JESSICA – Holding Fund Handbook

Joint European Support for Sustainable Investment in City Areas

European Investment Bank

European Union Regional Policy

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PricewaterhouseCoopers EU Services EESV
Woluwe Garden - Woluwedal 18
B-1932 Sint-Stevens-Woluwe
Belgium

Foreword

This Handbook comes at an appropriate time, when urban regeneration and development is recognised as a key policy issue in Europe and when there is a need for urban development stakeholders to be provided with clear principles on the implementation of JESSICA (Joint European Support for Sustainable Investment in City Areas).

The purpose of the Handbook is to explain the variety of features that MAs can implement, and provide guidelines that are compliant with EU Regulations. It aims to guide the various parties involved through some of the main JESSICA implementation paths and decision-making processes and is substantiated with references to relevant EC regulations and available best practice. Nevertheless, it should be noted that, as a guidance document summarising findings and implementation experiences available at the time of drafting, the Handbook should not be used to ensure compliance with all national rules.

From JESSICA's initiation in 2006 to the end of June 2010, 57 JESSICA evaluation studies have been launched at national, regional, and/or city level in 19 Member States. As a result of this work, awareness of the JESSICA initiative has expanded, with an increasing number of Managing Authorities expressing their interest in establishing Holding Funds to foster JESSICA implementation, and appointing the EIB for this purpose. Consequently, several Member States and regions have signed an agreement with the EIB to set up JESSICA Holding Funds, including Wielkopolska (Poland), Andalusia (Spain), Western Pomerania (Poland), Lithuania, Portugal, London (UK), Northwest England (UK), Sicily (Italy), Moravia-Silesia (Czech Republic) and Campania (Italy).

Since Managing Authorities are free to choose between the use of the EIB to implement the Holding Fund and the use of other private/public organisations offering similar services, some Managing Authorities have also considered alternative institutions (e.g. Estonia).

Given the fact that setting up a Holding Fund is a relatively new practice, there is an expressed need by the Member States to better understand the regulatory and operational requirements for establishing and managing Holding Funds, as well as their integration within the well-known Structural Funds (SF) mechanisms. In order to address this need, this document aims to provide guidance to Managing Authorities and other relevant stakeholders on how to:

- Conduct pre-appraisals and feasibility studies where necessary;
- Develop an investment strategy and make informed investment decisions;
- Set up and manage Holding Funds, with or without the EIB;
- Exercise investment control and audit; and
- Perform other activities related to JESSICA Holding Fund and UDF operations.

We believe that this Handbook will be useful to key government officials in Member States, to potential Urban Development Fund and Holding Fund managers and decision-makers, investment fund managers, political leaders and investors, as well as other agencies and organisations involved in the implementation of JESSICA operations.

This document offers a description of JESSICA Holding Fund schemes, of their functioning and the associated processes as well as the key tasks carried out under the Holding Fund's responsibility. This document develops:

- The rationale for a Holding Fund in section 1;
- The preliminary steps to JESSICA implementation in section 2;
- The Holding Fund processes in section 3, including the pre-investment, investment and post investment processes;
- Technical assistance in section 4.

Table of contents

Glossary of terms

Acronym	Description
AA	Audit Authority
CA	Certifying Authority
CEB	Council of Europe Development Bank
COCOF	Committee for the Coordination of the Funds
DG REGIO	European Commission's Directorate General for Regional Policy
EC	European Commission
EIB	European Investment Bank
ERDF	European Regional Development Fund
ESF	European Social Fund
EU	European Union
HF	JESSICA Holding Fund
IB	Intermediate Body
IC	Investment Committee
JESSICA	Joint European Support for Sustainable Investment in City Areas
MA	Managing Authority
MC	Monitoring Committee
MS	Member State
NSRF	National Strategic Reference Framework
OP	Operational Programme
PPP	Public-private partnership
RCG	Risk Capital Guidelines
RM	Risk Management
SF	Structural Funds of the European Union Budget
TFEU	Treaty on the Functioning of the European Union
UDF	Urban Development Fund

Definitions

For the purpose of this document, the following terms and definitions apply:

- Audit Authority: as defined in Art. 59 of Council Regulation (EC) No 1083/2006 of 11 July 2006, means a national, regional or local public authority or body, functionally independent of the Managing Authority and the Certifying Authority, designated by the Member State for each Operational Programme and responsible for verifying the effective functioning of the management and control system.
- Certifying Authority: as defined in Art. 59 of Council Regulation (EC) No 1083/2006 of 11 July 2006, means a national, regional or local public authority or body designated by the Member State to certify statements of expenditure and applications for payment before they are sent to the Commission.
- Final Recipients: the public or private bodies or firms responsible for commissioning urban projects. In the context of aid schemes, the Final Recipients are the bodies benefiting from the aid.
- Financial engineering instruments: under Art. 44 of Regulation (EC) No.1083/2006, revolving instruments such as venture capital funds, guarantee funds, loan funds and urban development funds. Investment by those financial engineering instruments in urban projects through equity, loan and guarantees allows for the re-cycling of public funds and leveraging of private capital, thus increasing the efficiency and impact of public resources.
- Funding agreement: in the context of this document, an agreement between a JESSICA Holding Fund and a Managing Authority setting out Holding Fund tasks and related parameters. For the sake of clarity, where Articles 43 (3) and 44 of the Implementing Regulation provide for the conclusion of funding agreements at two levels: Level I between the Member State or the Managing Authority and the Holding Fund, where financial engineering instruments are organised through Holding Funds; and Level II between the Member State or the Managing Authority (or the Holding Fund where applicable) and the individual financial engineering instruments, a funding agreement in the context of this document is a level I agreement.
- Holding Fund: a fund set up to invest in more than one UDF according to Council Regulation (EC) No 1083/2006 of 11 July 2006, Art. 44, amended by Council Regulation (EC) No 284/2009 of 7 April 2009 and further amended by Council Regulation (EC) No 539/2010 of 16 June 2010.
- Integrated plan for sustainable urban development: an integrated plan for sustainable urban development comprises a system of interlinked urban projects which seeks to bring about a lasting improvement in the economic, physical, social and environmental conditions of a city or an area within the city, based on a coherent and unitary vision of the city.
- Investment Committee: means a committee, established in accordance with a funding agreement, entrusted with responsibilities as supervisor and guiding the investment operations managed by the Holding Fund.
- Investment strategy: the description of the strategy and planning of the activities of the JESSICA Holding Fund in relation to JESSICA activities, usually part of the funding agreement between the Managing Authority and the Holding Fund.
- Intermediate Body: as defined by Art. 42 (2) Regulation (EC) No. 1083/2006, any public or private body or service which acts under the responsibility of a Managing or Certifying Authority, or which carries out duties on behalf of such an authority vis-à-vis recipients implementing projects.

- Managing Authority: in accordance with Art. 60 Regulation (EC) No. 1083/2006, a national, regional or local public authority or a public or private body designated by the Member State to manage the Operational Programme.

- Match Funding or National Co-financing: the European Structural Funds meet a proportion of the cost of any Operational Programme. The remainder has to be funded from national resources (often referred to as "match funding"), which can be either public or private sector match funding.

- Monitoring Committee: as defined in Council Regulation (EC) No 1260/1999 of 21 June 1999, these are bodies appointed by the Member State supervising assistance from the Structural Funds, checking on how it is being managed by the Managing Authority, ensuring compliance with its own guidelines and implementing rules and reviewing evaluations.

- National Co-financing: see "Match funding".

- National Strategic Reference Framework: the reference document of the targeted territory intended to pave the way for the programming of EU Structural and Cohesion Funds.

- Operational agreement: in the context of this document, an agreement between the JESSICA Holding Fund and the UDF setting out the terms of an operation. For the sake of clarity, where Articles 43 (3) and 44 of the Implementing Regulation provide for the conclusion of funding agreements at two levels: Level I between the Member State or the Managing Authority and the Holding Fund, where financial engineering instruments are organised through Holding Funds; and Level II between the Member State or the Managing Authority (or the Holding Fund where applicable) and the individual financial engineering instruments, the operational agreement in the context of this document is a level II agreement.

- Operational Programme: Operational Programmes are documents setting out development strategies, submitted by the Member States and adopted by the European Commission, covering the use of EU Structural Funds and match funding contributions during the 2007-2013 programming period in the context of the National Strategic Reference Framework.

- Progress report: means each of the reports, including the annual progress report to be prepared by the Holding Fund in accordance with the reporting procedures laid down in the funding agreement.

- Scheme: means, in the context of this document, a contribution by the JESSICA Holding Fund to a UDF, for the purpose of investing in urban projects by way of equity, loans and guarantees.

- Structural Funds: the European Regional Development Fund ("ERDF") and the European Social Fund ("ESF"), referred to under Regulations (EC) No. 1083/2006, 1080/2006 and 1081/2006.

- Sustainable development: can be defined as development that satisfies present needs without compromising the ability of future generations to meet similar needs.

- Urban Development Fund: an Urban Development Fund (UDF) is a fund as defined by Art. 43 and Art. 46 of Regulation (EC) No.1828/2006. It invests in urban projects structured in different forms such as public-private partnerships and other projects included in an integrated plan for sustainable urban development.

