traits and although there are significant social, local, and regional benefits that are realised from the renewal/re-development of such infrastructure, due to its limited potential for commercialisation, its economic and financial benefit levels are generally not sufficient to attract the typical private investors present in fully commercial real estate transactions.
Long-Term Project Sustainability	Ability of the urban regeneration project to endure and be self-sustaining over the long operational term.	Long-term sustainability of projects requires project promoters to: • maintain strategic objectives, outcomes and impacts in line with the investment strategy and regional policy; • properly institutionalize the process; • develop broad-based relationships/partnerships that foster collaboration; • involve all stakeholders, for instance: parents, students, business, politicians, community leaders, school administrations, funders; • nurture community involvement; and • develop a core of supporters. This risk also relates to the ability of the project promoter to develop an appropriate project structure and set-up that provides acceptable functioning level.

Market Failure / Sub-optimal Investment

Market failures were often mentioned as obstacles for market and private sector development, also in the area of infrastructure and urban development. Market inadequate response to public needs may result from different factors, including inter alia: insufficient information, real or perceived lack of investment attractiveness (including inadequate return levels), limited access to necessary public infrastructure, protection of property rights, and limited access to funding resources. The fact that the private sector does not invest in certain sectors does not always equate to market failure and could rather result from a poorly structured or a non-viable or non-affordable project.

In the case of Poland as in other countries, a significant number of urban and infrastructure projects are unable to proceed because of the lack of debt and equity finance that due to certain characteristics of infrastructure and urban regeneration projects. Lenders tend to view project risks as too high or returns too low to provide the required loan maturities and/or margins. Broadly speaking,

regeneration projects normally include different types of assets (land, infrastructure, properties, industries, etc.) with different risks and return profiles. These projects attract different categories of investors and lenders and therefore require either a group of senior and intermediary banks or a club deal (pool of banks). In addition, often lenders are not able to provide limited recourse (or project finance) loans but have to provide a corporate finance type of debt with a mix of underlying assets. The inability to secure financing is also exacerbated by the recent banking crisis.

Private Investor Return Requirements

As described above, the risk profiles of the urban regeneration and social infrastructure projects selected in the project portfolio are much broader than the risk profiles of the energy-focused projects. Projects at the conceptual phase have limited information available on the projects' commercial, financial, economic information. This limits the clarity in terms of projects' potential commercial and financial structures between project promoters and private finance investors and pushes the expected rates of return up. On the other hand, for the projects where the services are being paid by a creditworthy public entity (e.g. the municipality paying an availability payment for use of infrastructure provided by the private partner) the risk profile and the adequate return expectations are significantly lower. As a result of this, the potential investors perceive these urban regeneration projects to have a well-defined risk profile. As a result, the range of required rates of returns in this sector is much broader: from 10% for well-structured PPP projects with availability payment from a creditworthy public entity to 20% and over for projects bearing difficult to quantify demand risk. This assumption is based on the Project Team's experience in project finance, including PPPs, concessions and commercial projects in Poland and across Europe.

If it was possible to reduce the development and operational risks of these projects through the use of different FIs such as JESSICA equity, loan, and potentially financial guarantee products, a number of urban regeneration projects could be unlocked and attract both equity as well as debt providers.

7.3.1.3 Business Environment

The main risks associated with the selected portfolio of business environment project including ones that support R&D enterprises, SMEs, business incubators, technology / science parks and free trade / enterprise zones are very similar to the development and construction risks of urban regeneration type projects as described in the section 7.3.1.2 above. These risks in particular refer to inefficient and cumbersome local/regional planning regulations, construction and land costs, especially if brownfield remediation is concerned, and general management issues with putting together more complicated commercial and financial structures (including PPP models and JVs) to enable the project to get off the ground.

In addition to the risks mentioned above, the major risks for business environment sector relates to SMEs and high-growth companies (business incubators, innovation hubs, technology start-up) and lies within the operational phase, particularly with regards to the profile of business counterparties and tenants who are generally riskier, young start-up firms. Project's revenue stream tends to be less stable, therefore, there is a greater level of uncertainty if the returns would accrue from such investments through for example licensing of patents. Investments in R&D generally require a willingness to forego current profits to invest and focus on developing new innovative products, which may take years before returns are realised. Whilst the pay-back period may be long, certain group of investors have historically taken this risk because of the scale of potential returns.

Furthermore, there are significant economic, legal and political factors that makes investments in business environment-type projects for high-growth projects unpredictable that creates the higher risk for investors.

Market Failure / Sub-optimal Investment

Market failure for Business Environment projects share similar characteristics with urban development projects in terms of financing the physical premises and infrastructure however the counterparty risk of SMEs, start-ups and high-tech companies creates additional barriers to potential financing in the commercial market. Lenders tend to view project risks as too high or returns too low to provide commercial loans or equity.

Market inadequate response to developers' needs in this sector results mainly from insufficient information (in particular in case of start-ups with no previous operational and financial track record) and real or perceived high-risk profiles (despite potentially adequately high return levels). Often, commercial equity and in particular debt providers are not in a position to finance early development stage and do not accept unproven (innovative) technology and /or operational risk.

Private Investor Return Requirements

The projects in the business environment sector represent potentially the highest risk to potential investor. They often involve certain degree of technology and implementation risk that is inherent in the R&D ventures and innovative SMEs and suffers the highest failure rate of all the sectors presented in the Case Studies. In addition, practically all of the projects in the business environment sector are in an early development stage that increases the development risk for potential investors. Therefore, such a risk profile will be rather acceptable to investors with high risk-tolerance and adequate return potential, in the area of 20% – 25% measured in the form of equity IRR.

7.3.2 Optimal Project Funding Structure and FIs proposed

The analysis for each of the selected Case Studies focuses on delivering an optimal financial structure which (1) satisfies the financing / capital requirements for each type of projects, (2) optimizes the profitability of each project stakeholder, and (3) provides maximum level of risk mitigation for each project stakeholder by structuring the best use of available Financial Instruments (equity, loan, and financial guarantee).

As described in the assumptions' section, as a default we have assumed that FIs will match commercial funding in terms of FIs' sizing to optimise private co-financing (as opposite to covering the entire funding required with FIs and allow for sub-optimal private funding allocation). On several occasions where the projects' economics did not allow for such a structure, we have proposed higher FIs contribution.

7.3.2.1 Equity

In the case of FIs in the form of equity capital, the UDF can be used to supplement /co-invest with other equity funding providers (including initial developer). As most of the projects are situated in the so called "blue zone" where projects do not generate a sufficient level of return, but provide non-financial returns in terms of social, economic, and environmental impacts, their low project level profitability and high project risks on many occasions do not meet private equity investors' return profile, the financing offered through the UDF can thus provide two main benefits to the potential private equity investors:

- Availability of an additional source of capital which will lower equity capital funding requirements and alleviate any equity funding constraints relevant for 3rd party equity investors. In addition, this will offer a certain level of confidence and comfort to other investors.

- Facility customisation to match project-specific circumstances, requirements and challenges - in the cases where the inclusion of FIs using equity facility has not been assumed to provide sufficient level of incentivisation to the 3rd party equity investor in terms of equity returns, further consideration for the design and structuring of this facility has been made. This consideration has involved the set-up of equity FIs in a way which allows the UDF to purchase non-preferable project/SPV shares that require lower equity return for the same level of assumed risk, thus increasing the level of the private equity co-investor (but not the public grantor) return. While analysing the Case Studies, this applied mainly in large-scale urban regeneration projects as in Łódź and Poznań where we assumed rate of returns to JESSICA at the levels well below market standards for these types of projects. The Project Team believes this is a justified measure taking into account social impacts of these projects not only for the cities but also to the entire Regions. This assumption is a generally accepted form of equity investing; however in the context of JESSICA, due to the initiative's specific commercial, financial, regulatory, and legislative structures, it would require further investigation in terms of its applicability.

With the exception of the scenarios where equity is designed as "subordinated" to the private equity investor (i.e. where equity is used to purchase non-preferable project/SPV shares), the equity facility is assumed at pari-passu with the private equity investor and sized as an equal equity capital co-investor (i.e. providing 50% of the total required equity investment capital), and to exit on the same terms as the private equity investor (i.e. no buy-back options to original shareholders have been explored).

The FIs equity contribution might be provided through different instruments named by the Study respondents, including:

- seed capital;
- permanent equity (pari-passu or non-preferable);
- mezzanine;
- subordinated loans;
- convertible instruments.

Finally, it is worthwhile noting that despite initial interest of most of project promoters in loans, all 19 projects benefit most from FIs equity participation (combined with another instrument). **Equity contribution through a Financial Instrument bridges the ever-recurring market inefficiency resulting from relatively underdeveloped equity market in Poland in general.** The equity contribution provides funding to developers that in many Case Studies faced lack of interest from private equity side, especially due to early development or construction stage of their projects and the risks associated and/or lower than acceptable potential level of returns. This Study shows clearly that availability of loans (irrespective of their potentially attractive terms and conditions) helps the projects' economics (by increasing expected project's and investors' returns to the levels acceptable to investors) but often does not allow for projects to financially "unlock" (i.e. obtain financing on acceptable terms), especially if appropriate level of private co-financing is expected. Besides preferential conditions of available debt and equity, many of these projects will still require significant grant funding (in case of Poznań almost 50%) to cover necessary CAPEX but the Case Studies showed possible diversion from grant-dominated culture in urban regeneration and demonstrated possible financing options for very challenging large-scale urban regeneration projects.

7.3.2.2 Debt

In the case of loans, the FIs could be utilised for:

- Reduction of project's borrowing costs - due to the more favourable terms (i.e. lower interest rate and longer grace and repayment periods) of FIs in comparison to a traditional bank commercial loan offered in the Polish market, the participation of the UDF into project's funding structure can reduce project's financing costs.
- Mitigation of project's risks - The JESSICA-type loan could be designed/set-up in such a way as to be subordinated to the bank commercial loan if necessary, which means that it will be the first to incur any losses in interest and principal repayments driven by reduced project revenues. This therefore provides much needed comfort and protection for the bank commercial lender by mitigating their project risks exposure and hence their credit risk.

All debt instruments proposed in the "optimal" case scenario offer pricing benefits when compared with terms available in the commercial market for these types of urban projects. However, as a default assumption UDFs do not lend below the reference rate (WIBOR) unless it in cases when the project has significant social impacts but cannot support lending on a fully commercial basis, then the loans might be at or below WIBOR. Debt FIs might be provided through different instruments named by the Study respondents, including:

- loans (*pożyczki*)
- credit facilities (*kredyty*),
- debt securities (including bonds of municipal companies),
- revenue bonds,
- all instruments above provided to the SPVs (including PPP structures).

These debt instruments address well the current situation in Polish debt market. Polish debt financing has remained relatively stable through the financial crises and Polish banks have generally remained open to provide liquidity to the market participants. At the same time, majority of private enterprises cut back on their investment, thus reducing the demand for commercial financing. Both trends resulted in a relatively high liquidity across the commercial banks that could theoretically be used to finance urban regeneration projects.

The major hurdles in shifting the liquidity to these types of projects by the commercial banks are:

1) long-term financing expected by potential project promoters;

2) lack of necessary collateral often required by the banks;

3) insufficient equity to be provided by sponsors to meet debt to equity ratios acceptable to the banks; and

4) risk of development and operation stages of the projects as described above.

As of availability of long-term financing, as in other markets, also the majority of Polish commercial banks have strong preference for providing finance up to 7 years. Generally, urban regeneration projects require significantly longer tenors taking into account their revenue generation potential. There are several banks that offer longer tenors (even longer than 20 years) and are interested in lending to infrastructure projects.

Example of such long-term financing for a large-scale infrastructure projects is the recent financial close of debt financing for Waste-to-Energy plant in Poznań where a long-term debt (over 20 years) has been provided by the consortium of three Polish largest banks: PKO Bank Polski, Pekao S. A. and state owned development bank BGK. Such lenders are looking though for larger projects and very

strong sponsors and cannot form an exclusive debt-funding source for all urban regeneration projects. Most of commercial banks are looking for additional source of security and co-lending to be provided to the projects that would allow them to provide debt and possibly extend their tenors. Well-structured FIs can create such an additional source of finance to unlock commercial debt financing for urban regeneration projects.

What is important in the context of urban regeneration projects is also the capability of public entities (mainly municipalities and their companies) to increase their debt levels. After the years of heavy investments, including the need to provide co-funding for the EU grants, the majority of municipalities have reached or are close to reach their indebtedness levels, as described in Section 4.1. of this Study.

7.3.2.3 Guarantees

Last but not least, the UDF can be a part of project's funding structure providing financial guarantee products that offer an additional form of mitigating project risk exposure. Acting as a form of an insurance product, the JESSICA-type guarantee can be structured to cover specified or all project risks for a certain project operational period. This coverage could potentially allow for the enhancement of the commercial loan's lending terms, by lowering facility's interest rate and extending its tenor over longer operational project period, covered by the availability of a financial guarantee.

7.3.3 Summary

The analysis of 19 Case Studies across all 9 Regions demonstrated the need for FIs in getting the projects off the ground which otherwise might not receive financing. The Case Study analysis also proved that to a certain extent the FIs might substitute or complement the grant-funding.

In several cases, the Project Team proposed the PPP structures as they offered the optimum combination of incentives to private parties' financial contribution, long-term quality of services, and focus on social aspects secured by public entity involvement as well as most efficient use of public money, given public sector constraints. PPP structures were also proposed in cases where there was none or insufficient revenue generation potential. In such cases, the Study Team proposed an availability payment model that allows the public entity to use the infrastructure built, financed and operated by the private investor, and repay the capital expenditure over the asset life. The Case Studies proved these structures to be suitable for FIs co-financing where FIs efficient use enables to reduce availability payments to be paid by public entities and makes the projects more affordable. The PPP structures require adequate and often longer preparation period and relevant experience from a public grantor. Existing track record of successful transactions in Poland is still limited and the decision of using this model requires additional consideration as of its use for any given project.

The Case Studies revealed the situations of potentially sub-optimal use of scarce public financial resources, whereas the potential public promoters proposed excessive cash equity contributions. In several cases the projects were structured not to achieve the most financially efficient solution (including available debt leverage), but were based on cash available to the public grantor. In such cases, the Project Team proposed alternative structures that enable public grantor to benefit from debt funding and that allowed for significant savings to be made in project promoter's equity to be potentially utilized for other projects.

Finally, many projects offer good potential for combination of FIs with small-scale grant funding at the initial stage of project development. These small-scale grants do not significantly influence the potential returns to investors, however might play a critical role in project's overall success due to general conservatism of private investors on spending in the initial phase. The Project Team believes

that targeted grant funding for technical assistance at the early stage might significantly improve the project pipeline in terms of quality of potential projects for investments with FIs.

The high-level summary of Case Studies key findings and recommendations is presented in the table below.