- Urban Project: is any project or action carried out by the Final Recipients and supported by Urban Development Funds.

References

The following EC regulations and COCOF notes form the regulatory background for the HF Handbook:

EC Regulations

- Commission Regulation (EC) 1083/2006 of 11 July 2006, laying down general provisions on ERDF, ESF and the Cohesion Fund.
- Commission Regulation (EC) 1080/2006 of 5 July 2006, on the European Regional Development Fund and repealing Regulation (EC) No 1783/1999, as amended by Commission Regulation (EC) 397/2009 of 6 May 2009.
- Commission Regulation (EC) 1828/2006 of 8 December 2006, setting out rules for the implementation of Regulation (EC) 1083/2006, as amended by Commission Regulation (EC) 846/2009 of 1 September 2009.
- Regulation (EU) No 539/2010 of the European Parliament and of the Council of 16 June 2010, amending Commission Regulation (EC) 1083/2006 of 11 July 2006.
- Commission Regulation (EC) 846/2009 of 1 September 2009, amending Regulation (EC) No 1828/2006 of 8 December 2006.
- Commission Regulation (EC) 397/2009 of 6 May 2009, amending Regulation (EC) No 1080/2006 regarding the eligibility of energy efficiency and renewable energy investments in housing.
- Commission Regulation (EC) 396/2009 of 6 May 2009, amending Regulation (EC) No 1081/2006 on the European Social Fund to extend the types of costs eligible for a contribution from the ESF.
- Commission Regulation (EC) 284/2009 of 7 April 2009, amending Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund concerning certain provisions relating to financial management.
- Commission Regulation (EC) 1081/2006 of 5 July 2006, on the European Social Fund and repealing Regulation (EC) No 1784/1999, as amended by Commission Regulation (EC) 396/2009 of 6 May 2009.
- Council Regulation (EC) No 1260/1999 of 21 June 1999 laying down general provisions on the Structural Funds.

Notes of the Coordination Committee of the Funds (COCOF)

- COCOF "Rules and conditions applicable to actions co-financed from Structural Funds and Cohesion Fund – An overview of the eligibility rules in the programming period 2007-2013". February 2009.
- COCOF/08/0034/02: "Guidance note on eligibility and energy efficiency and renewable energies interventions under the ERDF and the Cohesion Fund (2007-2013) in the building sector including housing".
- COCOF/08/0002/03: "Guidance note No 2 on financial engineering".
- COCOF/07/0074/03: "Information Note to the COCOF guidance note on Art. 55 of Council Regulation (EC) No 1083/2006: Revenue-Generating Projects".
- COCOF/07/0073/01: "Major projects / Aid schemes and the automatic decommitment rule for the period 2007-2013".
- COCOF/07/0018/01: "Guidance note of the Commission services on financial engineering in the 2007-13 programming period".

Introduction

Regulatory framework of JESSICA

Joint European Support for Sustainable Investment in City Areas (JESSICA), is an initiative of the European Commission in co-operation with the European Investment Bank (EIB) and the Council of Europe Development Bank (CEB), intended to promote sustainable investment, growth and jobs in Europe's urban areas.

Thanks to the JESSICA initiative, Member States are being given the option of using some of their EU Structural Fund resources to make repayable investments in projects forming part of an integrated plan for sustainable urban development. This integrated plan is composed of interlinked actions which seek to bring about a lasting improvement in a targeted area.

The JESSICA initiative has been designed to leverage, in addition to EU Structural Funds, other resources for public-private partnerships (PPPs) and, in general, for urban renewal and development projects in the European Union (EU) regions. JESSICA therefore aims to complement the traditional use of Structural Funds (i.e. grants) and give Member States the option of using some of these funds to make repayable investments in projects forming part of an integrated plan for sustainable urban development and to enhance the role of urban regeneration in driving sustainable economic growth and competitiveness. Achieving this goal requires specific strategies that establish the framework for investments and complement the provision of infrastructure and public facilities in an integrated approach, mobilising a broad range of partners with different financing capabilities and management skills.

With the JESSICA financial engineering instrument, the public sector will still maintain its role of main driving force, but more as an aggregator of partners creating the conditions for the development of urban projects and for the use of Structural Funds within a new framework – instead of being the single or main investor or risk taker. It is expected that, thanks to the increasing relevance of JESSICA instruments, the public sector role will benefit from increased, differentiated resources to promote urban development and regeneration where needed. Public entities, namely municipalities, will be especially involved at urban project level. The private sector will be present at urban project and Urban Development Fund (UDF) level – at urban project level as an investor/developer of urban regeneration projects funded by the UDF; at UDF level as UDF manager or co-investor, and jointly with public entities, becoming an essential partner in the deployment of JESSICA.

As an illustration, JESSICA funds could be used to finance coherent integrated urban plans containing urban projects such as:
- Urban infrastructure, including transport, water/wastewater, energy;
- Heritage or cultural sites, for tourism or other sustainable uses, including hotels, university halls of residence, homes for the elderly;
- Redevelopment of brownfield sites, including site clearance and decontamination;
- Energy efficiency improvements.

Where an MA implements the JESSICA initiative, it needs to contribute resources from the relevant Operational Programme (OP) forming part of the National Strategic Reference Framework (NSRF), while other investors (public or private) could contribute additional loan or equity capital, as appropriate. Since projects will not be supported through grants from the Holding Fund (HF) – although JESSICA financial support to urban projects can be combined with grants – programme contributions to UDFs will be revolving and help to enhance the sustainability of the investment effort. This could leave a lasting legacy from the current 2007-2013 programme cycle to fund urban development efforts within the target region after 2013.

The OP contributions will be used to finance loans, guarantees or equity provided by the UDFs to the urban projects, channelled through a HF where one has been established. Urban projects will, where possible, obtain co-financing from commercial banks or other private sector players, acting as co-investors at UDF or project level.

The relevant legal basis and framework regulating JESSICA (e.g. EC Structural Fund regulations) are listed in the references at the beginning of this document and also quoted in the following sections where relevant:

- EC Regulations define the Holding Fund as a financial engineering instrument, in particular: a "fund set up to invest in several venture capital funds, guarantee funds, loan funds and urban development funds."[1]
- Urban Development Funds (UDFs), according to Commission Regulation (EC) No 1828/2006 of 8 December 2006, are "funds investing in public-private partnerships and other projects included in an integrated plan for sustainable urban development." Amongst other things, EC Regulations require that investments into projects are made via UDFs and specify that "urban development funds shall invest by means of equity, loans and guarantees."[2]

To summarise the Regulations[3], particularly those regarding financial engineering instruments, the JESSICA framework has the following characteristics:

- The Structural Funds' OP financial resources must be invested on a revolving basis;
- In organising and managing the investments, the MA has the option to use a Holding Fund structure in order to manage the investment of OP financial resources in Urban Development Funds;
- An Urban Development Fund invests in the form of loans, guarantees or equity in projects forming part of an integrated plan for sustainable urban development.

The various steps and processes involved in this approach are presented in this handbook, although the description will be limited to the Holding Fund scheme.

[1] Council Regulation (EC) No 1083/2006 of 11 July 2006, Article 44, amended by Council Regulation (EC) No 284/2009 of 7 April 2009.

[2] EC Regulation (EC) No 1828/2006 of 8 December 2006, Article 46.

[3] EC Regulation 1083/2006 and EC Regulation 1828/2006 setting out rules for the implementation of Regulation 1083/2006.

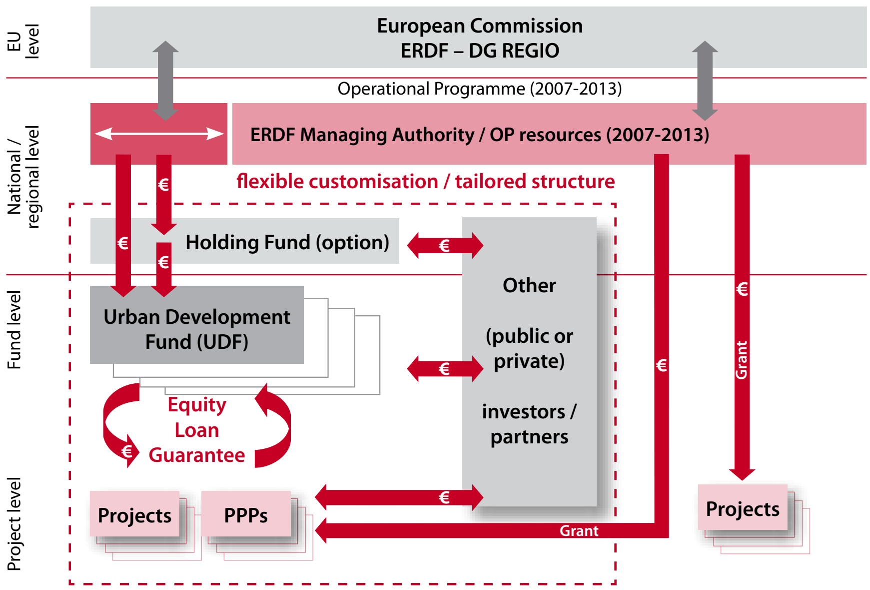
Organising JESSICA through Holding Funds (HFs)

As already stated, MAs have the option of organising financial engineering instruments for sustainable urban development through the intermediary of a Holding Fund[4].

Holding Funds invest the resources of Operational Programmes in one or more Urban Development Funds, under a revolving scheme, generally providing them with equity, loans or guarantees. UDFs are financial engineering instruments investing directly in urban projects. Urban projects, approved for investment by the UDF, will be funded through equity, guarantees or loans. However, it is acknowledged that the JESSICA investment may take place within the context of a wider Operational Programme and could also require traditional grant funding. Grant money can only be used outside the JESSICA HF structure as shown in Figure 1. This provides the possibility to blend grants and other financial resources to finance components of urban projects that are typically unable to generate enough revenues to be financially self-sustaining.

In any case, it must be emphasised that, under the JESSICA approach, projects can be supported only in the context of an integrated plan for sustainable urban development based on eligibility criteria defined by the MA under the relevant Operational Programme.

Figure 1: Flow of funds



The Urban Development Fund (UDF)

The HF will invest funds into each UDF, usually selected via a public procurement procedure and on the basis of the business plan established by the UDFs, which the HF or MA will appraise in accordance with its own rules and procedures. This implies that the UDF has to perform an in-depth analysis of the underlying urban projects, which have to comply with both the regulatory framework and the investment strategy incorporated in the applicable Operational Programme.

[4] Regulation (EC) No 1083/2006 of 11 July 2006 provides for the option of using a Holding Fund and states in Article 44: "When such operations (urban development funds) are organised through holding funds …" which makes it clear that the Holding Fund is optional. Moreover, COCOF Note 08/0002/03 dated 22/12/2008 confirms that Holding Funds are only optional in the implementation of JESSICA and that Managing Authorities themselves are allowed to directly finance Urban Development Funds.

Furthermore, the responsibilities of a UDF will include:

- Promoting its urban projects and co-ordinating the project partners as necessary to ensure that urban projects are implemented in line with its business plan;
- Promoting, as appropriate, partnerships with the private sector.

The revolving profile of each UDF investment can be different depending on the timing of costs and revenues, on the nature of urban projects and on its divestment features. As such, the UDF must be able to demonstrate that it can manage funds and be flexible within the constraints of European Regional Development Fund ("ERDF") rules, to deliver best economic impact.

Link between JESSICA and traditional use of Structural Fund resources

Although it represents a new concept, JESSICA operates in the context of Structural Funds, and therefore most of the well-known mechanisms (e.g. certification of eligible expenditure) and actors (e.g. Monitoring Committee (MC), Certifying Authority (CA)) applicable to grant funding are also present in the management of JESSICA transactions.

As a new concept, the JESSICA mechanism offers Managing Authorities the opportunity to:

- Utilise part of the public resources obtained from Structural Fund allocations and national co-financing, under a revolving scheme, to leverage other public and private funds in order to increase the financing capacity to support integrated plans for sustainable urban development;
- Increase the availability of public financial resources: the revolving scheme allows Managing Authorities to receive back the capital invested plus the revenue generated by the investment activities of the Urban Development Funds. These financial resources could then be reinvested in funding additional sustainable urban development projects;
- Anticipate the disbursement of Structural Funds allocations. The total amount effectively paid to the HF or UDF can be certified as interim payment when the HF or UDF is established. In the financial engineering approach, disbursement of Structural Funds occurs in accordance with a pre-defined and transparent investment strategy and contractual framework;
- Improve the absorption capacity of Operational Programme funds through the use of financial engineering instruments (i.e. Holding Funds and/or Urban Development Funds) which may provide incentives to accelerate project implementation.

The role of the EIB in JESSICA

EC Regulations[5] provide the Managing Authorities with the option of appointing the European Investment Bank directly, or selecting other public and/or private institutions, to act as a Holding Fund, delegating to the Holding Fund the tasks related to the establishment and funding of UDFs. Under the regulations the establishment of a Holding Fund is an option for the Managing Authority, which also has the possibility of implementing JESSICA by establishing Urban Development Funds directly.

In 2007, the EIB established the JESSICA Task Force as a dedicated unit, in order to facilitate the implementation of JESSICA financial engineering instruments in collaboration with the European Commission (DG REGIO) and to assist Managing Authorities in setting up and managing Holding Funds.

The European Investment Bank can play a dual role in supporting the Managing Authority in the implementation of JESSICA:

- It provides Managing Authorities with specialised advice and technical assistance for the implementation of JESSICA, from the preliminary feasibility studies to the operational phase, including the reimbursement and re-investment of the funds;
- It acts as a HF at the Managing Authorities' request.

[5] Council Regulation (EC) No 1083/2006 of 11 July 2006, Article 44, amended by Council Regulation (EC) No 284/2009 of 7 April 2009 and by Regulation (EU) No 539/2010 of the European Parliament and of the Council of 16 June 2010.

1. Rationale for a Holding Fund

1.1 Role and structure of a Holding Fund

In the JESSICA framework, the establishment of the Holding Fund is optional and Managing Authorities can appoint Urban Development Funds directly. For this reason, before MAs decide whether or not to appoint a HF, several issues have to be taken into consideration.

Amongst them, it is important to consider the maturity of the market in terms of UDF development. In most regions, UDFs are still at an early stage of their investment capabilities. In this context, the HF can play an important role in promoting the emergence of UDFs and in encouraging local public authorities to use the JESSICA approach for their investments in sustainable urban development.

The HF is a flexible structure which carries out the following activities:
- Pursuit of the strategy set out in an investment strategy agreed with the MA;
- Selection and negotiation of operational agreements with UDFs;
- Evaluation and, where appropriate, review of the business plans submitted by UDFs, in the selection and operational phase, in the light of the investment strategy;
- Monitoring and control of the implementation of the operational agreements established with the UDFs, in accordance with the terms and conditions of the funding agreement signed by the Holding Fund with the Management Authority and the business plans proposed by the UDFs;
- Reporting on the progress of the various investments;
- Ongoing treasury management of the outstanding balance of the JESSICA funds.

The experiences already gained and the elements presented above allow the identification of some operational characteristics of the Holding Fund structure, although these should be regarded as neither mandatory nor exhaustive:
- It should have the capacity to manage financial engineering instruments (e.g. a regulated vehicle with financial capacity, likely to be subject to external supervision);
- It should be able to maintain separate accounts to distinguish the new resources invested in Structural Fund financial engineering instruments from those initially available in the institution;
- It could be an *ad hoc* structure, although experience to date has shown that either the EIB or an existing national or regional institution have been selected as HF vehicles.

1.2 Added value of a Holding Fund

In order to assess the advantages and positive impact associated with the use of a Holding Fund, some of its key activity areas are highlighted below, while a more detailed discussion is contained in subsequent sections of this document.

The Holding Fund has to ensure the correct implementation of the investment strategy defined by the Managing Authority under the JESSICA financial engineering instrument and generally set out in the funding agreement between the MA and the HF. In this context, experience accumulated since 2006 indicates that for successful management of the financial engineering approach, two components are required in equal measure:
- The policy element, driven by the Managing Authorities and relating to the objective and scope of the investment strategy;
- The operating capability element, driven by specific, dedicated competencies in financial and urban issues complemented by the appropriate financial infrastructure, in order to manage the investments dedicated to sustainable urban development.

Consequently, the added value of the HF could be defined by reference to its role:

- of providing MAs with the necessary infrastructure and human capital to manage lending operations, equity investments and guarantee schemes in the highly regulated financial market of the European Union throughout the investment life-cycle;
- of ensuring the best fit between the investment of the HF resources in the UDF and the financial products offered by the UDF to the urban projects, within the objectives of the investment strategy, with a view to stimulating co-financing by private operators;
- of constituting a flexible tool that enables where possible diversification of investments in several types of UDFs with different features and investment goals. In this respect, Holding Funds can be particularly relevant in diversified investment frameworks, where several UDFs are in place and, in some cases, where the use of resources from more than one OP needs to be coordinated.

2. Preliminary steps to JESSICA implementation

2.1 Evaluation / feasibility studies

Before implementing JESSICA, an analysis of the feasibility and benefits of using JESSICA is strongly recommended. This analysis is usually carried out through so-called JESSICA evaluation studies and represents a key preliminary step which, amongst others, will permit the definition of an investment strategy in accordance with the Managing Authority's objectives in the field of sustainable urban development.

Experience of implementing JESSICA has demonstrated the need to carry out country-specific and/or region-specific evaluation studies, comprising a market analysis of financial engineering instruments, thus providing recommendations and proposals for appropriate actions regarding a possible JESSICA implementation.

The JESSICA evaluation study is performed at the request of the Managing Authority and/or the Member State. The European Commission supports the financing of these studies that are managed by the EIB under the contribution agreement with DG REGIO[6].

The Terms of Reference for the studies are defined jointly by the Managing Authority, DG REGIO, and the EIB. The latter is responsible for the management and supervision of the study. However, any decision concerning the implementation of JESSICA following the results of the study remains the sole responsibility of the Managing Authority.