Figure 41: High-level summary of Case Studies

Region	Project	Project promoter	Sector	Value (PLN M)	Preferred FIs proposed (PLN M)	Remarks
Kujawsko-Pomorskie	Combined Heat and Power Production	PEC Brodnica	Energy	15	Equity – PLN 2.4M Debt – PLN 5.7 M	Commercial returns available subject to market risks. FIs equity and debt to match commercial financing. Equity at pari-passu, debt with longer maturity (18 years vs. commercial 10 years).
Kujawsko-Pomorskie	Regeneration of downtown in Grudziądz	City of Grudziądz	Urban regeneration	90 (11)	Equity – PLN 1.6M Debt – PLN 2.7 M Grant funding	Significant social impact with limited revenue generation potential. Grant funding of approx.25% of CAPEX recommended to cover existing funding gap, even if FIs used. Equity and debt to match commercial financing. Equity at pari-passu, debt with longer maturity (14 years vs. commercial 9 years).
Łódzkie	Innovation: A Key to Success	Bełchatowsko Kleszczowski Park Przemysłowo Technologiczny	Business environment	50-100	Equity – PLN 16.9M Debt – PLN 22 M	Commercial returns available subject to market risks. FIs equity and debt to match commercial financing. Equity at pari-passu, debt with longer maturity (18 years vs. commercial 8 years). Significant savings made on sponsor's equity initially proposed for this project, to be potentially utilized for other projects.
Łódzkie	Revitalisation within the Inner City of Łódź	City Hall of Łódź	Urban regeneration	650	Equity – PLN 40.9M Debt – PLN 71.2 M Grant funding	Challenging project of critical importance to city centre with high social impact (supporting social inclusion and combating poverty). Grant funding of approx.25% of CAPEX recommended to cover existing funding gap, even if FIs used. JESSICA-type non-preferable equity proposed (with lower equity return requirements), debt with longer maturity (17 years vs. commercial 7 years). PPP structure proposed.
Lubelskie	New energy for Kraśnik	City of Kraśnik	Energy – energy efficiency, photovoltaic	20	Equity – PLN 0.75M Guarantee – PLN 7.3 M Grant funding	Commercial returns available subject to market risks to be covered by JESSICA-type guarantee over the development / construction and ramp-up period. FIs equity to match commercial financing. Equity at pari-passu, debt with longer maturity (18 years vs. commercial 10 years). Grant funding to cover initial costs (incl. energy audit and development costs).
Lubelskie	Retail Park Lokomotywownia	Private developer	Urban regeneration	66	Equity – PLN 13.3M Debt – PLN 21.0 M	Commercial returns available subject to market risks. FIs equity and debt to match commercial financing. Equity at pari-passu, debt with longer maturity (10 years vs. commercial 7 years).

Małopolskie	Małopolskie Research Centre and Małopolskie Centre of Biotechnology	Jagiellonian University	Business environment - SME/R&D	120+58	(for MCB) Equity – PLN 6.0M Debt – PLN 10.7 M Grant funding	Project limited to providing modern infrastructure availability (operating costs of personnel to be covered by the sponsor). Grant funding of approx. 35% of CAPEX recommended to cover existing funding gap, even if FIs used. JESSICA-type non-preferable equity proposed (with lower equity return requirements), debt with longer maturity (14 years vs. commercial 10 years). PPP structure between University and private biotechnology companies.
Małopolskie	Municipal Waste Thermal Processing Plant (MWTPP)	City of Tarnów	Energy	500-650	Equity – PLN 90 M Guarantee – PLN 43.6 M	Commercial returns available subject to market risks to be covered by JESSICA-type guarantee over the development / construction and ramp-up period. FIs equity to match commercial financing. Equity at pari-passu. Due to guarantee longer commercial debt maturity possible (18 years vs. commercial 10 years). Grant funding to cover initial costs (incl. energy audit and development costs). PPP structure proposed.
Mazowieckie	Modernization of the urban lighting	City of Sochaczew	Energy	21	Equity – PLN 2.7 M Guarantee – PLN 13.1 M Grant funding	Commercial returns available subject to market risks to be covered by JESSICA-type guarantee over the development / construction and ramp-up period and JESSICA-type non-preferable equity proposed (with lower equity return requirements), due to guarantee longer commercial debt maturity possible (10 years vs. commercial 7 years). Grant funding to cover initial costs (incl. energy audit and development costs). ESCO structure proposed.
Mazowieckie	Revitalisation of the Urban Municipal Centre of Culture	City of Pilawa	Urban regeneration / Social Infrastructure	5.5	Equity – PLN 0.6M Debt – PLN 2.2 M	Revenue bonds option analysed (deemed not applicable due to project size and nature of revenue stream). Significant savings made on sponsor's equity initially proposed for this project, to be potentially utilized to other projects. JESSICA-type non-preferable equity proposed (with lower equity return requirements), debt with longer maturity (13 years vs. commercial 8 years).
Śląskie	Construction of Multicentre Cieszyn	AMG Development Sp. z o.o.	Urban regeneration	70	Equity – PLN 13.8 M Debt – PLN 34.6 M	Commercial returns available subject to market risks. FIs equity match commercial financing. Equity at pari-passu, debt with longer maturity (14 years vs. commercial 10 years).
Śląskie	Regeneration of cultural heritage coal basin: historic mine "Saturn" in Czeladź	City of Czeladź, City of Będzin	Social Infrastructure / Urban regeneration	49	Equity – PLN 8.6M Debt – PLN 13.8 M Grant funding	Potentially high social impact. Grant funding of approx.12% of CAPEX recommended to cover existing funding gap, even if FIs used. FIs equity to match commercial financing. Equity at pari-passu. Debt with longer maturity (14 years vs. commercial 9 years). PPP structure proposed.
Śląskie	Integrated area development program for former Hard Coal Mine „Szombierki"/„Krystyna"	Armada Development	Urban regeneration	35	Equity – PLN 6.0 M Debt – PLN 9.6 M	Commercial returns available subject to market risks. FIs equity match commercial financing. Equity at pari-passu, debt with longer maturity (11 years vs. commercial 8 years).

Świętokrzyskie	Culture Brewery of Ostrowiec	Municipality of Ostrowiec Świętokrzyski	Social Infrastructure/ Urban Regeneration	90	Equity – PLN 7.4M Debt – PLN 2.2 M Grant funding	Potentially high social impact for the city. Grant funding of approx. 65% of CAPEX recommended to cover existing funding gap, even if FIs used. JESSICA-type non-preferable equity proposed (with lower equity return requirements), debt with longer maturity (16 years vs. commercial 10 years). General concerns on affordability of this project to the City.
Świętokrzyskie	Regeneration of Busko-Zdrój Spa zone	City Busko-Zdrój	Urban regeneration	30	Equity – PLN 7M Debt – PLN 11.2 M	Potentially high social impact for the city, not revenue generating, PPP structure with availability payment from the city proposed. JESSICA-type non-preferable equity proposed (with lower equity return requirements), debt with longer maturity (18 years vs. commercial 12 years). Use of FIs saves the taxpayer PLN 20M over the project's operational life of 20 years.
Wielkopolskie	District Heating with SMEs (Szamotuły)	Kogeneracja Zachód	Energy – energy efficiency	70 (+23M)	Equity – PLN 3.5 M Guarantee – PLN 8.5 M	Commercial returns available subject to market risks to be covered by JESSICA-type guarantee over the development / construction and ramp-up period. FIs equity to match commercial financing. Equity at pari-passu. Due to guarantee longer commercial debt maturity possible (18 years vs. commercial 8 years).
Wielkopolskie	River in the City: Development of Riverside Areas in Poznań	City of Poznań	Urban regeneration	2.375 (public project, to be supplemented with private projects)	Equity – PLN 232.5 M Debt – PLN 791.3 M Grant funding	Challenging project with potentially high social impact. The analysed project to cover public part of integrated refurbishment of the riverside. Grant funding of approx. 50% of CAPEX recommended to cover existing funding gap, even if FIs used. JESSICA-type non-preferable equity proposed (with lower equity return requirements), debt with longer maturity (27 years vs. commercial 15 years). PPP structure. Project of significant impact on the Region - financial contribution from various sources (including the City) to be discussed between the City of Poznań and the MA.
Zachodnio-Pomorskie	Redevelopment of the district heating networks and construction in Białogard	Kogeneracja Zachód S.A.	Energy – district heating	27	Equity – PLN 3.2 M Guarantee – PLN 7.7 M	Commercial returns available subject to market risks to be covered by JESSICA-type guarantee over the development / construction and ramp-up period. FIs equity to match commercial financing. Equity at pari-passu. Due to guarantee longer commercial debt maturity possible (18 years vs. commercial 8 years).
Zachodnio-Pomorskie	Renovation of Old Buildings in the City Centre	TBS "Prawobrzeże" Sp. z o.o.	Urban regeneration	10.5	Equity – PLN 2.2 M Guarantee – PLN 3.3 M	Commercial returns available subject to market risks. FIs equity and debt to match commercial financing. Equity at pari-passu, debt with longer maturity (18 years vs. commercial 10 years).

IV. RECOMMENDATIONS & CONCLUSIONS

8 GENERAL DEFINITION OF FINANCIAL GAP

This chapter discusses the prudent methodology adopted by the Project Team for a high-level definition of potential Financial Gap for FIs in the Regions.

Potential Financial Gaps for FIs in the Regions have been defined taking into account several factors and findings addressed in the following steps:

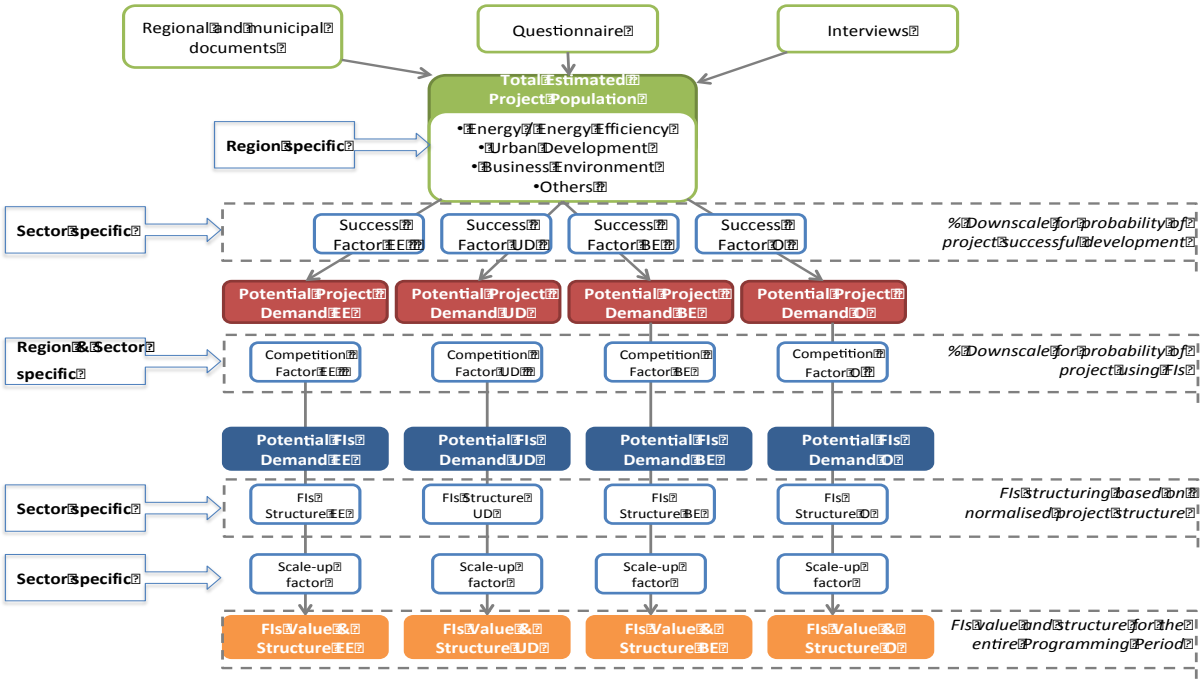
STEP 1: Total estimated project population in each Region and sector;

STEP 2: Potential project demand for financial products in each Region and sector;

STEP 3: Potential demand for FIs in each Region and sector; and

STEP 4: Estimation of the demand for FIs and structures to be used to cover project demands for FIs in defined sectors in each Region.

The approach to definition of Financial Gap in each Region has been illustrated below and explained in detail in this chapter. For a sample calculation of how the potential demand for FIs was derived, please see Figure 46 at the end of this chapter.



8.1 STEP 1: Total estimated project population in each Region and sector

The total estimated project population **(baseline)** was defined separately for each sector and for each Region as:

$$PP\ (Rx) = PP\ (EEx) + PP\ (UDx) + PP\ (BEx) + PP\ (Ox)$$

whereas:

PP (Rx) = Total Project Population in the Region x

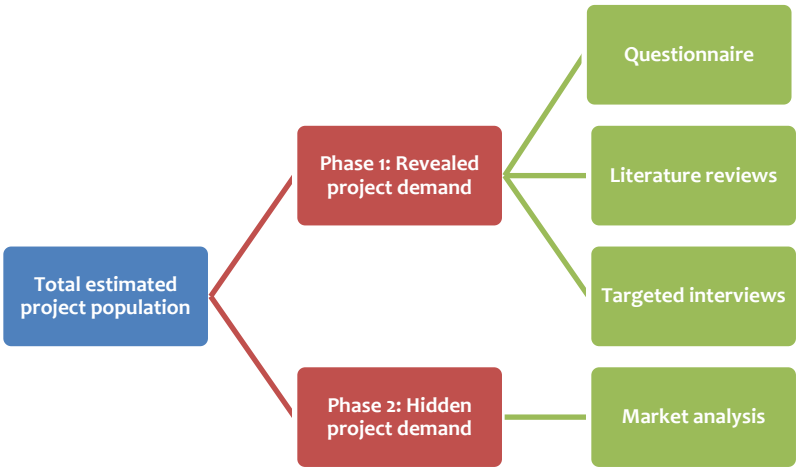
PP (EEx) / PP (UDx) / PP (BEx) / PP (Ox) = Project Population in respectively Energy and Energy Efficiency / Urban Development / Business Environment and Others sectors in the Region x

The potential project population has been defined, using a two-phased approach:

- Phase 1 - First, the Project Team **summarized the results of 225 pre-screened Questionnaires** received as part of this Study and **supplemented the list** with the feasible projects identified through a combination of:
    - **the analysis** of regional and/or municipal **documents** (including Local Development Plans for larger cities[79]) and
    - **targeted interviews** with market participants (in particular potential project promoters).

This allowed the Project Team to identify a long list of pre-screened projects in each Region by sector. After completion of Phase 1, the Project Team identified the ***"revealed project demand"***, derived from the Questionnaires, document reviews and consultations.

- Phase 2 - Second, potential additional projects population has been assessed by the analysis of market data within each sector in each Region. After completion of Phase 2, the Project Team identified the ***"hidden project demand"***, i.e. the demand that has not been revealed through the Questionnaire or relevant documents or interviews, but that is potentially present in the market based on the analysis on market data available as described in point 8.1.2 Phase 2 - Hidden project demand - Market Analysis below.



[79] All cities that were capital cities in any given Region in accordance to the old administrative division to 49 voivodships till 1998 were analysed. Additionally, in Śląskie four largest cities that were not capital cities before 1998 were reviewed taking into account specific territorial features of this Region.

8.1.1 Phase 1 – Revealed project demand - Questionnaire, reviews of strategic documents and targeted interviews

The projects received in the Questionnaire and identified through reviews of strategic regional documents and targeted interviews have been pre-screened for both coherence with regional strategies, ROPs and financial feasibility. In particular in the case of large value projects, the Project Team compared the investment needs relating to the project assessed by the project promoter with the financial situation and potential credit worthiness of the grantor / promoter (in particular in case of municipalities, the potential project values have been assessed against their present and planned budgets and revenue streams to support projects of large scale in comparison to their financial situation). In case, where the projects were, in the opinion of the Project Team, disproportionally large in comparison to the municipality's financial standing, their values were reduced not to exceed municipality's projected annual revenue, unless the project was the part of a larger regional program. The project values were reduced in particular in case of smaller municipalities planning larger scale investments in relation to their projected financial standing.