As of end of August 2010, 56 evaluation studies had been launched across more than 20 Member States, at national and regional levels. Evaluation studies aim to review the rationale and the commercial and financial feasibility of using the JESSICA mechanism in a region or country, and to identify the possible JESSICA architecture and suitable project types, often providing a preliminary financial assessment of pilot projects. Evaluation studies are usually published, and those publicly available can be consulted on the website: http://www.eib.org/products/technical_assistance/jessica/studies/index.htm or http://ec.europa.eu/regional_policy/funds/2007/jjj/jessica_evaluations_en.htm

In summary, evaluation studies are carried out in order to assess and investigate the rationale, the feasibility and the options for JESSICA implementation in the country/region**.** The objectives of an

[6] Under this contribution agreement between the EIB and DG REGIO, the European Commission allocates financial resources to finance 85% of the evaluation studies, with the EIB covering the remaining 15%. The studies are thus provided free of charge to the MA/Member State.

evaluation study can be summarised as follows:

- Establish the rationale for and the financial feasibility of using JESSICA to accelerate investments supporting urban regeneration as envisaged in the Operational Programmes;
- Identify and evaluate various options to implement JESSICA in the region concerned;
- Identify potential market participants for JESSICA from both the public and private sectors;
- Map urban regeneration programmes that could provide the framework for implementing JESSICA in the regions;
- Identify legal challenges and opportunities for implementing JESSICA in the region;
- Identify and evaluate specific pilot projects forming part of existing or proposed integrated plans for sustainable urban development; and
- Provide tools for the definition of the investment strategy to be implemented in the region via the JESSICA approach.

The last of these elements is crucial because the decision to establish a Holding Fund depends primarily on the investment strategy the Managing Authority intends to pursue, and whether such a fund is likely to facilitate its implementation.

The evaluation study typically includes the following recommendations regarding the practical implementation of JESSICA within the region:

- A SWOT analysis for the implementation of JESSICA;
- An activity plan for JESSICA implementation in the region;
- The HF / UDF architecture recommended and selection process envisaged by the MAs;
- The preferred financial structure and an assessment of the expected economic and social results;
- The possible and most suitable legal forms for UDFs and for the urban projects.

Box 1: Evaluation studies

The evaluation studies in the London region (UK) and Portugal are relevant examples. They analyse the value added and potential benefits from implementing JESSICA, as well as its added value for Operational Programme objectives.

The London ERDF Operational Programme 2007 – 2013 includes 4 priority axes:

1. Business innovation and research and promoting eco-efficiency
2. Access to new markets and access to finance
3. Sustainable places for business
4. Technical assistance

The evaluation study has determined that JESSICA will help deliver activities falling under the 3rd priority (sustainable places for business) which foresees a total amount of EUR 164 M (EUR 72 M allocated by the ERDF and EUR 91M as national co-financing). The OP has identified 6 actions within the priority:

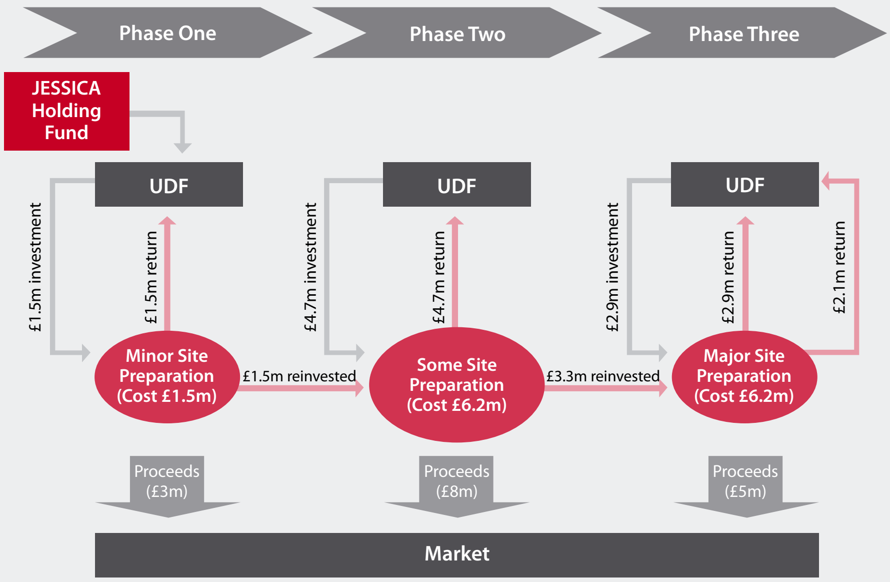
- Creating low or zero carbon employment sites and premises
- Supporting the development of business clusters
- Contributing to a low carbon economy through installing low or zero carbon energy generating systems and distribution networks
- Incorporating adaptation to climate change in employment sites and areas through the creation of associated high quality natural environment
- Delivery of sustainable urban regeneration activity through an investment fund
- Promoting the benefits of environmental sustainability and sharing best practices

A strategic alignment for some of these actions articulates the need for JESSICA investment within the "London Plan – overarching economic development route map" for ERDF intervention in London and the evaluation strategy has identified the appropriate activities for JESSICA implementation.

In consultation with the London Development Agency, 16 projects in 5 thematic areas have been highlighted for further consideration. The evaluation study has pointed out that one of the key challenges facing deprived areas in London is the degraded natural environment and poor quality of their surrounding urban space. The evaluation study presents a possible approach to environmental land improvement schemes that recycles an initial investment through a series of funding rounds.

As an example, a proposed structure for JESSICA in London has been determined with a view to ensuring spending targets are met, securing or enhancing the scope of intervention, delivering quick wins and providing flexibility for the future.

The role of each stakeholder has been defined, as well as the activities of each of them, also targeting the potential participants.



Following the results of the evaluation study, Managing Authorities typically have to decide among the following options:

- Not to implement JESSICA;
- To implement JESSICA by directly establishing UDF(s);
- To establish a Holding Fund for the implementation of the JESSICA approach.

In the last two cases, the investment strategy becomes a central element in the implementation of JESSICA.

2.2 Formulation of the investment strategy

The investment strategy consists in defining the investment policy and targets in line with the OP objectives and the integrated plans for sustainable urban development.

The purpose of an investment strategy is to set out the principles for a coordinated approach and co-operation between the MA and the HF, where this is established, for the preparation, programming and implementation of the JESSICA instrument within the region or country.

The investment strategy normally takes into account any relevant urban development priorities or evaluations and any integrated urban development plans or strategies included in the specific OP. Indeed, the investment strategy should spell out how the three dimensions (Operational Programme objectives, urban plan, and revolving approach) can work together and the type of investments more likely to achieve the desired outcomes. The investment strategy should include at least the following components:

- Target geographic areas and sectors;
- Typology of UDF and identification of preliminary projects ;
- Investment products offered;
- Envisaged amount to be invested in the UDF;
- Investment limits (e.g. % of project cost) and investment control;
- Broad criteria for selecting and evaluating UDFs – existing ones or expectations regarding those to be created in case the UDF market is not mature in the region;
- Provisions regarding the recycling of funds.

In line with EU Structural Funds regulations and depending on the specific priorities in the Operational Programme, the projects could pursue, inter alia, one or more of the following objectives (list is illustrative and non-exhaustive):

- Improvement of social integration;
- Development of cultural, sporting and recreational infrastructure;
- Improvement of mobility;
- Improvement in energy management and energy efficiency;
- Increase in the use of renewable energy;
- Conversion of buildings, including residential ones, for non-residential uses;
- Decontamination/conversion of industrial and degraded areas;
- Development of infrastructure systems bringing increased overall harmonisation to the patterns of use of urban fabric;
- Improvement of urban waste management.

The investment strategy should state that the terms and conditions for the contribution by the HF – or by the MA if no HF is established – to a UDF have to be negotiated via a specific operational agreement. If there is no existing financial vehicle on the market ready to take on the role of a UDF, the investment strategy can include additional actions to be taken by the HF or MA in order to identify appropriate partners and counterparts. This identification could take into account recommendations from the evaluation study and could be based on the experience and market knowledge of the HF. The investment strategy must also determine what kind of structure can be suitable to operate as a UDF (joint stock companies, limited liability companies, investment funds or a separate block of finance) within a financial institution, or other organisational forms which require special legal regulations/status. Various organisations and institutions can be taken into consideration as UDF candidates in the investment strategy.

The cases of:

- National/regional and international banks;
- Existing commercial investment funds / fund managers;
- Public agencies or other public institutions;
- Real estate developers;

underline the fact that specific requirements may be put forward as beneficial for each of these specific structures (e.g. experience in managing development funds, experience in co-operation with local public authorities, experience in financing projects in specific sectors, readiness to leverage ERDF allocation with additional funds, capacity to operate in the region etc.). As an example, Box 2 below provides an overview of the investment strategy established in the Wielkopolska Region in Poland.

Box 2: Example of investment strategy

The investment strategy established in the Wielkopolska region in Poland emanates from considerable demand for urban regeneration projects in large cities as well as in small and medium-sized towns. The areas needing regeneration in the Wielkopolska region include degraded parts of towns and cities, post-military and post-industrial sites. Cities in the region are also interested in the long-term development of urban areas and in creating incentives for their growth. The market for regeneration is therefore significant and the investment strategy sets the outputs and results to be achieved by the MA for the regional Operational Programme.

Among other things, the investment strategy provides that the overall strategic objectives will be achieved by the Wielkopolska HF through contributions to UDFs, and will aim to revitalise urban, post-military and post-industrial areas and strengthen institutions in the business environment.

In order to meet the objectives stated, the investment strategy underlines that the HF will take various actions detailed in the funding agreement such as:
- Developing a network of contacts in order to ensure better understanding of JESSICA among potential JESSICA stakeholders in Wielkopolska;
- Pre-identifying public and private institutions, which could potentially be UDF candidates;
- Organising, managing and supervising the calls of expressions of interest to identify and select UDFs (in accordance with the EC Structural Funds regulations);
- Appraising the offers received;
- Presenting, for decision by the investment board, UDF candidates which could possibly receive contributions from the HF;
- Negotiating and agreeing details of each contribution from the HF to the selected UDFs;
- Executing and monitoring the operations;
- Providing other forms of support to MAs.

The investment strategy lays down that criteria for the evaluation of UDFs should include:
- General criteria, related to compliance, credibility, experience and adequate internal controls, accounting and reporting procedures;
- Financial criteria, related to financial standing, robust cash flow forecasts, operational budget, the UDF's policy, and arrangements for winding up the UDF;
- Project-related criteria, related to the robustness and compliance of the project, references, and economic rates of return.

Potential urban projects are considered within the investment strategy as well as their conditions of eligibility. Once again, criteria to identify urban projects as part of the UDF portfolio are divided into three categories:
- General criteria (as explained above);
- Financial criteria; and
- Criteria related to the Operational Programme.

The latter is particularly important as it underlines the need for the project to contribute to the achievement of outputs which are listed as key indicators encompassing measurement units and target values. These indicators can be, inter alia:
- Surface area of regenerated zone;
- Number of jobs created in the area;
- Number of projects related to urban regeneration and renewal (including, for example, those ensuring sustainable development and enhancement of the attractiveness of cities, those fostering equal opportunities and preventing social exclusion of national minorities and young people, etc.).

Ultimately, the investment strategy targets the expected types of projects according to demand in the region. These projects can be identified at the stage of the evaluation study, as explained in Box 1.

It is worth highlighting that the investment strategy is usually part of the funding agreement established between the Managing Authority and the Holding Fund, as described further in section 3.

Within the investment strategy, preliminary projects and/or project typology should also be identified and have to form part of an integrated plan for sustainable urban development.

2.2.1 Integrated Urban Development Plans

An integrated plan for sustainable urban development ("integrated plan") comprises a system of interlinked actions which seek to bring about a lasting improvement in the economic, physical, social and environmental conditions of a city or an area within the city. Even if certain conditions – such as public consultation and adequate management schemes – must be guaranteed, the key to the planning process is "integration", meaning that the relevant policies and their associated plans, programmes and projects are approached taking into account their reciprocal effects in order to effectively capture synergies and achieve balanced outcomes.

In this regard, implementing the physically and operationally interlinked elements of an integrated plan should lead to its global impact being more intense than the sum of the effects of its components implemented in isolation. In some Member States, city-wide and area-based development plans prepared and adopted in accordance with current planning procedures may satisfy such a definition.

As the urban regeneration market is not mature in many European regions and Member States, a "culture of financing sustainable urban development" has to be reinforced. Developing an urban development culture which understands the role of cities as privileged areas of a region's growth, employment and social cohesion is an important factor for the successful implementation of the JESSICA initiative.

More precisely, reinforcing the appropriate urban development culture requires a workable definition of integrated plans for sustainable urban development, which could include:

- The definition of the geographic area targeted depending on the nature and objectives of the integrated plan (neighbourhood, municipality, district, metropolitan areas etc.);
- The identification of the public works needed and the land-use parameters and minimum public services required (transport, health, education, security, etc.);
- To integrate these services into a wider area as part of transport and utilities networks as well as social and environmental services;
- The assessment of demand/requirements to ensure the efficient use of resources, if necessary through market analysis and/or socio-economic appraisals;
- The development of a clear governance scheme with a timetable and responsibilities, including private stakeholders.

Urban I and Urban II initiatives, undertaken during the programming periods 1994-1999 and 2000-2006, used an area-based integrated approach focused on alleviating concentrated deprivation within cities. This approach, valuable as it is, should be broadened to encompass the following key elements in order to develop a more comprehensive approach to achieving sustainable urban development:

1. Address the financial performance as well as the socio-economic performance within the integrated plans;

2. Operate on the appropriate territorial scale for the development objectives at stake – for instance the appropriate spatial scale to combat city unemployment may be wider than a city neighbourhood;

3. Make clear that intervention by the Structural Funds also supports measures enhancing wider competitiveness and employment objectives (productive clusters, the knowledge society, restoration of the cultural heritage, tourism, etc.).

Box 3 presents the experience of Andalusia where integrated plans were not clearly defined within the Operational Programme. Guidelines have been developed with the assistance of the HF in order to define JESSICA-compliant urban plans as illustrated in the Box below.

Box 3: JESSICA-compliant integrated plans in Andalusia

The urban dimension in the Operational Programme in Andalusia for 2007-13 focuses on the rehabilitation of dilapidated areas, the improvement of old city centres, transport upgrading, restoration of cultural sites, re-use of industrial brownfield sites and support to SMEs and innovative companies. In order to achieve these goals, the Andalusia integrated plan concept incorporated in the JESSICA investment strategy has capitalised on the existing urban investment tools, namely:

- The URBANA initiative, inspired by the prior Urban I and Urban II experience;
- Strategic multi-sector plans (land use plan, mobility plan, etc.);
- Comprehensive investment plans developed by regeneration/urban development agencies;
- Plans driven by a "flagship project" for large-scale projects.

JESSICA-compliant integrated plans within the investment strategy can be set up on the basis of existing plans and planning experience including:

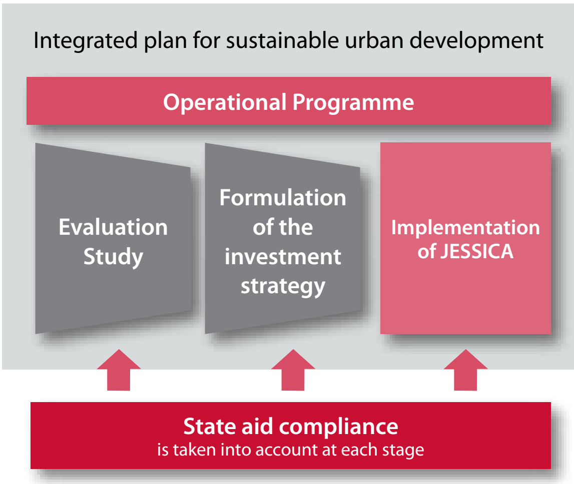
1. A clear delimitation of the target area (with a geographic description and cartography) covered by the Integrated Plan;
2. A SWOT Analysis of the expected impact from the implementation of the identified plan and associated portfolio of urban projects;
3. The impact analysis and monitoring of the financial and socio-economic performance of the project portfolio, with suitable indicators closely linked to the JESSICA objectives.

In this context, performance indicators could include inter alia:

- Transport and urban facilities: newly created or regenerated public spaces, additional jobs in the targeted area, increased use of public transport, trends in tourist volumes;
- Re-adaptation of derelict industrial areas: new businesses and activities in the area, new investments in the area, etc.;
- Facilities for SMEs and innovative firms: newly created SMEs, number of new jobs created, etc.

2.2.2 State aid considerations

Figure 2: State aid in JESSICA implementation



Throughout the JESSICA implementation process, State aid should also be considered at every stage, and particularly in the definition of the investment strategy, as illustrated in figure 2. Indeed, the MA should assess if State aid could be involved and on what basis such aid would be compatible with EU competition rules.

Article 9 of Council Regulation (EC) No 1083/2006 lays down that all projects financed by Structural Funds must respect competition rules.

Managing Authorities are responsible for ensuring compliance with community policies (Art. 60a of Regulation 1083/2006). State aid control in ERDF implementation is the responsibility of the MAs or Member States, which have to set up and ensure the proper functioning of the management/control system as regards aspects of State aid. Therefore, any public support under JESSICA must comply with the procedural and substantive State aid rules applicable when public support is granted.

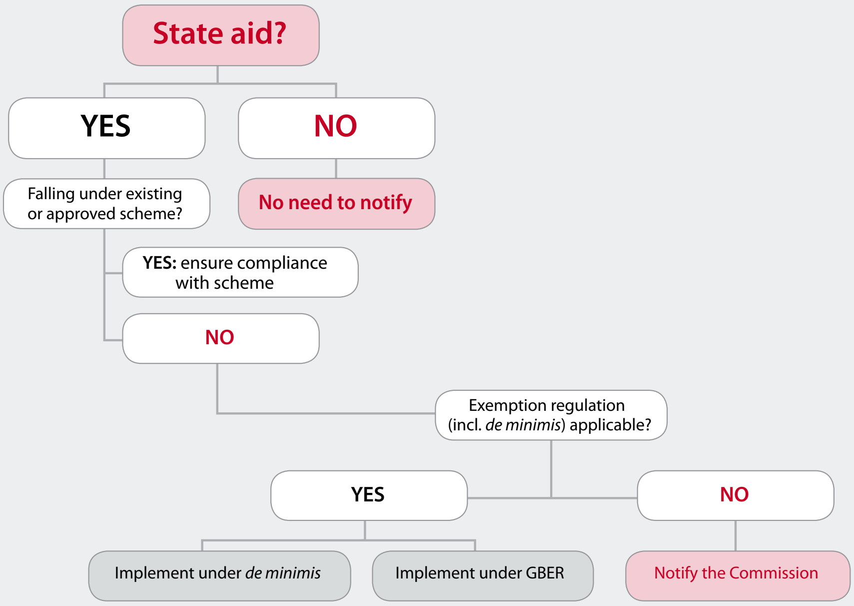
Box 4: State aid compliance

If according to Art. 107(1) of the Treaty on the Functioning of the European Union (TFEU), the following criteria related to aid:

- Granted by a Member State or through State resources;
- Conferring an economic advantage to undertakings;
- Selectivity: "certain undertakings or the production of certain goods";
- Potential to distort competition and affect trade;

are cumulatively fulfilled (at any level – fund managers, private investors, project companies), such intervention constitutes State aid.