Additionally, in order to minimise distortion with the sample for extrapolation purposes, large projects have been limited to PLN 200 M unless they were subject of detailed Case Study, which gave the Project Team more realistic assumptions and figures on the project's cost and revenue projections.

The sample was also reduced by the large-scale hospitals (in case of Kujawsko-Pomorskie and Wielkopolskie) as the situation as of demarcation of large-scale healthcare projects was unclear and in accordance to discussions conducted with the relevant Regions.

8.1.2 Phase 2 - Hidden project demand - Market Analysis

In addition to potential projects being identified through the Questionnaire and regional / urban documents as well as discussions with market participants, the Project Team estimated the additional potential demand in several sub-sectors, based on available market data. Taking into account the estimated revealed project population in each Region and in each sector, the Project Team made a "scale factor" adjustment of how many similar projects by total value in the Region can be expected in the pipeline over the next nine to ten years to give an indicative idea of total value of potential project demand. The approach to each sub-sector has been described in detail below.

8.1.2.1 Energy / Energy Efficiency sector

The Project Team estimated additional potential "hidden demand" in several subsectors in energy and energy efficiency sector based on available market data.

<u>Small-scale district heating projects</u>

Based on market data collected through sector associations (i.a. Polish Chamber of Heating Sector and websites of selected municipalities) and business intelligence, the Project Team collected numbers of mid-to-small-scale CHP installations requiring capital investments as well as their average size for each Region separately. The number of installations identified in each Region varied from 6 to 20 with an average size varying from PLN 15 M to PLN 30 M.

<u>Energy efficiency – Thermomodernisation</u>

The Project Team analysed the data published by the Regional Funds for Environmental Protection and Water Management and the BGK in its capacity as fund managers for Polish

Thermomodernisation Fund (whose activity has been limited recently). Historical data have been collected for each Region to demonstrate the total value of projects that have used thermomodernisation funds so far. Based on discussions with the private and public sector market participants, it has been assumed that the same project values will be demanded in the next Programming Period even though several market players (including the Polish Agency for Energy Preservation, KAPE) forecast a significant growth in the total demand size due to advent of new demand groups as in particular:

- Industrial players (thermomodernisation and other energy efficiency measures);
- Commercial office buildings, shopping centres, retail areas;
- Public buildings;
- Educational facilities (eg. schools, colleges and universities);
- Medical facilities (eg. hospitals, health care facilities);
- Others (eg. sport facilities).

However, to ensure estimation prudence this potential market development has not been taken into account while assessing "hidden project demand" in thermomodernisation sector.

Energy efficiency – Street Lighting

Based on market data collected through the Questionnaire and the information published by the National Fund for Environmental Protection and Water Management, the Project Team identified the potential interest in street lighting projects. Analysing the recently closed call for proposals for the street lighting program called SOWA[80], and the detailed Case Study being developed as part of this Study for the municipality of Sochaczew, the Project Team estimated a small-scale project value at approximately PLN 20 M.

Based on the discussions with market participants, it has been assumed that the small-to-medium size municipalities (population between 20,000 to 100,000) will be most probable project demand group due to public sector budgetary constraints and relatively smaller attractiveness to potential investors. On the other hand, these cities might generate projects of minimum 2,000 lamps, which in accordance to discussions with KAPE represent the minimum project size to justify preparatory costs. This assumption has been founded on a market sounding conducted among potential beneficiaries and investors that proved that the larger cities are attractive enough markets for large international investors who will be willing (and currently pursuing these opportunities) to develop street lighting through the PPP or ESCO structures and providing necessary funding. The analysis showed existing market gaps in medium-size municipalities that might not attract the largest industry players with necessary funding, yet they are able to generate project of a value that justified intervention through the FIs.

The Project Team collected numbers of municipalities between 20 and 100 thousand inhabitants in each Region and assumed an average project value at PLN 20M in each Region as described above. This is in line with an estimated project value for street lighting Case Study in Sochaczew that is a municipality with population of below 40,000 and covered ca. 70% of city area. Therefore, the Project Team finds this assumption prudent. In addition, other cities in the Regions (in particular those larger than 100,000 population) that have not been taken into account while estimating potential "hidden project demand" might create additional demand for these types of projects.

[80] The first call for projects closed on 30 April 2013.

8.1.2.2 Urban Development and Social Infrastructure

Urban regeneration projects formed the majority of all projects submitted in the Questionnaire (urban regeneration 43.6% and social infrastructure 22.2%). The Project Team estimated additional potential "hidden demand" for:

Urban regeneration projects to be potentially developed by the cities

The Project Team reviewed historical data of urban regeneration projects that applied and failed to receive EU funding until 2012 for each Region separately. Based on the market sounding conducted with the municipalities and the Managing Authorities it is assumed that some of these projects might have presented either too early stage of development or potentially revenue-generating projects that prevented them from receiving the EU funding in the past. Therefore it was assumed that that some of these projects, if properly structured, might look to apply for FIs in case they were available. This approach based only on proven historical data has been adopted for the sake of estimation prudence, however this category represents in our view a potential for significantly higher market demand, taking into account the overall interest especially in mid- and small-size municipalities in finding alternative funding for their urban regeneration needs. Taking into account that the strategic document reviews in urban development and regeneration area (mainly Local Development Plans) were limited only to the largest three to six cities[81] in each Region, the potential project demand for projects in smaller municipalities should form additional project base in project portfolios for each Region.

8.1.2.3 Business Environment (incl. SMEs support, R&D, technology parks and clusters)

Additionally to the projects submitted in the Questionnaire by the potential promoters in business environment sector, the Project Team estimated additional potential demand for:

Projects that might be generated by technology parks and clusters

The Project Team collected data on all technology parks and clusters active in the Regions and analysed their activities. In addition, the activity of the National Centre for Business and Development Strategy (activity to date and planned programs), as well as sector initiatives as for example InnoMed (healthcare technologies) or InnoLot (aircraft technologies) have been reviewed to estimate a potential project demand and common characteristics of typical projects.

Figure 42: Number of technology parks and clusters per Region

	Technology parks	Clusters
Mazowieckie	1	32
Śląskie	5	15
Małopolskie	3	16
Wielkopolskie	2	23
Świętokrzyskie	1	15
Lubelskie	2	14
Łódzkie	2	10
Kujawsko-Pomorskie	1	9
Zachodniopomorskie	3	7

Source: http://www.pi.gov.pl/

[81] All cities that were capital cities in any given Region in accordance to the old administrative division to 49 voivodships till 1998 were analysed. Additionally, in Śląskie four largest cities that were not capital cities before 1998 were reviewed taking into account specific territorial features of this Region.

Based on these analyses and relatively high interest demonstrated in the Questionnaire, it has been assumed that half of technology parks and 20% of clusters currently active in the market will be able to generate one project of an average size, estimated in the Study. For the Regions that applied for the multiple projects in this sector in the Questionnaire, the Project Team applied an average project size from their Region (average values ranging from PLN 16M in Świętokrzyskie to PLN 97M in Małopolskie), for the Regions where the sectors have been under-represented the Project Team used an average project value from all Regions which was PLN 54M. It is worth noting that in all 9 Regions potential projects in this sector were identified therefore the assumptions adopted seem justified. Additional project demand (after applying the Success Factor as described in Step 2) in this sector as potential "hidden demand" was estimated at from PLN 10M in Kujawsko-Pomorskie and Świętokrzyskie to PLN 95M for Małopolskie.

These assumptions were crosschecked with general projects interest demonstrated by similar project promoters in the past in response to calls for projects within the Measure 5.1 "*Support for development of supra-regional cooperative*" under the Operational Programme Innovative Economy 2007-2013 that identified projects of total value of over PLN 2,270.0 M (for more detailed information please refer to section 8.2.3 in later in this chapter). Furthermore, taking into account number and a total value of PLN 680M of potential projects that have been submitted as part of the Questionnaire by potential project promoters in only one Region – Małopolskie, the Project Team believes there is a potential "hidden demand" that needs to be taken into account while defining total potential project demand in the future. This is of particular importance given the Regions' targets to support cooperation between regional scientific institutions with local businesses (including innovative start-ups and SMEs) and to promote their smart specializations that relate to business environment sector. Considering that the above assumptions are based on a limited sample of projects identified through the Questionnaire any recommendations related to the support of Business Environment projects need to be carefully analysed during Ex-Ante Assessments.

Figure 43: Region's smart specialisations potentially related to BE sector

Mazowieckie	• ICT; • Medical sector; • Chemistry.
Śląskie	• Power engineering, • Medicine / healthcare and • Information and communication technologies.
Małopolskie	• Life sciences • Sustainable energy • Information and communication technologies (including multimedia) • Chemistry
Wielkopolskie	Currently under development
Świętokrzyskie	• Efficient use of energy, • Medical tourism
Lubelskie	• Bio-economy / biotechnology • Medical and healthcare services • Low-emission energy • Emerging specialisation ICT and control engineering

Łódzkie	• Biotechnologies • Mechatronics • Nanotechnology and functional materials, • Information technologies
Kujawsko-Pomorskie	• Best safe food – processing, fertilizers and packaging • Medicine, medical and health tourism • Automotive, transport equipment and industrial automation • Information processing, programming, ICT services • Bio-intelligent specialization • Creative industries.
Zachodniopomorskie	• Bio-economy • Maritime and logistics activity (including maritime technology) • Metal and machine sector (an increasing offer of industrial parks, shipping industry); • Knowledge-based services (dynamically developing ICT industry, and business support institutions or creative industries)

No additional "hidden demand" has been projected in the category "Others", taking into account heterogeneity of project population identified in Phase 1 "Revealed project demand". In the Project Team opinion, the population in category "Others" has not formed sufficient base for further project extrapolations, given the need for prudence in project demand estimation.

8.2 STEP 2: Potential project demand for financial products in each Region and sector

The data collected as a potential project population in each Region and in each sector as described above in Step 1, has then been weighted using probability factors for the likelihood of success of the project in each sector ("Success Factor").

For example, the project demand for energy / energy efficiency in Region x has been estimated as follows:

$$PD\ (EEx) = PP\ (EEx) \times SF\ (EEx)$$

whereas:

PD (EEx) = Project Demand for financial products in Energy / Energy Efficiency in the Region x

PP (EEx) = Total Project Population in Energy / Energy Efficiency ("Revealed" and "Hidden Demand" as estimated accordingly in Phase 1 and Phase 2 of Step 1 described above) estimated in the Region x

SF (EEx) = Success Factor understood as probability of project to reach a development stage in the Energy / Energy Efficiency sector (subsector) in the Region x, expressed in percentage.

In order to obtain realistic data estimations, all projects in each category and in each Region have been weighted by probability factor of successfully reaching a development stage. The probability ratios varied from sector to sector and from Region to Region, based on the Project Team's advisory experience in project finance across the sectors within Poland and from other countries such as the U.K. (including projects developed under JESSICA framework).

For the standard probability, the Project Team assumed as a baseline that 50% of all projects irrespective of the sector would fail to be implemented for a combination of reasons i.e. bad projects, poorly structured projects, not aligned with regional policies, projects being in a conceptual phase, etc. Then for each sector, various factors were considered to derive the final standard probability for each sector. In particular, based on the Project Team's experience in

advising on similar projects in both Poland and across Europe as well as a high-level review of market research, the Project Team considered: early development stage risks, planning risk, complexity of permitting procedures as it has been described below for each sector. For Regions currently involved in FIs, a special adjustment was made of 500 basis points to reflect their experience in developing and financial structuring to get projects off the ground.

	Standard Success Factor adopted	Deviation from standard Success Factor (Region or subsector with reasons)
1. Energy / Energy Efficiency	40-60%	See detailed description below
2. Urban Regeneration / Social Infrastructure	15-30%	35% - in Mazowieckie, Śląskie, Wielkopolskie and Zachodniopomorskie due to its experience in using FIs in urban regeneration
3. Business Environment	15-30%	35% - Małopolskie due to extraordinary interest in this sector in the Region (30% of all projects' applications) and role of advanced technologies in Region's strategy / smart specialisation and support from the top academic centres
4. Others	20-25%	

8.2.1 Energy / Energy Efficiency sector

Due to the relative simplicity in the development and construction phases associated with most of energy and energy efficiency projects, the Project Team assumed a higher than standard probability of success. Most of energy and energy efficiency projects (with exemption for more technically challenging projects, as for example waste incinerators) are standardised technical solutions and are often developed as brownfield projects (i.e. being performed on existing infrastructure or industrialised area), with significantly shorter development periods compared to other regeneration projects (2 years for energy projects vs. 5 years for the most complex urban projects).

In particular, the Project Team estimated standard Success Factors in several sub-sectors in energy and energy efficiency sector based on their market experience.

Small-scale district heating projects

Taking into account limited developers' experience in development of small-scale co-generation plants (please refer to Chapter 3.6. Case Studies Conclusions) on the one hand but relative technological simplicity and commercial soundness of these projects on the other hand, it has been assumed that 40-50% of the identified CHPs will successfully reach the implementation phase. This assumption has been crosschecked based on discussions with Questionnaire respondents concerning major project and regulatory risks that might impair successful project development.

Energy efficiency – Thermomodernisation

Based on the discussions with KAPE (Polish Agency for Energy Preservations) and existing and potential investors and ESCO companies, it has been assumed that 50-60% of the identified thermomodernisation projects will successfully reach the implementation phase. This assumption is based on previous experience in implementing these types of projects that are characterised by relatively the lowest technological complexity and significantly reduced development risk due to its "brownfield" character (i.e. being performed on existing infrastructure).

Energy efficiency – Street Lighting

Based on the discussions with existing and potential investors and ESCO companies, it has been assumed that 40-50% of the identified street lighting projects will successfully reach the implementation phase. The major risks named by potential market participants interested in these types of projects with whom interviews have been conducted referred to administrative barriers and slow decision-making process on municipalities' side. However, most of respondents referred to a learning curve and increasing interest on municipal side that cover potential risks of projects delays or abandonments that justifies the Success Factor of 40-50%.

8.2.2 Urban Development and Social Infrastructure

It has been assumed that only approximately 15%-30% of projects in urban development and social infrastructure sector will successfully reach the implementation phase. The reason for low Success Factor adopted in this sector is that in accordance to Project Team's experience these types of projects often face serious development and construction risks that might seriously impede its successful implementation (please refer to Section 3.6. Case Studies Conclusions). Many of projects in this category might use PPP models to develop and finance their investment needs and therefore the data from the Polish PPP market might also serve as verification measure for Success Factor adopted for project in this sector. In accordance to the report published by the PPP Platform affiliated by the MID, less than 20% of PPP projects that were announced in 2011 reached the implementation phase subsequently[82]. The Project Team's experience shows that PPPs are one of the most complicated transaction structures that require long negotiation period and complex agreements and risk-sharing mechanisms that all negatively influence project closing probability, whereas simpler straight-forward projects (in particular in real estate sector) enjoy higher success rate, hence the upper Success Factor limit of up to 30% for selected transactions. Therefore, projects to be potentially implemented through the PPP structures (in particular social infrastructure) were downsized using 15% Success Factor, whereas plain real estate projects enjoyed higher Success Rate of 30%.

Additionally, based on the Project Team advisory experience and having reviewed the Long-List of projects in these sectors submitted in Questionnaires, the Project Team believes that some of these projects potentially represent municipalities' aspirations rather than realistic assumptions based on a robust feasibility study. This issue has to certain extent been addressed earlier in Step 1 in case of projects from the Long-List (revealed project demand) when the Project Team reduced potential projects' values not to exceed municipality's projected annual revenue. For the sake of estimation prudence, additional scale-back with the Success Factors has been adopted to reflect potential decision of the municipalities to scale back or abandon the project altogether.