Where State aid is present, Member States should choose a compatibility system: either exemption from the notification requirement under Art. 108(3) TFEU (based on the block exemption regulation adopted pursuant to Art. 109 TFEU) or approval by the Commission following notification.



The compatibility system that would be applicable to JESSICA is based on a mixture of State aid rules:

- Urban development is currently not considered as a separate State aid policy instrument and, therefore, there are no specific State aid compatibility guidelines. Consequently, depending on the purpose of the investment (energy efficiency, etc.), appropriate State aid rules apply. For information on State aid rules, reference can be found in the State aid Vademecum on the following European Commission website: http://ec.europa.eu/competition/state_aid/legislation/compilation/index_en.html.

- Due to the funding architecture of JESSICA (the involvement of HF/UDF) some principles from the Risk Capital Guidelines (RCG) will be applied as far as State aid to fund managers and investors is concerned. By analogy to the RCG, a fund is considered to be a vehicle to transfer finance and is generally not regarded as a State aid recipient. Moreover, there is normally no State aid to HF/UDF managers if the remuneration for management services is market-conform. If State aid to fund managers (HF/UDF level) or private investors at UDF level cannot be excluded, in principle, such aid could be fund compatible, provided it is necessary and proportionate.

In other cases, JESSICA measures could be declared compatible by assessing them directly under the TFEU, in which case, Member States would have to demonstrate that the proposed intervention targets a well-defined objective of common interest, that it is well-designed (appropriate, incentive effect, proportional) and that it has limited effects on trade and competition in order for the Commission to carry out a balancing test. The key is to limit UDF intervention to what is necessary to proceed with a project and to ensure that private partners do not benefit from a higher-than-market rate of return on investment. The principles of an economic assessment are provided in the following draft staff paper: http://ec.europa.eu/competition/state_aid/reform/economic_assessment_en.pdf.

The next section presents the procedural framework for HF selection. The option of establishing a UDF without a HF is only summarised for the clarity of the presentation, as it is not considered within the main scope of this Handbook.

2.3 Selection of options to establish a HF

When selecting the Holding Fund, the Managing Authority has to evaluate the options provided by the regulations. Article 43 of Regulation 1828/2006[7] lays down that financial engineering instruments, including Holding Funds, shall be set up as

- Independent legal entities governed by agreements between co-financing partners or shareholders; or as
- A separate block of finance within a financial institution. In the latter case, separate accounts should be set up to distinguish the new resources invested in the financial engineering instrument from those initially available in the institution.

As such, the possibility is given to adopt a flexible approach and to adapt the Holding Fund to the MA's specific context for the implementation of JESSICA.

However, taking into account the role of the Holding Fund, it is suggested that if it is not a regulated financial institution, it should be associated – or should operate in close co-operation – with a supervised financial body for the management of the Holding Fund's investments.

In most EU countries, financial institutions operate in a heavily regulated environment. Regulation structures differ between each Member State, but they typically involve prudential regulation as well as consumer and savings protection and market stability. Some countries have a consolidated agency that regulates all financial institutions, while others have separate agencies for different types of institutions such as banks, insurance companies and brokers.

In using an existing financial institution, the implementation of a separate block of finance is mandatory and contractual arrangements will ensure that this is the case. From an accounting standpoint, this means that the funds have to be ring-fenced from all other assets and obligations of the chosen financial institution[8]. Furthermore, regardless of the form in which a HF is established, investment management activities are economic activities that are subject to State aid rules. Therefore the separate account is essential if a fund is set up as a separate block of finance, as care should be taken to avoid indirect State aid to the financing institution.

The Regulation[9] makes it possible to implement a Holding Fund in one or more of the following forms:

a. The award of a public contract in accordance with applicable public procurement law;
b. When the agreement is not a public service contract within the meaning of applicable public procurement law, the award of a grant, defined for this purpose as a direct financial contribution by way of donation to a financial institution without a call for proposals, if this is in accordance with a national law compatible with the Treaty;
c. The award of a contract directly to the EIB or the EIF.

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7 Article 43 of EC Regulation No 1828/2006 of 8 December 2006 setting out rules for the implementation of Regulation (EC) 1083/2006.

8 All other obligations also include costs linked to the management of the funds which must be supported by the chosen financial institution and which are remunerated through the management fees.

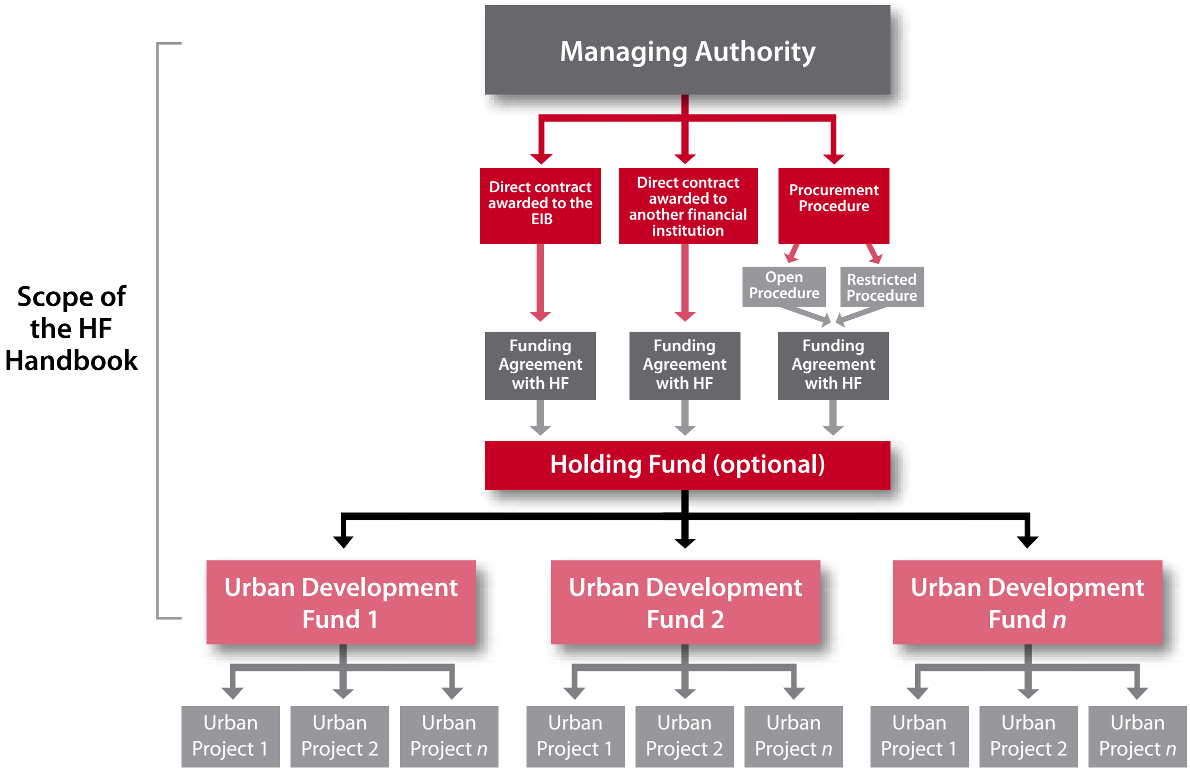
9 Council Regulation (EC) No 1083/2006 of 11 July 2006, Article 44, amended by Council Regulation (EC) No 284/2009 of 7 April 2009 and by Regulation (EU) No 539/2010 of the European Parliament and of the Council of 16 June 2010.

In operational terms, this means that MAs have the following options:

1. Direct award to:
    a) The EIB; or
    b) Another financial institution.
2. Procurement procedure.

The figure below summarises the MA's options in establishing JESSICA structures. It is worth mentioning that a more detailed analysis of UDF schemes, both where MAs invest directly into UDFs and where a HF acts as an intermediary between the MA and the UDFs, will be described in another forthcoming publication, which could be useful in conjunction with this document.

Figure 3: Decision tree for JESSICA implementation



Furthermore, it is recommended that MAs hold preliminary discussions with DG REGIO and possibly with the EIB JESSICA Task Force in order to benefit from prior experience and to optimise the decision-making process as regards the schemes described below.

Finally, the evaluation study conducted prior to the selection of the Holding Fund should provide the profile of a potential candidate to act as a HF, if that is the intended alternative, and advise on the procedure for its selection. The operational implications for the three options are presented in the following paragraphs.