8.2.3 Business Environment (incl. SMEs support, R&D, technology parks and clusters)

Most of the projects submitted in the Questionnaire by the project promoters in this sector have been well-prepared and presented feasible source of information to assess potential projects' probability of success. When compared with other sectors, the projects submitted within this sector were significantly better prepared and rationalised. However, the experience in this sector till date, both regarding grants and JESSICA instruments demonstrated moderate success rate that needed to be considered while assessing potential likelihood of projects' success. In particular, the cluster initiatives in Poland could have benefitted from the EU funds through the

[82] Raport "Partnerstwo Publiczno-Prywatne w Polsce w latach 2009 – 2011", Platforma PPP, 2011.

Measure 5.1 "*Support for development of supra-regional cooperative*" in the Operational Programme Innovative Economy. In total, since 2008, seven calls for proposals have been announced with 316 applications for funding for a total amount of over PLN 2,270.0 M submitted (the amount of funds applied for is more than 3.5 times higher than the amount assigned for this purpose)[83], which proves significant interest from project promoters. On the other hand, the amount of contracts signed as of the end of June 2013 (32 contracts for a total amount of PLN 230 M) is only approximately 10% of applications submitted that in accordance to the Project Team knowledge results mostly from the relatively poor quality of submissions made.

Based on the relatively highest quality of projects' preparation in this sector from all projects submitted through the Questionnaire, the Project Team believes that the business environment might create a healthy project demand that has been proven through all three Case Studies in this sector (two integrated R&D implementation projects in Małopolskie and a business park in Łódzkie) and also other projects submitted across the Regions (including other projects in particular in Małopolskie, Kujawsko-Pomorskie and Śląskie) that have not been analysed in detail as Case Studies but that presented tangible project concepts. Taking the above into account but also considering difficulties experienced to date, it has been assumed that 15%-30% of these projects will make it through to the implementation phase (with a Success Rate of 35% in Małopolskie as the Region with the largest potential). There are clear areas for improvement in preparatory process (in particular in case of clusters as envisaged by low success rate in project implementation in the past) and project promoters in this sector may benefit from targeted Technical Assistance to support them in increasing the quality of project preparation process. This technical support is of key importance taking into account Poland's target to increase its expenditures on R&D and to support innovation and entrepreneurship also on a local level.

8.2.4 Others

Finally, the probability of success in project development for the category "Others" has been reduced to 20-25% as these category represented less developed projects, very often generally in conceptual stage as illustrated in the Questionnaire where a sizeable number of projects identified are at the conceptual stage for projects under the "Others" category.

8.3 STEP 3: Potential demand for FIs in each Region and sector

The estimated project demand in each Region and in each sector has then been further downscaled by probability of successful projects to seek financing from FIs ("Competition Factor").

The probabilities are derived by the Project Team's experience in advising on similar types of projects in each sector, soft-market testing with financial institutions active in certain sectors and in the Regions, as well as an analysis of potential competition of other financial support for the same type of projects available in the market.

For example, the demand for FIs Energy / Energy efficiency in Region x has been estimated as follows:

[83] Number of applications submitted and the amount of funding requested does not include data from the second call for proposals conducted in 2010.

$$PDF\ (EEx) = PD\ (EEx) \times (1 - CF\ (EEx))$$

whereas:

PDF (EEx) = Demand for FIs in Energy / Energy Efficiency in the Region x

PD (EEx) = Project Demand estimated in the Region x

CF (EEx) = Competition Factor understood as probability of a successful project to use the FIs given potential competition from other financial instruments available in the market, expressed in percentage

	Standard Competition Factor adopted
1. Energy / Energy Efficiency	50%-75%
2. Urban Regeneration / Social Infrastructure	10%
3. Business Environment	0%
4. Others	0%

As a general assumption, the Project Team believes that well-structured FIs available at competitive terms should well fill an existing market gap and rather complement than compete with other potential financial providers.

However, based on competitive market analysis and targeted interviews with financial institutions (including commercial banks) and project promoters, Competition Factors in case of energy and energy efficiency projects were assumed at levels ranging from 50% to 75%. This is due to relatively higher competition in the market from other financial institutions in case of these sectors. Lower Competition Factor of 50% has been adopted in subsectors as district heating, WtE installations and other renewables where projects returns might potentially attract commercial funding. The highest Competition Factor of 75% has been adopted for thermomodernisation and street lighting. This is due to significant competition from other programs, including aforementioned the instruments available through calls for proposals announced on a yearly basis by the Regional Funds for Environmental Protection and Water Management, as well as funds provided by the Regional Funds for Environmental Protection and Water Management through the recently implemented SOWA program (street lighting).

The second sector where the Project Team introduced a Competition Factor is urban regeneration and social infrastructure. A Competition Factor assumed at a low level of 10% refers to certain real estate projects, especially with a relatively significant revenue generation potential that might attract straight-forward "vanilla" corporate lending from commercial institutions for private developers. As discussed with current UDF managers and also from responses to the Questionnaire received from several private developers, in particular in case of smaller projects, private borrowers might prefer commercial institutions and be able to offer them sufficient collateral (including their strong balance sheets) to receive commercial funding. However, taking into account the high and strongly increasing interest in JESSICA FIs in the 2007-13 Programming Period in this sector, and after discussions with project promoters (both public and private) participating in the Questionnaire, the Project Team believes that the potential competition from other financial institutions will be very limited.

8.4 STEP 4: Estimation of demand for FIs and structures to be used to cover project demands for financial products in defined sectors in each Region

The demand for FIs has been assessed based on potential project demand for financial products estimated as described in the sections above and on the conclusions and recommendations on Case Studies developed in each specific sector / subsector (please refer to a General Section of Case Studies).

8.4.1 Estimation of financial structures for projects in each sector

Financial structures for projects in each sector have been aggregated and analysed using data collected from all 19 Case Studies. The result was demonstrating an indicative financial structure that could be used for a project in any given sector.

The pre-screened projects were **arranged** in four categories, identical to the sectoral approach that was adopted for analysis of 19 Case Studies, i.e.:

a. Energy / Energy Efficiency

b. Urban Development and Social Infrastructure

c. Business Environment (incl. SMEs support, R&D, technology parks and clusters)

d. Others (incl. sustainable transport and tourist development)

This categorisation of projects enabled the Project Team to analyse projects by common characteristics such as:

- characteristics and challenges in project's implementation;
- financial structures to be used,
- potential risks to be borne by the investors and related return expectations,
- market failures expected or experienced so far, as well as
- financial products (and potentially FIs) to be used.

Detailed characteristics of each sector as of its experienced and potential market failures, financial structures used, access to and available conditions of external financing, as well as key project risks and operational risks in project implementation have been described in detail in section 7.2.1 General Project Assumptions.

After identifying specific structures for various Case Studies (in the Region and other Regions) in each of four categories, the Project Team was able to adopt an unified approach as of FIs architecture in each category and taking into account of State Aid regulations.

This allowed for a definition and quantification of an indicative financial structure for sector-specific FIs. The estimation were derived from aggregating all the financial structures across 19 Case Studies together by product type i.e. equity, loans, and guarantees by sectors, divided by the total CAPEX by each sector to obtain a percentage for each product.[84]

Based on the Project Team's consulting and advisory experience with respect to JESSICA FIs, it also assumed the projects should have FI equity between 10-15% and/or FI loans between 20-30%, but the combination of FI loans/equity should be less than 40% of the total financing of the project as it is expected that projects should seek other sources of financing for co-investments.

[84] It should be noted that this is an indicative financial structure derived from the data collected from the project promoters for the Case Studies, and supplemented by the Consultant's experience in advising similar funds. The financial structure was used as a proxy in order for the Project Team to estimate the potential demand for FIs and should not be viewed as definititve. The financial structure will vary on a project-by-project basis, and the type of financial products to be offered through the FIs should be subject to an ex-ante assessment.

If applicable, FI guarantees should be no more than 10%.[85] As in the new regulatory framework allows for a combination of grants/FIs, it is assumed that up to 10% of the financing would come from grant-funding, particularly for riskier or less revenue-generating projects in for example, highly deprived areas or projects of significant social impact.

Figure 44: Indicative estimation of financial structures for projects in each sector*

	Energy Efficiency	Urban Regeneration	Business Environment	Others
FIs				
FIs Equity	12%	15%	15%	15%
FIs Loans	27%	20%	25%	20%
FIs Guarantee	10%	5%	10%	5%
Private				
Equity	15%	30%	13%	30%
Loans	28%	20%	27%	20%
Others				
Grant Funding	8%	10%	10%	10%
TOTAL	**100%**	**100%**	**100%**	**100%**

*Note: Based on Case Study analysis and Project Team market experience in structuring projects in Project Finance model in Poland and on other European markets – note this is an indicative estimation for the purposes of this Study only. Financial structures adopted by the Regions should be subject to further analysis of their needs with the Ex-Ante Assessment.

8.4.2 Indicative Estimation of the potential demand for FIs

The Project Team then quantified potential FIs that may be used to address investment needs. The estimated values of FIs represent the potential demand on the pipeline, taking into account that the gap is assessed for the entire Programming Period (plus two years, i.e. till 2022). The estimations are based on a scale factor with the financial structure for all sectors remaining unchanged.

The Base Scale Factor[86] is based on a similar scale used for other 2014-2020 JESSICA Evaluation Studies concurrently taking place but also taken in consideration of specific findings during the stakeholder consultations in the Polish context as well as market trends in Project Finance for this extrapolation exercise. The Scale Factors have been differentiated among three Region groups depending on the interest and readiness of potential beneficiaries to use FIs. The classification has been made on the aggregated data from the Questionnaire and subsequent interviews with project stakeholders.

In particular, the aggregated responses on the Questionnaire on potential interest in FIs should FIs remain the only available source of funding for the projects were analysed. With the average denial rate of 20% (understood as lack of interest in FIs even if they were the only source of funding available) across all Regions, there were Regions where this rate was significantly higher, with the highest denial rate of over 47% in case of Świętokrzyskie. Potential lower

[85] In the Programming Period 2007-2013, guarantee products were not used, however, there is a study (July 2013) that discusses how guarantees could be used to support urban regeneration through FIs.
[86] The Base Scale Factor was applied in order to estimate the future demand covering the entire Programming Period plus 2 years in each sector. This factor was also incorporated into the analysis to reflect regional specificities with respect to their investment readiness and experience.

readiness for using FIs has been noted in 4 Regions giving the grounds for reducing potential scale factor from the base assumptions for all Regions (marked as Group 1 in the table below):

- in case of 3 Regions with a relatively low readiness to use FIs (over 20% denial rate) – reduction by 10% from base scale factors for each sector – (marked as Group 2 in the table below – relevant to Kujawsko-Pomorskie, Lubelskie and Łódzkie);
- in case of the Region with the lowest readiness to use FIs (denial rate over 45%) – reduction by 30% from base scale factors for each sector – (marked as Group 3 in the table below – relevant to Świętokrzyskie).

Figure 45: Estimation of FIs by a scale factor*

	Base Scale Factor (Group 1)	Scale Factor (Group 2)	Scale Factor (Group 3)
1. Energy / Energy Efficiency	3.5	3.15	2.45
2. Urban Regeneration / Social Infrastructure	4	3.6	2.8
3. Business Environment	4	3.6	2.8
4. Others	3	2.7	2.1

*Note: this is a conservative estimation of the projected pipeline over the next 9 years. These figures are subject to an Ex-Ante Assessment.

Figure 46: A sample calculation of estimating the potential demand for FIs

		Energy Efficiency	Urban Development	Business Environment	Others
Step					
1.1	Case Study Project Population	€ 500	€ 600	€ 700	€ 400
1.2	"Hidden Demand"	€ 50	€ 75	€ 40	€ 40
	Total Project Value	**€ 550**	**€ 675**	**€ 740**	**€ 440**
2	Success Factor (SF)	45%	30%	20%	25%
	SF Total Project Value	**€ 247.50**	**€ 203**	**€ 148**	**€ 110**
3	Competition Factor (CF)	40%	10%	0%	0%
	CF Total Project Value	**€ 149**	**€ 182**	**€ 148**	**€ 110**
4.1	Financial Structure (FS)				
	FIs Equity	12%	15%	15%	15%
	FIs Loans	27%	20%	25%	20%
	FIs Guarantee	10%	5%	10%	5%
	FS Total Project Value				
	FS FIs Equity	€ 17.82	€ 27.34	€ 22.20	€ 16.50
	FS FIs Loans	€ 40.10	€ 36.45	€ 37.00	€ 22.00
	FS FIs Guarantee	€ 14.85	€ 9.11	€ 14.80	€ 5.50
	FS Total Project Value	**€ 72.8**	**€ 72.9**	**€ 74.0**	**€ 44.0**
4.2	"Scale Up" Factor	3.5	4	4	3
	Scale Up Total Project Value	**€ 254.68**	**€ 291.60**	**€ 296.00**	**€ 132.00**
	ESTIMATED POTENTIAL DEMAND	**€ 254.68**	**€ 291.60**	**€ 296.00**	**€ 132.00**

Step 1.1: Case Study Project Value (Baseline): Derived from the total value of projects collected in the case studies
Step 1.2: Incorporating "Hidden Demand": It also included additional projects based on the literature review of key regional documents ie) estimated number of projects x average size of projects derived from 1.1
Total Project Population + 1.1 + 1.2 for each sector

Step 2: Success Factor: As a standard probability, the Project Team assumed 50% of the Total Project Population would not be successful, then special probabilities were applied for each sector depending on the risks associated ie) high start-up cost, planning risk, etc. The range of probabilities were as follows:
- Energy / Energy Efficiency 40-60%
- Urban Regeneration / Social Infrastructure 15-30%
- Business Environment 15-30%
- Others 20-25%

Step 3: Competition Factor: The estimated project demand in each Region and in each sector has then been further downscaled by probability of successful projects to seek financing from FIs
- Energy / Energy Efficiency 50%-75%
- Urban Regeneration / Social Infrastructure 10%
- Business Environment 0%
- Others 0%

Step 4.1: Applying "Financial Structures:" This was derived from aggregating all the financial structures across 19 Case Studies together by product type i.e. equity, loans, and guarantees by sectors, divided by the total CAPEX by each sector to obtain a percentage for each product to provide an indicative (or proxy) financial structure to estimate the potential demand for FIs.
Calculation: CF Total Project Value * FI Equity (12%) = FS FI Equity
FS Total Project Value = FS FI Equity + FS FI Loans + FS FI Guarantees, this represents the indicative pipeline for one year.
Step 4.2: Scale Factor: The estimated values of FIs represent the potential demand on the pipeline, taking into account that the gap is assessed for the entire Programming Period (plus two years, i.e. till 2022). The estimations are based on a scale factor with the financial structure for all sectors remaining unchanged. This is a conservative estimate

	Base Scale Factor (Group 1)	Scale Factor (Group 2)	Scale Factor (Group 3)
1. Energy / Energy Efficiency	3.5	3.15	2.45
2. Urban Regeneration / Social Infrastructure	4	3.6	2.8
3. Business Environment	4	3.6	2.8
4. Others	3	2.7	2.1

In particular, the aggregated responses on the Questionnaire on potential interest in FIs should FIs remain the only available source of funding for the projects were analysed. With the average denial rate of 20% (understood as lack of interest in FIs even if they were the only source of funding available) across all Regions, there were Regions where this rate was significantly higher, with the highest denial rate of over 47% in case of Świętokrzyskie. Potential lower readiness for using FIs has been noted in 4 Regions giving the grounds for reducing potential scale factor from the base assumptions for all Regions (marked as Group 1 in the table below):
• in case of 3 Regions with a relatively low readiness to use FIs (over 20% denial rate) – reduction by 10% from base scale factors for each sector – (marked as Group 2 in the table below – relevant to Kujawsko-Pomorskie, Lubelskie and Łódzkie);
• in case of the Region with the lowest readiness to use FIs (denial rate over 45%) – reduction by 30% from base scale factors for each sector – (marked as Group 3 in the table below – relevant to Świętokrzyskie).

9. FINANCIAL GAP SUMMARY AND SUGGESTED ARCHITECTURE FOR FINANCIAL INSTRUMENTS FOR EACH REGION

9.1 Regional Financial Instrument Strategy

The financial analysis of case studies demonstrates the value-added and benefits of using FIs. To briefly summarise:

- The use of FIs combined with private sector funding enables projects in the "Blue Zone" i.e. projects that do not generate sufficient returns due to market failures however provide economic, social, and environmental non-financial returns to get off the ground due to low-cost financing.
- FIs providing "junior" or *pari-passu* debt improve the project's risk profile by reducing the overall cost of financing.
- The longer investment period means there is relatively less pressure to generate immediate returns, depending on the funding structuring.
- The ability to attract private co-investments could potentially encourage further investments by providing assurance and a positive signal to the private market.
- Utilising ESIF through FIs allow for a "recycling" of public monies to ensure that a 'legacy' fund is created to re-invest in future projects falling within the MA's regional strategy.

The table below provides an overview of the recommended FI strategy by the Region, including:

- The indicative demand for FI is derived from the total investment by project value taking into account the probability of the success rates for project implementation, and scaled up to cover the entire Programming Period across all four sectors for each Region. The indicative demand for FIs is based on the assumption of a co-financing of 50% from ESIF and 50% from national/regional funds or private sector (or a combination of public/private) co-financing. For example, if the indicative demand for FIs is €100, then it is assumed that €50 will be from ESIF and the other €50 will be from private and/or public sources of finance. This is only an assumption and MAs should complete an Ex-Ante Assessment prior to allocating ESIF to FIs.
- The expected leverage effect of private sector financing per Region from FIs. The leverage effect is defined as the aggregated total project cost divided by the total financing from FIs. For example if the total value of a project covering the entire programming period is €100 and the amount financed by FIs is €40, then the leverage effect would be €100/€40 = 2.5. In other words, the Region is able to leverage 2.5 times additional financing from the public and/or private sector.
- The recommended investment typology or intervention areas (i.e. urban regeneration, post-industrial revitalisation, SME, energy efficiency) is based on three sources: literature reviews of related policy documents, qualitative discussions with the MAs, and an assessment of the market demand for FIs based on various sectors, as well as the analysis drawn from the previous section.
- The suggested implementation/organisational structure with indicative range of figures on the indicative demand for FIs for each Region.

The difference between the market gap or the demand for FIs and the total project value is thus estimated co-investment at the project level. It should be reiterated that before the ESIF are

dedicated to FIs the MAs should undertake an Ex-Ante Assessment with careful consideration to State Aid and other relevant issues.

Figure 47: Indicative Potential Demand for Financial Instruments and Strategy by Regions

	Kujawsko-Pomorskie	Łódzkie	Lubelskie	Małopolskie	Mazowieckie	Śląskie	Świętokrzyskie	Wielkopolskie	Zachodnio-pomorskie
(EUR)*	€ 80-95 M	€ 220-255 M	€ 130-150 M	€ 270-320 M	€255-300 M	€300-355 M	€ 70-85 M	€ 205-245 M	€ 155-180 M
Leverage Effect[87]	~2.6	~2.7	~2.3	~2.2	~2.2	~2.3	~2.3	~2.2	~2.2
Suggested FI Typology	Urban Development SME Energy Efficiency	Urban Development Energy Efficiency	Urban Development Energy Efficiency	Business Environment /SME/R&D Urban Development Energy Efficiency	Urban Development Energy Efficiency	Post-Industrial Urban Development	Urban Regeneration Energy Efficiency	Urban Development Energy Efficiency	Urban Development Energy Efficiency
Proposed areas of intervention									
	Urban Development	*City of Łódź*	*Urban Development*	SME/University/ R&D	*Urban Development*	*Post-Industrial regeneration*	*Post Industrial Regeneration*	*Energy Efficiency*	*Urban Development*
	SME/Business Parks	*Small-Mid Size Cities*	*Energy Efficiency*	*Energy Efficiency*	*Energy Efficiency*	*Post-Industrial for SME/Business Parks*	*Urban Development (Cultural Heritage /Tourism)*	*Urban Development*	*Energy Efficiency*
		Energy Efficiency		*Urban Development*		*Energy Efficiency*			

* It should be noted that this is an estimated demand for FIs, however, the size of FI should be subject to a full Ex-Ante Assessment in due course. The EIB/EC will be issuing guidance on Ex-Ante Assessments in early 2014.

[87] Pursuant to Article 223 of the Rules of Application of the Financial Regulations the leverage effect is defined as: "*Financial instruments shall aim at achieving a leverage effect of the Union contribution by mobilising a global investment exceeding the size of the Union contribution. The leverage effect of Union funds shall be equal to amount of finance to eligible final recipients divided by the amount of the Union contribution.*" However, for the purposes of this Assignment, the leverage effect is based on the upper limit range of the estimated potential demand for the Financial Instrument. Leverage effect is calculated as the total project value divided by the value of Financial Instrument and reflects the effect of public spending (including EU funds) activating private investments and multiplying the total amount of investments because the level of co-financing was not clearly defined by Regions at the time of the Study. The leverage effect will be examined more thoroughly in the Ex-Ante Assessment.

10 IMPLEMENTATION PROCEDURE AND ACTION PLAN

This section provides an outline of the suggested investment strategy for urban development for each Region based on demand for FIs assessed in the previous section within each Region and recommendation for practical arrangements for implementation of FIs for the next Programming Period.

The use of FIs has multiple benefits, namely:

- The "revolving" character of FIs allows for recycling of funds once investments are repaid which can then be re-invested in new projects in line with regional strategy, thereby creating a "legacy" effect on public monies.
- Investments into projects must generate revenue and at the same time contribute to economic, social, and environmental impacts as stipulated within respective investment strategies.
- Addresses market failure (or market gap) using tool for funding long-term and mitigate risks blocking the financing of eligible projects.
- Leverage additional resources by attracting co-investments from the private sector.

For the new Programming Period 2014-2020, there is greater incentive to use FIs, therefore, the Commission intends to encourage the take up of FIs by increasing the maximum co-financing rate by 10 percentage points, where the whole of the priority axis is delivered through FIs. For example, the ESIF contribution will be 60% instead of 50%, and national co-financing will then be 40%.

It is also envisaged that FIs can be complemented with grants, which is particularly advantageous for projects that do not generate sufficient revenues to payback the resources invested.

FIs in urban projects should be structured so that: (1) expected financial returns are adequate to ensure that the resources employed can operate as revolving funds; and (2) expected socio-economic and environmental impacts are closely assessed during project appraisal, are achievable.

10.1 Ex-Ante Assessment for Financial Instruments

Pursuant to Article 37 of the CPR mandates that prior to allocating OP resources to FIs, MA must undertake an Ex-Ante Assessment to establish evidence of market failure or sub-optimal investment situations prior to allocating ESIF to FIs. The Ex-Ante Assessment shall include:

- **Assessment of market failure, sub-optimal investment situations and investment needs**: The European Commission has seen that successful design and implementation of FIs hinges on a correct assessment of market gaps and needs and therefore during the 2014-2020 Programming Period FIs should be designed on the basis of an Ex-Ante Assessment. The mismatch between the demand and supply of the different types of FIs , known as the financing gap, constitutes the rationale for public intervention in market.
- **Investment strategy:** Experience shows that it is crucial to link the Ex-Ante Assessment and the Programme strategy as the first step. Particularly considering the future possibility to combine FIs with grants, the Ex-Ante Assessment should be integrated with programming to address the different market gaps. The Ex-Ante Assessment must include more information on what type of financial products should be put in place to avoid overlaps and inconsistencies between funding instruments implemented by different actors at different levels and what final recipients shall be targeted. Options for implementation arrangements should be also examined.

- **Additional public and private resources**: Knowledge of the level of funds (from ESIF and as national co-financing sources, as well as the expected level of involvement from the private sector in the form of co-investment, for example) which the MAs intend to channel in to FIs under their OPs will be a crucial component of the Ex-Ante Assessment process, as it allows the evaluators to suggest what type of financial products could be put in place to address the identified funding gap(s). The need for, and level of, preferential remuneration to attract counterpart resources from private investors should be also assessed.
- **Expected results and impacts**: Expected results and impacts to be assessed focus on a specification of the expected results and how the Financial Instrument concerned is expected to contribute to the achievement of the specific objectives and results.
- **Value added**: The Ex-Ante Assessments will tie the findings related to market gaps more closely into the objectives and priorities of the ESIF programmes, and the added value of FIs under consideration must be explained.
- **Application of lessons learnt**: There must be an assessment of lessons learned from similar instruments or ex-ante or interim evaluations in the past. This Programming Period has been a learning experience for many MAs implementing FIs for the first time and there is now considerable experience being built up which can usefully feed into the development of the Ex-Ante Assessment methodology for 2014-2020.
- **Provisions allowing for periodic reviews and updates**: during the implementation phase MA may consider that the Ex-Ante assessment no longer accurately represents the market conditions existing at the time of implementation; therefore, the review and update of the Ex-Ante Assessment may become necessary to reflect changes in the market.

There is no deadline for the Ex-Ante Assessment and it does not have to be conducted in parallel with the ex- ante evaluation of the OP. Ex-Ante Assessments must be submitted to the monitoring committee of the relevant operational programme(s) for information. The summary findings and conclusions of Ex-Ante Assessments should be published within three months of their finalisation, under the responsibility of MAs.

To reiterate, the scope of this Study is not an Ex-Ante Assessment, therefore each Region will need to undertake its own Ex-Ante Assessment in due course. This Study does provide however indicative estimation of the demand for FIs and preliminary suggestions regarding the target final recipients and products that can be used as the basis for an Ex-Ante Assessment at the MA's discretion.

10.2 Investment Strategy and Funding Agreement

The Investment Strategy should be well-defined and structured to address the potential demand and prevailing market failures identified in each market segment. Discussion of market failure grouped by sectors has been discussed in detail in Section 7.3 Case Studies Conclusions. The Investment Strategy should also reflect the objectives of ROPs from which the ESIF will be drawn. Together, this will drive the strategy, size, typology, geographical scope, products, and implementation structure of future FIs to ensure that investments in eligible projects meet the broader Europe 2020 strategy, in particular that it links to 11 Thematic Objectives. Additionally elements for the Funding Agreement should also consist of:

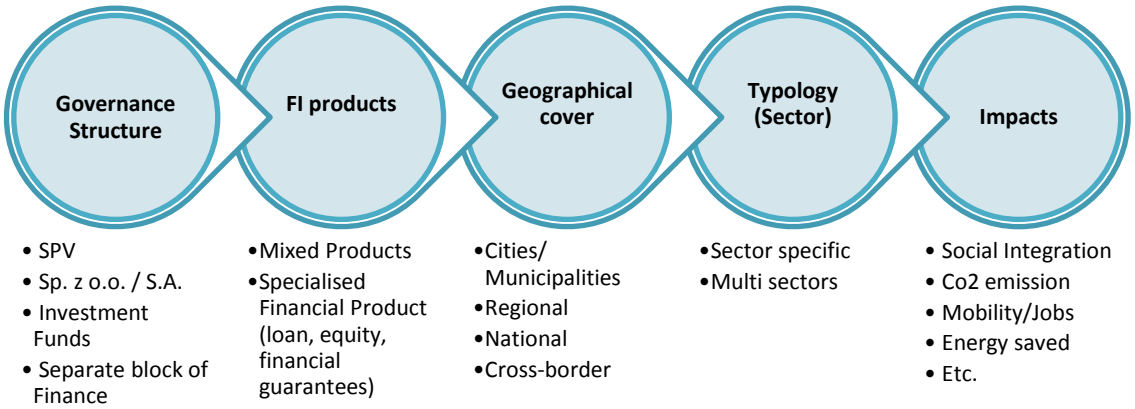
- Business Plan including the expected leverage effect pursuant to Article 37(2) of the CPR;
- Targets to be achieved resulting from the use of FIs and contribution to specific objectives;
- Monitoring of investments and deal flows and compliance with Article 46 of the CPR;
- Tranche requirements as MAs can pay programme contributions as indicated in Article 41 of the CPR and described in detail in section 10.4 Phased-Contribution to Financial Instruments;

- Audit Requirements including the minimum number of documentation and maintenance of separate records for different forms of support;
- Procedures for managing phased contribution provided by OPs as per Article 41 of the CPR; forecast of the deal flow and fiduciary/separate accounting requirements outlined in Article 43 of the CPR; and managing interest gained; provisions regarding calculation for management fees;
- Outline the re-utilisation of resources until and after the end of the eligibility period in compliance with Articles 44 and 45 of the CPR and exit policy/winding up on Financial Instruments;
- Condition for withdrawal and irregularities.

The size of the UDF should reflect potential demand in the market, as well as ensure economies of scale. Based on our experience across Europe as well as the discussions with relevant stakeholders, as a general rule to ensure economies of scale the size of the FI vehicle should be at least €50 million. The rationale is that the cost associated with design and management costs either under a Fund of Funds or directly UDFs should decrease inversely relative to the size of the investments. As a result, a larger fund may offer better value-for-money. Furthermore, there is strong argument that larger funds with a focused investment strategy are more likely to be attractive counterparty to potential beneficiaries and to private investors.

Lastly, investment strategy will seek to define the expected impact of the FI in each sector, the market absorption capacity, an indicative project pipeline and potential co-financing as well as co-investment sources. The investment strategy is generally part of the overall Funding Agreement between the MA and the Fund of Funds (if applicable) and the UDF.

Figure 48: Investment Strategy Criteria



10.2.1 Single-Sector UDF vs. Multi- Sector UDF

Whether to design a single UDF focusing exclusively on one sector or taking a multi-sector approach is more suitable for various Polish regions needs to be carefully considered.

This Study has taken a sectoral approach to identifying projects. There are advantages in structuring specialised UDF, for example in energy efficiency, due to knowledge of the market, key players, and technical expertise. Furthermore, sector-based UDF are more likely to have a very focused and targeted strategy that could help in structuring and building a robust pipeline of projects and attract the relevant key co-investors at the UDF or project levels.

Whilst sector-focused UDFs may have desirable advantages in terms of capitalising on market knowledge, the suitability of deploying such a structure will depend on practical circumstances, among them is the size of the MA and potential project pipeline and the investment priorities.

Amongst the urban projects identified through the Questionnaire, there was considerable interest across all nine Polish regions in urban regeneration across all sub-sectors, followed by social infrastructure particularly strong interest in refurbishment of public buildings including schools and social housing, and energy particularly with energy efficiency and district heating projects, and business environment. For detailed information please refer to Figure 18: Distribution of projects across sectors by value of projects submitted (for aggregated data) and to Part II of this Study (for Region-specific data).

10.2.2 Geographical cover

The geographical scope whether it is on a city, regional, or national level will need to be clearly defined within the investment strategy. In the current Programming Period, some UDFs have focused on a specific groups of cities differentiating between smaller and larger ones. The pros and cons of different approaches to geographical cover of UDFs are summarised below:

Cities	Regional	National
• **PROS** Familiar with local/regional market, rules and players • Integrated approach for larger cities and their functional areas • **CONS** Smallest fund size and diversity	• **PROS** Larger fund size, economies of scale Technically more sophisticated (risk, pricing) • **CONS** Less familiar with local market and risks	• **PROS** Largest fund size, lessons drawn lead to high level expertise • **CONS** Potenital issues with budget allocation, governance, accounting, and management.