2.3.1 HF selected through a direct contract with the EIB

In launching the JESSICA initiative, the European Commission has given the opportunity to directly appoint the EIB as Holding Fund.

There are very few instances of Holding Funds being selected under a scheme without using the EIB. Indeed, the EIB has both the technical and financial competences to manage urban renewal and development projects across Europe. The EIB has been and still is a key player in the launch of the JESSICA initiative and its experience has been recognised across 9 Member States of the European Union through its 15 assignments as a HF up to the end of August 2010. As the European Union's long-term lending institution, the EIB has, in particular, an internal structure that is particularly suitable and experienced to act as a HF. Indeed, all the governance structures, rules and procedures usually required in the context of fund management are already in place within the EIB.

A key benefit of using the EIB as Holding Fund is that the EIB has the skills, knowledge and expertise covering both the targeted investment sector and the operational procedures needed for the fund management. EIB involvement may also increase the visibility of the HF and UDF, making them more attractive to other investors. Finally, the EC general regulation allows the EIB to be appointed without procurement procedures[10], which reduces the time necessary to establish a Holding Fund.

Despite the preferential treatment allowed by the Regulations to appoint the EIB as HF, within the EU Member States, several national or regional institutions exist with a profile potentially suitable to operate as a JESSICA HF. These institutions may have a profile different from that of the EIB, but at the same time could offer other advantages related to the specific regional context in which the candidate Holding Funds have to operate.

2.3.2 Direct award of HF tasks to a financial institution

When a financial institution other than the EIB or EIF is selected to implement operations organised through a Holding Fund, this selection may be made either by way of public procurement or by way of a grant, without a call for proposals, if this is pursuant to a national law compatible with the Treaty.

Regarding the national law compatible with the Treaty, allowing the direct award of a grant, for the purpose of Article 44 second paragraph (b) of the General Regulation, to a national or regional financial institution, it is expected that the law will:
- designate the financial institution in question;
- present the public policy objectives justifying the direct award of a grant to it; and
- justify the existence within this financial institution of the expertise necessary for the successful accomplishment of the Holding Fund tasks.

Appointing a financial institution as a Holding Fund implies no loss, reduction or waiver of responsibility by the relevant authorities for those resources under the SF Regulations. Therefore, such grants to Holding Funds have no impact on the definition of the functions and exercise of responsibilities of the Managing, Certifying and Audit Authorities concerning investment in financial engineering instruments of contributions from Operational Programmes and the subsequent investment of such contributions in urban development projects.

In order to determine the conditions under which a financial institution can be directly appointed to obtain a grant, it is of course important to identify the differences between a public contract and a grant, according to the Regulation.

[10] Council Regulation (EC) No 284/2009 of 7 April 2009.

The COCOF note "Guidance Note no. 2 on Financial Engineering" (22/12/2008) gives some indications as to what can be considered as a grant:

It lays down that "in general, a grant will have the following features:
- a contribution is made either to an action or project carried out by a grantee which falls primarily within the scope of the grantee's activities or direct to the grantee because its activities contribute to policy aims of the grantor, such action or project of the grantee usually being in the interest of the grantor;
- the application for financing originates with the grantee, who submits a proposal for support for activities it is carrying out or plans to carry out; its proposal sets out the specifications for the action to be performed, which may be within a pre-set legal or other framework laid down in advance by the grantor;
- ownership will usually remain with the grantee, although it is possible in some cases for the financial contribution to revert to the grantor at the end of an action;
- the grant does not necessarily finance the total cost of the action;
- the financial contribution of the grantor should not be in consideration of any product or service provided by the grantee to the grantor;
- conditions can be attached to the grant awarded, but there is no direct and specific link between individual obligations on either side (grantor and grantee), although the grantor has the right to monitor technical implementation of the action and the use made of the funds granted;
- the grant must not have the purpose or effect of producing a profit for the grantee;
- the outcome of a grant award procedure is a grant agreement or a grant decision."

Based on the above, it is suggested that the target entity should be one already involved in activities related to urban development and in the management of financial engineering instruments.

Box 5: Case Study of a HF appointed without a procurement process

In Estonia, KredEx has been appointed without a procurement process and directly by the MA. KredEx operates under the jurisdiction of the Estonian Ministry of Economic Affairs and Communications, which renders it compliant with the regulations and requirements presented in this section. The organisation is fully accredited for the use of ERDF and Structural Funds.

KredEx is a self-sustaining guarantee fund that offers:
- Business loan guarantees;
- Mezzanine financing;
- Long-term funding for commercial banks;
- Export guarantees;
- Housing finance and loan guarantees;
- Implementation of housing policy.

With a capital of EUR 60 million, KredEx has state guarantee limits for:
- Housing loan guarantees (EUR 96 million);
- Business loan guarantees (EUR 96 million);
- Export guarantees (EUR 192 million).

The opportunity to implement JESSICA in Estonia to support energy-efficiency improvement in multi-apartment buildings emanates from several facts and circumstances regarding the housing stock:
- 95% of the housing stock is in private ownership:
  – 60% of the housing stock was built in the period 1960-1990;
  – 30% was built before 1960.
- 75% of the population lives in multi-apartment buildings;
- Low quality and low energy efficiency;
- Average energy consumption per year in buildings which have not been renovated is around 200-220 kWh/m^2.

Before implementing JESSICA, the Estonian government used State grants throughout Estonia but faced issues such as insufficient funding with only a single cycle, while ERDF grants would become available only after payments to households. The Ministry of Economic Affairs and Communications of Estonia has therefore taken the opportunity to employ some of their 2007-2013 ERDF funds through financial engineering mechanisms and has appointed KredEx to negotiate with Ministries and politicians, national and international banks and the European Commission in order to define the eligibility criteria and the integrated plan with measures included in its Operational Programme. KredEx has then acted as a Holding Fund, receiving EUR 17 million from the ERDF and EUR 29 million from the CEB. Adding additional financing from KredEx own resources, the HF reached a capacity of EUR 57 million.

As a HF, KredEx has selected 2 UDFs (Swedbank and SEB) through a call for tenders. These UDFs offer low interest rates to the Final Recipients. In order to select UDFs, KredEx has adopted the following main selection criteria:

- The candidate's rating is at least BAA3 (Moody's) or BBB (Fitch or Standard & Poor's);
- The candidate has a licence and complies with the provisions of the Credit Institutions Act;
- The candidate has a budget of over 15 billion EEK (approximately EUR 958.672.000);
- The candidate has at least 1 year's experience of financing multi-apartment buildings;
- The candidate accepts 20-year loans.

2.3.3 HF selected by a public procurement process

This option refers to the selection of a Holding Fund structure through a procurement process.

In preparing the procurement process, the Managing Authority can apply the principles summarised in Box 8 "Type of procurement procedures", within section 3.2.1 defining the pre-appraisal of UDFs as a first step. There are no current examples of JESSICA Holding Funds being selected through a procurement process.

As for any other typical procurement process, the tender specification should contain all the necessary elements to enable the Managing Authority to receive the best offers in terms of quality and financial conditions, and to select the best service provider. The type of Holding Fund and its ability to be selected then have to comply with:

- **Eligibility and regulatory aspects:** exclusion criteria have to be laid down in the specification documents and should be in line with both national and European regulations for procurement;
- **Technical aspects:** the tender specifications should include criteria for the evaluation of the financial and technical capacity (e.g. financial capacity, business plan analysis, etc.).

2.4 Why a Holding Fund? Pros and Cons

Following this presentation of the different features of and procedure for selecting the Holding Fund, some benefits and limitations of the HF in the JESSICA context are illustrated below. This should enable MAs to make an informed decision on whether or not to implement JESSICA through the intermediary of a Holding Fund. For the sake of completeness, a case study on the implementation of JESSICA without a Holding Fund is outlined at the end of this section.

Table 1: Holding Fund: Pros and Cons

Pros	Cons

A Holding Fund has several interesting advantages and functions:
• A HF is a robust financial structure, equipped to manage funds, investments and reimbursements, and to assess controls and risks, on behalf of Management Authorities. It will ensure independent and professional management of funds by performing a variety of functions and tasks, including:
  • Treasury management (as described in section 3.1.1.1 of this handbook);
  • Risk management (as described in section 3.1.2.3 of this handbook);
  • Monitoring (developed in section 3.3.1 of this handbook);
  • Reporting on the implementation of the investment strategy (as set out in section 3.3.4 of this handbook).
 	
• Furthermore, as a flexible and dedicated tool managing the allocation of funds to several UDFs, a HF enables diversification of investments in several types of UDFs and more effective controls. Indeed, as UDFs can have different features and characteristics according to the investment goals they pursue and due to the necessary flexibility of investment strategies, the use of a Holding Fund mechanism can be particularly relevant to diversify a portfolio of investments.
 	
• In certain cases, the HF can be seen as a valuable temporary Technical Assistance structure, supporting the MA in the acquisition of sufficient skill and knowledge to manage and supervise the UDFs in-house at a later stage.
 	
• In cases where plans and projects are at an early development stage, it will not only hold the funds but invest them as well, generating interest income on the funds deposited before they are disbursed into UDFs. Interest earned on the monies committed to the HF can thus be used to defray HF management fees and finance the cost of Technical Assistance services in the planning and preparation of projects. This remuneration could not be obtained under the conventional grant mechanisms within the time necessary to design and/or revise investment strategies.
 	