As stated earlier in the Study, in the Programming Period 2014-2020, EU funds will likely be implemented through eight nationally implemented programmes, including one supra-regional programme covering the voivodeships of Eastern Poland, and 16 regional programmes. The planned programmes include the "Programme for environmental protection, counteracting and adaptation to climate change, transport and energy security". As such, it is theoretically possible to establish a nationwide fund that supports certain areas / sectors covering the objectives of this programme, *e.g.* environmental protection or energy security that could be developed through environment friendly generation units. Such a fund could be product- (e.g. seed capital or guarantees) and sector-oriented (for example, energy efficiency or small-scale district heating or R&D in cooperation with local academic centres). Such an approach could offer a much greater focus and highly specialised team as well as allow for developing standard documentation and procedures that could expedite the absorption.

Based on this Study, the Regions might wish to consider an implementation of UDFs focused on development of certain cities of crucial importance to these Regions and their functional areas. This approach would be especially justified in the Regions where their capital cities experience severe problems and a targeted intervention through FIs would aid to combat these problems and create more growth potential in an integrated way. An indicative example of such an approach is a creation of UDF for City of Łódź, as described in Part II of this Study in the Region-related section. Considering that the recommendations and conclusions of this Study are based on a limited sample of projects, the potential for establishment of UDFs focused on development of certain cities should be carefully analysed at the stage of Ex-Ante Assessments.

However, taking into account (1) the role of regional governments as MAs for the region-related EU funding to date, and (2) the need to understand local needs to successfully implement especially small-scale local investments, we believe the sector focused multi-product UDFs at the local government level (MA's) seems to be a more realistic option. See Chapter 9 for recommendations on the FI typology by each Region.

10.2.3 Financial Products

As part of the investment strategy, the financial products (loans, equity, and/or guarantees) or a mix of products offered through the UDFs should be clearly outlined. Similarly, the investment strategy should consider whether a multi-product through a single fund or a specialised single product is more appropriate depending on the soft-market testing with prospective co-investors, and the specific market failure.

Loans	Equity	Guarantees
• Reduce project's borrowing cost due to favourable terms • Mitigate project risks for equity providers • Well recognized products	• Address key project development hurdle, especially at the early stage • Lower equity capital funding requirement • Provide an additional layer of confidence to other investors • Bring additional know-how and expertise	• Maximise levarage of FIs • Mitigate project risk exposure • Potentially unlock further investments • Enhancement of commerical loan's lending terms

For a more thorough discussion on financial products, see Sections 7 on the Case Study analyses.

To date, FIs to support urban development projects via JESSICA within the context of Poland have used loans exclusively. Other FIs elsewhere have also utilised equity financing whilst so far guarantees have not been offered as a financial product for urban development projects via JESSICA across the EU.

Based on the Case Study analyses, it is evident that there is high demand for equity financing to make the projects falling in the so-called "Blue Zones" viable, particularly for development equity to get projects off the ground. As many projects have riskier profile, the involvement of guarantee products, which is proposed as part of the financing structure in many of the Case Studies help to de-risk the projects and secure more favourable commercial loan terms. This is subject to Polish local banks accepting and valuing guarantees issued by UDFs as has been discussed earlier in this Study.

UDFs could potentially benefit from ESF and/or ERDF grant funding, to finance "soft" cost and where eligible combine grant funding with FIs. The initial funds could be provided to the project companies in the form of grants at the early stage of project development and could cover "soft" costs such as energy studies, feasibility studies, designs, training and other project preparatory costs. The market sounding performed in the context of the Study clearly identified a strong interest by potential beneficiaries in Poland in such an approach; this would form a relatively attractive alternative to the current grant system and address the transition period from grants dominated 2007-2013.

10.2.4 Co-investment and Co-financing

In the Common Provisions Regulation, Title IV (Articles 37 to 46) lays down provisions for ESIF for the next 2014-20 Programming Period that will allow for flexibility in designing programmes as well as for national co-financing as part of the OP resources (subject to eligibility rules) which can be invested at all levels: Fund of Funds, UDFs (financial intermediaries), and/or at the level of the Final Recipient (project promoter). Furthermore, national co-financing does not have to be paid upfront but could be provided at a later stage of FI implementation.

Under Article 37 of the CPR **contribution in kind** is not eligible expenditure for FI except for contributions of land or real estate in respect of investments with the objective of rural development, urban development or urban regeneration where land or real estate forms part of the investment. This may also be considered as co-financing or be regarded as eligible expenditure in respect of the FIs investment. It is important that the demarcation of co-investing/co-financing should be separate for audit purposes. This approach would facilitate the management of a combination of ESIF (less flexible) and non-ESIF sources of financing (possibly more flexible) under the applicable regulatory and investment guidelines.

In summary, it is important to understand varying motivations for co-investments from the private sector when trying to attract additional funding for the investment strategy. For most private investors, the motivation is purely financial; therefore, investment into FIs would have to provide a diversifying effect on the investor's portfolio and to offer attractive conditions. As such, it would be sensible to expect that these investors will provide co-investments at the MA or UDF level where investments can be diversified within the portfolio of projects. Whereas the motivation of project promoters for being a co-investor into projects could be both financial and non-financial such as broader economic impacts, as well as strategic as part of their regional investment goals.

10.2.5 Non-Financial Returns (Impacts)

Embedding a set of indicators (also known as Key Performance Indicators – "KPI"s) to measure non-financial returns are essential and should be confirmed and clarified in advance with the MA as part of the investment strategy to ensure adherence to ROP priorities. UDF Managers will have responsibility to ensure that a certain level of social, environmental, and economic outcomes are met through investments in projects.

The Case Studies undertaken as part of the Study demonstrated that these projects help to create non-financial impacts. Whilst an economic impact assessment is not in the scope of this Study, all projects selected for the Case Studies have gone through qualitative evaluations to ensure the projects fits within the regional strategies and helps to deliver the overall objectives of the Europe 2020 Strategy of Smart, Sustainable, and Inclusive Growth. Non-financial impacts for urban development and energy efficiency projects include jobs created, unemployment rate, SME created, reduction in travel time, amount of Co2 saved, energy savings, etc. There are also intangible values, such as boosting the image or "branding" of the region and/or city that should also be considered as a non-financial impact. Underpinning the use of FI is PPP, and this collaborative relationship between the public and private sectors should not be underestimated as a non-financial impact.

10.3 Eligibility Rules

10.3.1 Eligibility Rules on Expenditure

The eligible expenditure is clarified by the Common Provisions Regulation and Fund-specific Regulations which state:

- VAT is considered eligible at the operation level only where it is non-recoverable under national VAT legislation. The treatment of VAT at the level of final recipients is not taken into account for the purposes of determining the eligibility of expenditure under the operation. Where financial instruments are combined with grants, the provisions on VAT eligibility apply to the grant (Article 37(11) of the CPR);
- Financial Instruments support to enterprises, may include investments in both tangible and intangible assets as well as working capital within the limits of applicable EU State Aid rules, and where it is to stimulate the private sector as a supplier of funding to enterprise (Article 37(4) of the CPR);
- Contributions in kind are eligible only as contributions of land or real estate in respect of investments with the objective of supporting rural development, urban development or urban regeneration, where the land or real estate forms part of the investment (Article 37(10) of the CPR);
- The investments to be supported through financial instruments cannot be physically completed or fully implemented at the date of the investment decision except for support provided to final recipients in respect of infrastructure investments with the objective of supporting urban development or urban regeneration or similar infrastructure investments with the objectives of diversifying non-agricultural activities in rural areas where such support may include the amount necessary for the reorganisation of a debt portfolio regarding infrastructure forming part of the new investment, up to a maximum of 20% of the total amount of programme support from the financial instrument to the investment (Article 37(5) and (6) of the CPR);
- Eligibility of some capitalised expenditures will go beyond the eligibility period – please refer to the point 10.3.2 Eligibility Rules at Closure below.

10.3.2 Eligibility Rules at Closure

The eligibility rules at closure is clarified by the Common Provision Regulation which states (recital 45):

"It is necessary to lay down specific rules regarding the amounts to be accepted as eligible expenditure at closure of a programme, to ensure that the amounts, including the management costs and fees, paid from the ESI Funds to financial instruments are effectively used for investments in final recipients. The rules should be sufficiently flexible to make it possible to support equity- based instruments for the benefit of targeted enterprises and should, therefore, take into account certain characteristics specific to equity-based instruments for enterprises, such as market practices in relation to the provision of follow-on finance in the field of venture capital funds. Subject to the conditions laid down in this Regulation, targeted enterprises should be able to benefit from continued support from the ESI Funds to such instruments after the end of the eligibility period".

At closure of a programme according to Article 42 of the CPR, the eligible expenditure of the Financial Instrument shall be the total amount of programme contributions effectively paid or, in the case of guarantee funds committed, by the Financial Instrument within the eligibility period corresponding to:

- payments to final recipients per Article 37(7);

- resources committed for guarantee contracts, whether outstanding or already come to maturity, in order to honour possible guarantee calls for losses, calculated according to a prudent ex ante risk assessment, covering a multiple amount of underlying new loans or other risk-bearing instruments for new investments in final recipients;
- capitalised interest rate subsidies or guarantee fee subsidies, due to be paid for a period not exceeding 10 years after the eligibility period, used in combination with Financial Instruments, paid into an escrow account specifically set up for that purpose, for effective disbursement after the eligibility period (but in respect of loans or other risk-bearing instruments disbursed for investments in final recipients within the eligibility period);
- reimbursement of management costs incurred or payment of management fee of the Financial Instrument.
- in the case of equity-based instruments and micro-credit: capitalised management costs or fees due to be paid for a period not exceeding 6 years after the eligibility period, in respect of investments in final recipients which occurred within that eligibility period if paid into an escrow account specifically set up for that purpose.
- in the case of equity-based instruments targeting enterprises for which the funding agreement was signed before 31.12.2017, which by the end of the eligibility period invested at least 55% of the programme resources committed in the relevant funding agreement, a limited amount of payments for investments in final recipients to be made for a period not exceeding 4 years after the end of eligibility period if paid into an escrow account specifically set up for that purpose, provided that State Aid rules are complied with and that the amount paid into the escrow account:
  - shall be used solely for follow-on investments in final recipients having received initial equity investments from the financial instrument within the eligibility period, which are still outstanding wholly or partially, and
  - shall be used solely for follow-on investments to be made in accordance with marketstandards and market standard contractual arrangements and limited to the minimum necessary to stimulate private sector co-investment, while ensuring continuity of financing for the target enterprises so that both public and private investors can benefit from investments, and
  - shall not exceed 20 % of the eligible expenditure of the equity based financial instrument from which ceiling capital resources and gains returned tothis equity based instrument during the eligibility period shall be deducted.

10.4 Phased-Contributions to Financial Instruments

For the Programming Period 2014-2020 it is required to have phased programme contributions for FIs instead of having MAs pay the total contributions upfront. This is a novelty with respect to FIs to allow greater flexibility for MAs.

As per Article 41 of the CPR, MAs should pay programme contributions in at least four tranches which shall not exceed 25% of the total amount of programme contribution for FIs per payment.

MAs can issue the second phased contribution when at least 60% of the amount in the first application of the interim payment has been spent as eligible expenditure either paid to or committed to Final Recipients. For subsequent payments when 85% of the amount included in the previous interim payments. It is expected that for each application for interim payments may include up to 25% of the total national co-financing.

As a simple example, if the total programme contribution is €100, then the first payment shall be €25, the second payment can be made when 60% of the first payment (€15) has been paid as eligible

expenditure. The subsequent payments can be done when at least 85% of the amounts included in the previous payments have been used as eligible expenditure for the third and fourth payment (or €42.5 and €63.75).

10.5 State Aid Implications

State Aid should be considered at every stage particularly in defining the investment strategy. State Aid rules apply only to measures that satisfy all of the criteria listed in Article 87(1) of the Treaty[88], and in particular:

- transfer of State resources including national, regional or local authorities, public banks and foundations;
- the aid should constitute an economic advantage that the undertaking would not have received in the normal course of business;
- State Aid must be selective and thus affect the balance between certain firms and their competitors; and
- State Aid must have minimal distortion on competition and trade between Member States.

All projects financed by Structural Funds must respect competition rules.

There are categories of State Aid exemptions:

- No aid – *de minimis:* The exemption covers small amounts of State Aid ("*de minimis* aid"), which are not subject to the notification requirement. The *de minimis* rule sets a threshold figure for aid below which Article 87(1) of the Treaty can be said not to apply, so that the measure need not be notified in advance to DG Competition. The rule is based on the assumption that, in the vast majority of cases, small amounts of aid do not have an effect on trade and competition between MS, and therefore do not create market distortions.

  The regulation only applies to "transparent" forms of aid i.e. grants and interest rate subsidies, loans, guarantee schemes, fiscal measures (with a cap) and repayable advances under certain conditions where it is possible to calculate precisely the gross grant equivalent *ex ante* without any need to undertake a risk assessment. *De minimis* has been used in Poland for some FIs, including JEREMIE initiative and some guarantees offered by BGK.

- General Block Exemption Regulations ("GBER"): Individual aid measures or aid schemes that satisfy all the conditions laid down in the GBER adopted by the EC do not need to be notified to the DG Competition. Articles 87(3)(a) and 87(3)(c) of the Treaty both provide a basis for the acceptance of State Aid measures aimed at tackling regional problems. Two categories of eligible regions can be distinguished:
  - Article 87(3)(a) regions: These are regions where the standard of living is abnormally low or where there is serious underemployment (NUTS II regions with a GDP/cap lower than 75% of the EU average); and
  - Article 87(3)(c) regions: These are problem areas defined on the basis of (national) indicators proposed by the MS, subject to a maximum population coverage and some minimal conditions to prevent abuse.

  In order to be eligible for aid, the project has to comply with the following key conditions:

[88] "Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees" (Official Journal No C 155, 20.6.2008, p. 10-22 and corrigendum to p. 15 in Official Journal No C 244, 25.9.2008, p. 32).

- New assets (except for SMEs);
- Maintenance of the investment in the region for a minimum period of at least 5 years (3 years for SMEs) after its completion;
- Financial contribution of the beneficiary of at least 25% of the eligible costs.

The Regional Aid exemptions set a ceiling of State Aid that can be delivered to a project. Aid for initial investment can be calculated as a percentage of the investment's value or as a percentage of the wage cost of the jobs linked to the initial investment:

- Investment: material investment (land, buildings, plant/machinery) and a limited amount of immaterial investment (expenditure incurred by technology transfer). Expenditure on transport equipment in the transport sector is not eligible.
- Wage-cost: expected gross wage-costs and the compulsory social security contributions, calculated over a period of two years multiplied by the number of jobs created (net job creation in the establishment concerned).

The GBER authorises the following aid types: aid in favour of SMEs; aid for research and innovation; regional development aid; training aid; employment aid; aid in the form of risk capital; environmental aid; and aid promoting entrepreneurship. The table below summarises the relevant aid amounts and aid intensities applicable under the GBER to energy-related projects.

Type of aid measure	Maximum allowable aid amount under the GBER under Articles 21-25[89]	Aid intensity ceiling under the GBER expressed as a percentage of eligible costs		
Aid for energy savings	EUR 7.5 m per under-taking, per project	Large enterprise	Medium Enterprise	Small Enterprise
		Extra investment costs (net)		
		60%	70%	80%
		Extra investment costs (gross)		
		20%	30%	40%
Aid for renewable sources of energy	EUR 7.5 m per undertaking, per project	45%	55%	65%
Aid for cogeneration	EUR 7.5 m per undertaking, per project	45%	55%	65%

Taking into account the portfolio of potential projects as identified in the Study (mostly through the Questionnaire), energy-related projects require financial aid that falls within the thresholds prescribed under the GBER, with large-scale WtE projects being an exemption and representing larger investment needs.

10.5.1 State Aid Notification Process

Member States have the option to submit a formal notification for State Aid approval. This would require an economic assessment of aid compatibility[90] outlining the "balancing test" of the positive

[89] For more information on General Block Exemption Regulations, please see: http://ec.europa.eu/competition/state_aid/reform/economic_assessment_en.pdf

[90] Common principles for an economic assessment of the Compatibility of State Aid under Article 87.3 http://ec.europa.eu/competition/state_aid/reform/economic_assessment_en.pdf

effects of aid in terms of achieving a well-defined objective of common interest and the negative impacts resulting from distortion in market competition and trade.

There are two elements to consider: 1) the efficiency objective which discusses the specific market failure, namely: externalities, asymmetric information, and coordination problems; and 2) the equity objective on tackling socio-economic issues such as deprivation and disparity.

In the context of FI to support urban development in the Programming Period 2007-2013, DG Competition approved four State Aid approvals in 2011 and 2012 citing that the investment funds to support urban regeneration is a "common interest objective promoted by EU's Cohesion Policy through the JESSICA initiative":

- JESSICA Holding Fund Northwest England (SA 32835 2011/N) - 2011
- JESSICA Holding Fund Andalucia, Spain (SA32147 2011/N) - 2011
- JESSICA Holding Fund Greece (SA 34405 2012/N) - 2012
- JESSICA Holding Fund Bulgaria (SA 35040 2012/N) - 2012

The aid provided through FIs products such as equity and loans at sub-commercial terms to private investors for investments in sustainable urban development projects is compatible with Article 107(3)(c) TFEU as it allows tackling urban regeneration market failures identified in preparatory studies and does not adversely affect trade between Member States. Based on the "Fair Rate of Return" methodology, the aid is necessary and proportionate in order to attract the required levels of private sector co-investments in order to make projects viable.

The timescales involved in getting State Aid approval is lengthy. In the case of the four aforementioned JESSICA State Aid notifications, it took approximately 12 to 18 months for approval by DG Competition. Therefore, if MAs in Polish Regions are considering State Aid notification for large-scale regeneration projects, it is recommended to start this process as early as possible after the investment strategy has been define. Otherwise, based on the Case Study analysis, the GBER should suffice and should not create distortions to the market.

10.6 Reporting Requirements for FIs

MAs are required to report annually on all Financial Instruments under their responsibility or management, including Financial Instruments set-up at national, regional, transnational or cross-border level and the ESIF programmes contributions to Financial Instruments set-up at Union level. The report shall detail the following in line with Article 46 of the CPR[91]:

(a) identification of the programme and of the priority or measure from which support from the ESI Funds is provided;

(b) description of the financial instrument and implementation arrangements;

(c) identification of the bodies implementing financial instruments, the bodies implementing funds of funds (where applicable) and the financial intermediaries;

(d) total amount of programme contributions by priority or measure paid to the financial instrument;

[91] For more information on the Reporting for Financial Instruments, please see: http://ec.europa.eu/regional_policy/what/future/pdf/preparation/2_fiche_4b_ia_financial_instruments_reporting_template_2013_22_07.pdf

(e) total amount of support paid to the final recipients or to the benefit of final recipients, or committed in guarantee contracts by the financial instrument for investments in final recipients, as well as management costs incurred or management fees paid, by programme and priority or measure;

(f) the performance of the financial instrument including progress in its set-up and in selection of bodies implementing the financial instrument, including the body implementing a fund of funds;

(g) interest and other gains generated by support from the ESI Funds to the financial instrument and programme resources paid back to financial instruments from investments;

(h) progress in achieving the expected leverage effect of investments made by the financial instrument and value of investments and participations;

i) the value of equity investments, with respect to previous years;

(j) contribution of the financial instrument to the achievement of the indicators of the priority or measure concerned.

The aim for a uniform reporting model is to enable MAs to monitor FIs and report to the Commission in a consistent fashion so that data can be aggregated to an EU level if necessary. Such reports on FIs must be included as an annex to annual implementation reports regarding the relevant OP(s). The reporting model should be completed separately for each Financial Instrument and, where applicable, Fund of Funds.

Starting in 2016, the Commission must provide on an annual basis a summary of annual reports on the implementation of Financial Instruments submitted by MAs within six months of receipt of the annual implementation reports.

10.7 Reuse of Resources and Interest Gained

Pursuant to Article 44 of the CPR, it is expected that interest and other gains generated by support from the ESI Funds to financial instruments are reused until the end of the eligibility period for the same purposes, including the reimbursement of management costs or fees, by the same, or following the winding up of the financial instrument, in other financial instruments or forms of support in line with the specific objectives set out under a priority.

Resources paid back to financial instruments until the end of elgibility period from investments or from the release of resources committed for guarantees, including capital repayments and gains and other earnings or yields, such as interest, guarantee fees, dividends, capital gains or any other income generated by investments, which are attributable to the support from ESI Funds must be re-used for further investments through the same or other financial instruments in line with the specific objectives set out under a priority, or for preferential remuneration of private investors, or public investors operating under the market economy principle, who provide counterpart resources to the support from ESI Funds or who coinvest at the level of final recipients, or to cover management costs and fees.

Pursuant to Article 45 of the CPR, resources paid back to FIs after the end of the eligibility period, which are attributable to the support from the ESI Funds must be used in accordance with the aims of the programme(s), either within the same financial instrument or, following the exit of these resources from the financial instrument, in other financial instruments, provided that an assessment of market conditions demonstrates a continuing need for such investment, or in other forms of support.

10.8 Off-balance sheet treatment of obligations

Based on the analysis of debt levels of Polish municipalities and the new regulations in this respect, most of Polish municipalities have approached maximum debt levels that might undermine their

further potential for funding much needed infrastructure / urban development investments. Transaction structures that use FIs possibly without impacting public debt levels would increase potential interest of municipalities in FIs. This Study reviewed potential off-balance transaction structures and proposed specific FIs that could be used – please refer to Case Studies descriptions and Chapter 4.

10.9 Implementation of Financial Instruments

This section aims to draw upon recommendations on the potential implementation structure for FIs.[92] In the 2007-13 Programming Period, MAs have the option to establish Holding Fund or select a UDF manager without the use of the Holding Fund. Whilst there is no legal requirement on the number or type of UDFs that could be set-up with FIs, consideration should be focused on geographical scope and thematic focus as discussed previously in Sections 10.2.1 and 10.2.2. In terms of implementation option, under the CPR for the Programming Period 2014-2020, there will be greater flexibility in decision on the implementation option under Article 38. The MAs will be able to select the following options:

1. Contribute to the **EU level instrument** that will be managed directly or indirectly by the European Commission such as the COSME initiative for SMEs, Horizon 2020 for research and innovation, Connecting Europe Facility for Infrastructure, and Guarantee Facility for the Cultural and Creative Sectors. In such case, OP contributions for FIs are ring-fenced for investments through a priority axis (co-financing at 100%).[93]
2. Set up **FIs at the national, regional, transnational, or cross-border level**, managed by or under responsibility of the MAs. If such route should be selected, MAs must sign funding agreements with selected bodies implementing financial instruments (or bodies implementing funds of funds) such as existing or new legal entities, the EIB, other international financial institutions, or other appropriate bodies. In discussion with the MAs, the successful implementing body can adopt several approaches for setting up FIs:
    - "Tailor-made" implementation route where the MA sets up the FI(s) at a national, regional, or cross-broader level with or without Fund of Funds in which funds can be drawn from the five ESIF subject to an Ex-Ante Assessment.
    - "Off-the-shelf instruments", or standardised instruments which the terms and conditions will be pre-defined within the Commission's Implementing Act. This is currently being designed by the European Commission under shared management in order to help accelerate the set-up process and a quicker rollout of FIs in the next Programming Period. "Off–the-shelf instruments" are designed based on the implementation experience and know-how during the 2007-2013 Programming Period.[94] The purposed off-the-shelf which the technical and financial parameters should be fully compatible with future State Aid rules, thus allowing for a swift rollout under existing frameworks, include:
        1. Loan for SMEs based on a portfolio risk sharing loan (RS loan);
        2. Guarantee fund for SMEs (partial first-loss portfolio) (Capped guarantee);
        3. Equity investment fund for SMEs and starter companies based on a co-investment model (Co-investments Facility);

[92] http://ec.europa.eu/regional_policy/sources/docgener/informat/2014/financial_instruments_en.pdf
[93] The exact modalities of allocation of funds are to be determined by the Commission.
[94] For more detail, see Draft Standard Terms and Conditions for Financial Instruments pursuant to Article 38(3)a of the CPR, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:347:0320:0469:EN:PDF (20 December 2013).

4. Loan fund for energy efficiency or renewable energies in the building sector (Renovation Loan).

Other off-the-shelf instruments may be developed by the Commission at a later stage.

- MA can implement loans or guarantees directly (or through intermediate body) without formal set-up of a fund.

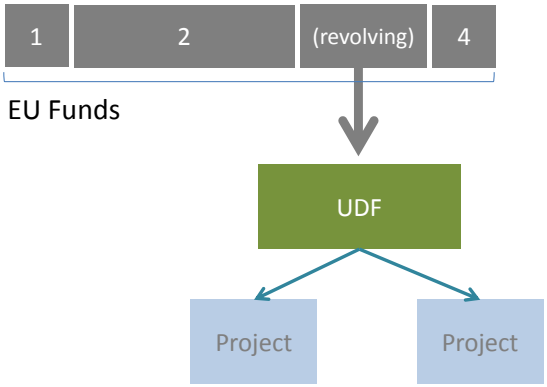
For the purposes of this Study, the recommendations will focus on the traditional implementation with tailored products to fit regional strategies. The 2014-2020 proposed legislation allows for organising FIs through Fund of Funds structure, which follows the same logic as the Holding Fund approach used in the current Programming Period 2007-2013. To determine whether the "Fund of Funds" approach is appropriate in the context of Poland, MAs will need to take into consideration several important issues, amongst them are:

- the maturity of the FI markets,
- the number of funds,
- internal administrative capacities of MA to managing FIs, and
- the size of FIs.

Different options should be considered before designing and implementing the FI structure depending on the investment priorities and objectives of each respective Region.

It is the discretion of MA to set up an UDF directly, without a Fund of Funds. This means that the MA will be obliged to select the UDF managers in accordance with the EU and national level regulations, and transfer the financial means directly to them and effectively take over all monitoring tasks.

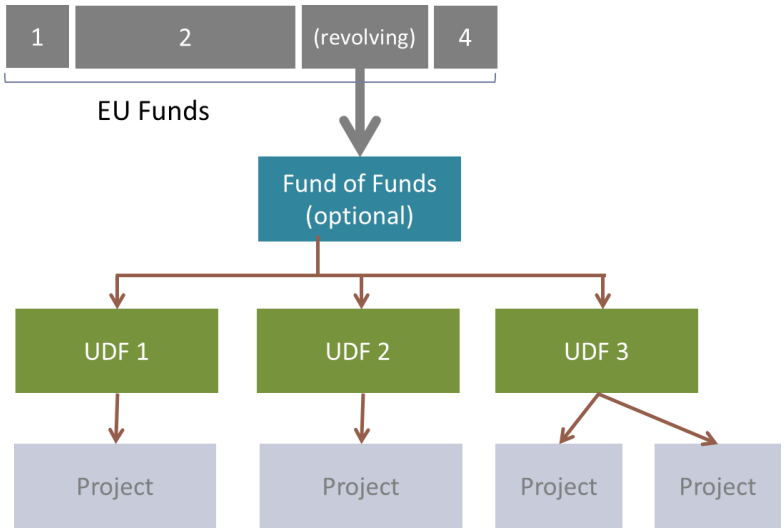
Figure 49: Single UDF without Funds of Funds



10.9.1 Benefits of 'Fund of Funds' Structure

In the context of Poland where JESSICA FIs for urban development exists (Mazowieckie, Śląskie, Pomorskie, Wielkopolskie, Zachodniopomorskie), FIs implemented in the 2007-2013 Programming Period are organised through a two-level structure represented by the UDF and Holding Fund where all UDFs are managed by the EIB.

Figure 50: Indicative Fund of Funds Structure if FIs are set up



Fund of Funds is a useful structure for establishing future FIs because it offers flexibility to the fund managers to diversify investments across multiple UDFs to reflect the market demand, and the ability to diversify the portfolio of investments. Having multiple UDFs under a Fund of Funds creates efficiency, allowing the fund manager to capitalise on economies of scale, share expertise, and cross-pollinate marketing and communication activities to promote FIs.

This structure is especially recommended for MAs who have little or no experience involvement with managing complex FIs during the current Programming Period, or where the financial market is still relatively underdeveloped, thus allowing MAs to tap into specialised expertise in designing and managing future FIs. The Fund of Funds structure is also recommended where MAs have limited internal capacity and technical skills in investment management and risk mitigation that is prerequisite for successful implementation of FIs.

Where similar revolving instruments are already well established, then the benefits of having FoF Managers could potentially reduce over time as technical skills are gained in-house through previous experience of implementing FIs depending on the complexity of the instruments. Required ad-hoc advisory services could then commissioned by the MA on a need basis that is complementary to in-house capacity. For instance, for MAs currently implementing FI via JESSICA including Wielkopolskie, Zachodniopomorskie, Śląskie, and Mazowieckie having the experience of using FIs could theoretically implement loans and guarantees FIs directly as under the Article 38(4)c of the Common Provision Regulations.

Funds of Funds	Urban Development Funds
• Strategy • Co-financing sourcing • Performance Monitoring • Fund Management • Reporting to MA	• Communications & Marketing • Acquisitions and Investments • Project structuring, if necessary • Performance Monitoring • Asset Management • Compliance and Audit

Given the complexity associated with FIs and based on the experience on the ground with implementing FIs in the current period, it is recommended that all Nine Regions take the Fund of Funds approach due to the flexibility and expertise afforded to the MAs.

Furthermore, Managing Authorities should focus on their core competences, i.e. establishing and realizing regional policies and strategies rather than enter a new area of expertise, not in line in their core competencies. Having discussed with the Regions that currently use JESSICA, they stressed the value of having an experienced Holding Fund. Cooperation with competent Holding Fund has its benefits during the UDF selection phase (by "objectifying" the selection process, limiting risks resulting from Polish public procurement rules that would have to be used otherwise) and also during the operational period where MAs lack adequate monitoring and management competences.

Should a Fund of Funds structure be used, the roles of the Fund of Funds and the UDF can be summarised in the illustration above.

10.10 Governance Structure

The CPR does not impose specific requirements on the governance structure, however to avoid any future conflict of interest and to ensure the ability to regularly monitor activities related to FIs, a robust governance structure is strongly recommended.

Should the Fund of Funds structure be adopted, it is the FoF manager's responsibility for setting out the governance structure that should be flexible and offer various possibilities for overseeing the management of the fund. Governance will need to be determined on the basis of the organisations selected for fund management and whether the fund managers are public or private sector entities. Where the private fund manager or commercial bank have been contracted to oversee the fund, the governance structure generally but not always mirrors that of a venture capital or private equity fund. A strong Polish bank regulator KNF provides additional level of oversight in relation to the banks being the UDF's managers. However, the scope of KNF's control does not relate to the objectives set by the MAs and should in no circumstances limit proper governance procedures to be exercised in case of any UDF, irrespective of UDF's manager's type. The rationale for this is if revolving fund is established using a market-oriented approach, then the structure should be similar to the private (or as close as possible) to the private market according to some stakeholders involved in managing FIs elsewhere in Europe.[95]

In line with best practice with existing HFs supporting urban development in the 2007-13 Programming Period, all HFs have an independent Investment Board appointed comprising of members from both the private and public sectors who will supervise the investment operations. The Investment Board should be knowledgeable in one or more of the following areas: investment management; EC regulations, particularly Structural Fund programmes; sectoral expertise (as for example urban development or energy efficiency), and the regional policy.

Ultimately, an Investment Board will be appointed by the Managing Authority in consultation with the MAs and other stakeholders. Working together with the Holding Fund, the Investment Board will advise on the following, if applicable:

- Criteria for the tendering process for UDF Managers' selection;
- Approval of the terms and conditions of the Funding Agreement to be concluded with the successful UDF Manager;
- Reviews the HF's overall performance in relations to the investment strategy;
- Gives recommendations on high-level strategic activities such as marketing and promotion of the funds to relevant private and public stakeholders;

[95] Financial Instruments Stocktaking in Preparation for the Programming Period 2014-2020, EIB, April 2013: http://www.eib.org/attachments/documents/jessica_stocktaking_final_report_en.pdf

- Works in collaboration with the MA, reviews the progress and the strategy of the HF, as approves progress reports.

10.11 Architecture of UDF

There are no specific requirements as to the legal structure to be adopted by UDFs within European regulations. There are several options with regards the set up and operations of UDFs either as 1) a separate legal entity (joint stock companies, limited liability companies, investments funds); 2) as a block of finance within a financial institution; or other organisational forms which require special legal status:

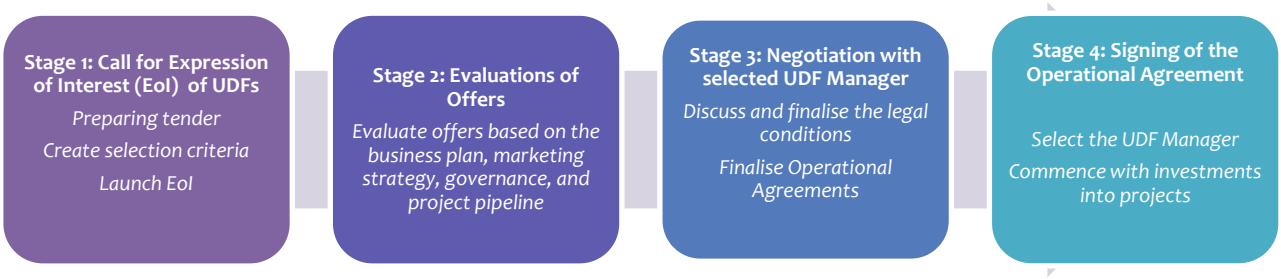
- Existing legal entities - it is likely that an existing vehicle would need to review and potentially amend/ restructure its current constitution, objectives and functions. Any change to the existing structures would also require approvals, and would need to be carefully considered in terms of any impact on balance-sheet treatment for the owners of the vehicle.
- Separate block of finance within a financial institution or fiduciary accounts opened on behalf of the MA – it is envisaged that an existing bank or property/ regeneration fund would manage the activities under the responsibility of UDF in making investments in projects (as the case for all UDFs in Poland currently in operation). The advantages of this are that existing infrastructure and funds management expertise would be present within these institutions, and hence both set up costs and timescales may be decreased. However, this approach also has its disadvantages, mostly relating to two areas: 1) in some cases inflexibility and limits resulting from banking and investment fund regulations that these organisations fall within and 2) lack of fund management skills in case of banks being UDF's managers.
- New stand-alone entities – a tailored investment vehicle structured specifically to achieve local/ regional objectives subject to relevant Polish regulations. The main advantage of this approach is a "tailored-made" solution that may draw upon the market knowledge of local partner of such UDF. This option may however have disadvantages compared to the other options where the UDF is managed by an organisation which has other similar funds or provides other financing, giving access skills, experience and capacity elsewhere within the organisation. Therefore, while deciding for this option, the MA would have to require a combination of local knowledge with know-how and experience in financing of urban development projects on commercial basis.

UDFs can be financial institutions such as banks, real estate developers (for urban development), or professional fund managers with track record in PPPs, Project Finance, working with cities and municipalities, and with Structural Funds. UDFs will be selected on the basis of their business plan and indicative project pipeline. Each UDF should also have the appropriate governance arrangements in place including a management board.

There will be State Aid implications (see Section 10.5) and public procurement implications when selecting the successful UDF and MAs should therefore seek guidance from the European Commission and legal advisors in due course.

Broadly speaking, the selection process for a suitable UDF is illustrated in the diagram below, and divided into four stages. The process of preparation of tenders for selecting UDF(s), launching the respective Calls for Expression of Interest, evaluation of offers and Business Plans as well as drafting and negotiating the respective agreements with successful candidates can take approximately 6 to 8

months based on previous research conducted by the EIB[96], allowing for time to advertise the tender, review proposals, and finalising the agreements.



The implementation procedures for establishing FIs have been discussed in detail in section 10.9.

10.12 Selection Rules for UDFs

According to Article 38(4) of the CPR, the Commission will adopt delegated acts laying down specific rules for selection of bodies implementing financial instruments (UDFs) and bodies that implement funds of funds.

In case MA assesses that the selection of UDFs must comply with the requirements stipulated in the EU Directive 2004/18/EC on public procurement as transposed into the applicable national law, the following award procedures may be in most cases applied:

- Open Procedure – This is the standard open procedure when the Contract Notice is widely published on the Official Journal of the European Union ("OJEU") and at the national level (if applicable). All interested parties may respond to the advertisement by tendering for the contract.
- Restricted Procedure – This process selects an initial list of applicants through a pre-screening of eligible UDF managers. Criteria could be established that only tenders who meet minimum scores (minimum five) are then invited to submit a full tender. The benefit of this approach is that it avoids the need to deal with a large number of tenders.
- Competitive Dialogue Procedure – In the case of particularly complex contracts, following the issue of the Contract Notice and after selecting a limited number of suitable candidates, a dialogue with selected potential bidders commences. The purpose of the dialogue is to develop one or more suitable solutions for required services, and to select a final set of bidders who are invited to tender.
- Negotiated procedure – The FoF/MA may select one or more potential bidders with whom they will then negotiate with respect of the contract. An advertisement in the OJEU is usually required but, in certain circumstances described in the regulations, the contract does not have to be advertised in the OJEU.

10.13 Management Costs and Fees

UDFs and Funds of Funds have a start-up cost in connection with the vehicle set-up and the operational costs of managing the funds.

Management costs as noted by the EU regulations[97] which are considered eligible expenditure includes cost for preparing of investment strategies, technical assistance as required, monitoring performance,

[96] Financial Instruments Stocktaking in Preparation for the Programming Period 2014-2020, EIB, 2013
[97] Article 42 of the CPR further specified in the Delegated Act.

legal, due diligence, and audit at both the Fund of Funds and UDF levels. Managent costs and fees shall be based on a performance based calculation methodology.

Considering the management costs to date during the Programming Period 2007-2013, the size of the FI needs to ensure a minimum scale to achieve critical mass and to absorb the cost of the management. Based on our experience across Europe as well as our discussions with various stakeholders within Poland, at minimum the scale of the UDF needs to be at the same scale of existing UDFs, with the minimum scale of a Fund of Funds of at least €50 million.

10.14 Implementation Procedures for Establishing FIs

The Partnership Agreement and Regional OPs for 2014-2020 are still under negotiation. The regulations currently in discussion allows for greater flexibility and wider scope for deploying FIs, including the ability to combine various forms of support such as grants. Furthermore a range of implementation options is being proposed to ensure successful implementation of future FIs depending on the suitability of each MAs.

The aim of this Study is to provide MAs a preliminary assessment of how FIs could potentially be included within the ROP. It should be reiterated that this Study does not in any way substitute for the full Ex-Ante Assessment required by MAs prior to establishing FIs. The following actions need to be taken for implementing future FIs, although it should be noted that certain actions can be undertaken simultaneously, whilst others such as marketing/communication, project identification, monitoring/report should be on-going or undertaken periodically.

- Ex-Ante Assessment: Under Article 37 of the Common Provisions Regulation, Title IV, all MAs are required to undertake an Ex-Ante Assessment prior to setting up FIs to support any of the 11 Thematic Objectives. Based on a recent study[98], implementing FIs require a long preparatory period of up to two years in some cases. As such, it is highly recommended that MAs begin the preparatory actions as soon as possible, starting with an Ex-Ante Assessment which initially were intended to be completed by the end of 2013 although there is no deadline to complete the Ex-Ante Assessment. It is also encouraged to undertake a market assessment update periodically, for example, around the same time as mid-term evaluation of OPs to ensure its up-to-date compatibility with current market needs and absorption potential as stipulated in Article 37.
- Fund Structuring/Co-Financing: This involves putting together the FI architecture and governance structure as discussed earlier. This Study provides a high-level indicative structure and further refinement on the precise FI size will be provided through the Ex-Ante Assessment.
- Legal Opinion: MAs should seek legal advice as and when is required. However, once the FI architecture is decided, MAs should consult with legal advisors to ensure compliance with national and EU regulations with regards to FIs.
- Fund Manager Selection/Business Plan/Contracts and Co-Investment Agreements: This relates to the UDF selection process discussed earlier. The Fund Manager selection will in most cases be preceded by the selection of Fund of Funds Manager (optional but recommended) that will take over several tasks in relation to Fund Manager selection and management, as discussed earlier.
- Compliance/Audit and Communication Strategy: These two elements should be considered "horizontal" tasks. Whilst it is of critical importance to promote and market the fund in order to gain viability amongst private sector investors not familiar with FIs at the earlier stages, communication and marketing should be on-going with support from the Fund of Funds where possible on broader promotional activities.

[98] Financial Instruments Stocktaking Exercise in Preparation for 2014-2020, EIB, April 2013.

- Project Identification and Selection: Identifying suitable projects via call for projects for investments is equally important and will require support from UDF in with helping Final Recipients with project development i.e. project structuring, feasibility studies, etc.
- Disbursements: This is a major milestone in the project lifecycle of FIs. The UDFs normally cover disbursement management and control, should this approach be adopted.
- Impacts: As noted earlier in the Study, investments into projects are expected to generate non-financial impacts that support the MA's ROP, and in turn the EU 2020 objectives. This should be already defined within the ROPs and discussed in the Ex-Ante Assessment.
- Monitoring and Reporting: This is an on-going activity by the UDF (reporting to the FoF), FoF (reporting to the MA) and MA (reporting to the Commission) to ensure the milestones are met.
- Repayments: In line with financing agreement of selected projects, repayments are expected as outlined in the business plans.
- Winding Up/Exit Strategy: The provisions of the Common Provisions Regulation set out requirements regarding the inclusion of an exit policy and winding-up provisions in the funding agreement signed between the MA/FoF and the selected UDF.[99]

10.15 Information and Promotion

"Horizontal" actions such as marketing/communications strategy should be executed as early as possible to educate the private and public sector about the potential use of FIs. Previous studies[100] suggest that the lack of understanding and awareness as well as a "culture" gap for using market-oriented instruments are perceived to be barriers to the establishment and implementation of FIs. This concept requires a double "cultural" shift: from public sector bodies and policy makers to be more in tune with market-oriented financial products to support policy objectives, and from private sector investors and project developers to understand public policy and the associated regulations.

Therefore, a strategic communication/marketing plan needs to be designed alongside the investment strategy. Once stakeholders have a good understanding of the aims and objective of FIs in unlocking investments to support urban development and other thematic areas by working in partnership, then it is reasonable to expect a quicker absorption of funds and benefits of FIs can be realised.

10.16 Technical Assistance and Project Development

Furthermore, the provision of Technical Assistance should be incorporated into the investment strategy. It is evident based on the projects identified and through discussion with stakeholders that there is a clear need for more involvement on the part of the UDF in project development and project structuring. Actively identifying, sourcing, and developing a solid pipeline of investment ready projects is also critical for the success of the FI implementation. Technical assistance must enable different areas of expertise to work together: finance, investment management, and Structural Fund management.

Based on findings from a recent joint EIB/EC Study,[101] successful delivery of FIs using ESIF requires new technical expertise and internal administrative capacity. To that end, the Commission envisage a new Technical Assistance Platform organised under two work programme: horizontal assistance and multi-

[99] Annex IV to the CPR setting out mandatory provisions of the funding agreement.
[100] Financial Instruments Stocktaking Exercise in Preparation for 2014-2020, EIB, April 2013 and Marketing, Communications and Knowledge Dissemination for JESSICA Operations (not published).
[101] Financial Instruments Stocktaking Study in preparation for 2014-2020, EIB, April 2013.

region assistance to provide support on various legal and financial issues related to setting up and implementing FIs.[102] The purpose of such technical assistance would be to:

- Guide the MAs through the stages in creating and managing funds, the supervision of studies (Ex-Ante Assessment methodology and legal);
- Assist the MAs in tendering procedures in line with public procurement rules;
- Develop guidelines for MAs for setting up FIs. This could form part of the Technical Assistance Platform currently being developed at the European Commission;
- Support MAs, UDF Fund Managers and other relevant stakeholders with State Aid rules and guidelines for seeking State Aid approval if required;
- Develop high-level project assessment methodology and scoring criteria, including financial modelling, if applicable;
- Develop monitoring and progress evaluation system;
- Support with identifying and structuring projects on the UDF level;
- Support MAs, UDF Fund Managers, and other stakeholders with marketing and communications of the funds.

Ring-fenced grants drawn from ESF and ERDF funds could be used for "soft" development of projects through technical expertise or advisory services either internally or hiring an external consultant. It is strongly recommended that this support has a priority within each ROP, in the limit of 4% of the total budget allocated for Technical Assistance.

In summary, Technical Assistance for all stakeholders involved would enable better management of FIs through the lifecycle, and as a result better impacts and outcomes for communities, cities, and regions. Technical Assistance is crucially important for MAs who have limited experience in designing and implementing FIs. Successful implementation requires knowledge in project finance, PPP structures, investments, and management of EU programmes and Structural Funds.

10.17 Implementation Schedule

In order to capitalise on the benefits of FIs over the longest period, FIs need to be operational ideally by the end of 2014 or beginning of 2015. This allows for sufficient time to develop the investment strategy and scope to be undertaken after the Partnership Agreement and ROPs are finalised in the first half of 2014 (timescales to be confirmed by the Commission).

As FIs under Article 44 of Council Regulation (EC) No 1083/2006 were relatively novel instruments using Structural Funds, the preparatory and early implementation stages took longer than envisaged due to a variety of reasons, among others: financial crisis, poor pipeline of projects, and legal issues. Based on experience regarding JESSICA implementation currently in five Polish voivodeships, the preparatory phase took on average 5 months and the project assessment phase took approximately 12 to 18 months.[103] It is expected that the lessons learnt combined with the aforementioned Technical Assistance Platform would help to accelerate the implementation process in the next Programming Period.

An implementation schedule for each Region is provided within the Dedicated Regional Sections.

[102] Currently under discussion at the European Commission
[103] EIB State of Play of JESSICA, JESSICA Networking Platform, June 2012