• In some case a single HF can manage the resources from different OPs and MAs, achieving significant economies of scale and acting as centralised manager for payments and a catalyst in the investment process.
	A Holding Fund, however, has the following drawbacks:
	• The added value of the Holding Fund mechanism is lower when UDF-type structures are already active in the market and ready to be mobilised by the MA.
	
	• The added value of the Holding Fund is lowered when only one UDF with well-established objectives and structure is targeted. This UDF would then be the direct counterpart of the Managing Authorities.
	
	• The added value of a HF is lower when the MA already holds in-house expertise in urban planning, public-private partnerships, EU fund management and financial engineering instruments. In this case the Technical Assistance capabilities of a HF are less valuable to the MA.
	
	• The choice of establishing a Holding Fund can be complex and potentially time-consuming due to the need to reach agreement on the manner in which UDF capital can be invested, requiring validation at several levels within the HF structure. Therefore, if a specific and well-defined investment strategy is already in place, a UDF set up directly can be effective.
	
	• With a HF, an additional layer of reporting and monitoring is introduced. While if properly structured this could lighten the burden on the MA, reporting lines and communication channels between the various actors, and cross-compliance with reporting requirements may be demanding and costly.

Implementing JESSICA without a Holding Fund: practical experiences

As previously stated, Regulation (EC) No 1083/2006 of 11 July 2006 provides that the HF is an optional structure.

Box 6 presents the case of the Welsh Administrative Government, which has selected a UDF without establishing a Holding Fund.

Box 6: Selecting a UDF without establishing a Holding Fund: The case of the Welsh Assembly Government and the Regeneration Investment Fund for Wales (RIFW)

In 2009 the Welsh Assembly Government made a commitment to implement a JESSICA Urban Development Fund (UDF), and in March 2010 the Regeneration Investment Fund for Wales (RIFW) project, submitted by the Assembly Government's Department for Economy and Transport, was approved by the Welsh European Funding Office (WEFO), the Managing Authority for the Structural Funds programmes in Wales. The project secured £25m of European Regional Development Funds (ERDF) from the EU's Convergence programme 2007–2013 for West Wales and the Valleys, matched with an Assembly Government investment of £30m in cash and property assets. It was an early decision to move directly to a UDF without a Holding Fund as it was determined that Wales needed only a single UDF that would cover the whole of the country.

The project's key aim is to create a recyclable capital Fund, managed on a commercial basis that will use the ERDF, and WAG assets and cash, to lever additional private sector finance and invest in sustainable regeneration schemes across Wales. Returns from investment will be reinvested to support further regeneration schemes, and therefore create greater benefits over a longer period of time than would otherwise be the case through a traditional grant funding mechanism.

Core to the strategy was establishing a UDF which held both the ERDF, Assembly Government match funding and additional investment during 2010, and which could quickly become operational and able to invest in suitable regeneration schemes. There are two key benefits to this approach:

- it would implement a structure which could be operational quickly, attracting private equity into regeneration projects; and
- build credibility with potential private sector investors at the Fund level by demonstrating the commitment to deliver an investment vehicle, as well as demonstrating the viable nature of the investee schemes.

A further consideration was the need to ensure that investments of circa £40m (ERDF plus match funding) were delivered within the current 2007–2013 programming period to help ensure the achievement of Operational Programme targets as agreed with the European Commission. The additional £15m resources also enable RIFW to invest in non-ERDF expenditure and create benefits for areas of need across the whole of Wales.

The RIFW takes the form of a Limited Liability Partnership, giving it a separate legal identity from the Assembly Government. Strategic management of the fund will be implemented through a Management Board comprising private and public parties. Day-to-day fund and investment management will be undertaken by private sector fund and investment managers appointed through open competition. The managers will prepare Annual Business Plans to deliver the corporate policy of the Management Board, and will make recommendations to the Management Board on investments, and manage the portfolio of assets and investments of the fund. The intention is for the UDF to operate as a commercial entity, with a strategy for investment that is driven by the policy context set by the Management Board.

The strategy is a two-step approach that sets up public financing to support projects while developing the attractiveness to private equity investors through a marketing programme and the communication of initial results and achievements. The intention is for the Fund to seek to double the resources of RIFW to £110m by attracting a private sector institutional partner or partners ("PSPs") to take a circa 50% share in the Fund.

3 Holding Fund Processes

After having introduced and illustrated the role of the Holding Fund and the selection procedures, the Holding Fund's operational processes are presented below.

In order to facilitate the description of JESSICA Holding Fund management processes, the Holding Fund activity is subdivided into three main sets of processes:
- The pre-investment processes (described in section 3.1 of this Handbook);
- The investment processes (described in section 3.2 of this Handbook);
- The post-investment processes (described in section 3.3 of this Handbook).

3.1 Pre-investment process

The pre-investment process comprises the set-up phase and the investment decision-making phase.

a. **The set-up phase** covers activities related to the Holding Fund's creation. This phase encompasses the negotiation and signature of the funding agreement[11]; the processes of setting up an Investment Committee and the HF's governance rules; the creation of separate accounts within a financial institution, if applicable, and possibly with third-party depositary banks, including the defined treasury management rules; the confirmation / refinement of the HF investment strategy; and the transfer of HF resources from the Managing Authority. This phase is considered completed when the structure in place is ready to carry out preliminary investment management activities, e.g. the criteria for UDF selection and/or refining the criteria for the selection of urban projects;
b. **The investment decision-making phase** includes all the activities related to the selection of UDFs in which the Holding Fund may invest. This phase covers the procedures for the UDF selection and is completed with the signature of the operational agreement.

3.1.1 The set-up phase

The set-up of the Holding Fund focuses on two main activities:
- The formulation and signature of the funding agreement;
- The definition of the governance rules and set-up of the Investment Committee.

3.1.1.1 Formulation and signature of the funding agreement

The funding agreement is the contractual document that regulates the relationship and reciprocal obligations between the Managing Authority and the body responsible for the ongoing management of the Holding Fund.

According to article 44 of Council Regulation (EC) No 1083/2006 of 11 July 2006, amended by Council Regulation (EC) No 284/2009 of 7 April 2009, the funding agreement should at least contain the following elements:
- The definition of the parties involved in the agreement;
- The subject of the agreement;
- The obligations of each party (reporting, audit, amount invested, criteria for investing the funds, etc.);
- The investment strategy or a reference to it;
- The governance rules of the Holding Fund covering the issues related to the implementation of

[11] COCOF 08/0002/03-EN: Article 44(1) of Regulation (EC) No 1828/2006 requires the interested MS or MA to enter into a funding agreement with the HF, which shall, inter alia, set out the "terms and conditions for contributions from the Operational Programme to the HF".

the investment strategy. The rationale and benefits of the set-up of an Investment Committee are described in section 3.1.2. It is an option offered in order to improve the decision-making process, avoid conflicts of interest and enhance the overall fund's governance;
- The Holding Fund budget, applicable fees and eligible expenditures. Before formulating the funding agreement, the selected HF should analyse the possible cost reimbursement / cost coverage for HF management-related services in order to define the appropriate eligible management costs according to the thresholds indicated by Structural Funds regulations, and negotiate them with the MA[12];
- Options for the temporary investment of the funds contributed to the HF (i.e. treasury management) before investment in UDF and the treasury management during the investment period when necessary, defined jointly by the selected HF and the MA. The HF, as a financial institution, proposes the most suitable opportunities to the MA according to market conditions and takes into account the obligation to preserve the value of the financial resources temporarily invested. Appropriate treasury instructions should be included in the funding agreement along with the process to be followed for any modification of the treasury management scheme and the necessary flow of information that the HF has to provide on any changes to the selected treasury investment scheme. In most cases it is recommended that the MA communicates its treasury preference formally in order to provide evidence that it has granted or delegated to the Holding Fund all necessary powers to duly carry out its functions under the terms of the funding agreement;
- The exit policy for the contribution from the Operational Programme out of the JESSICA Holding Fund and winding-up provisions of the JESSICA Holding Fund;
- A funding agreement should also consider the appropriate measures to be taken in the event of a dispute (e.g. due to a delay or a failure of a party to comply with its obligations), and the provisions for termination of the contract.

It could be possible for more than one MA to contribute to the same HF. In that case, a coordinator should be appointed from the different MAs in order to liaise between the parties. This solution needs to be specified in the funding agreement, including the coordinator's roles and responsibilities agreed with the MAs. The MA coordinator carries out the same function as a MA in the context of JESSICA, but coordination with all the MAs involved is essential during the complete lifecycle.

In order to provide additional details, Box 7 below presents the model funding agreement developed by the EIB.

Box 7: EIB Funding Agreement

At the time this handbook was prepared, 15 funding agreements had been signed between MAs and the EIB (acting as a HF). The model funding agreement developed by the EIB includes the following elements:
- A preamble identifying the parties and summarising the subject and conditions of the agreement;
- Definitions of the specific terms used in the agreement;
- The purpose of the rules included in the agreement;
- The structure of the Holding Fund (i.e. separate block of finance) and its main responsibilities;
- The list of activities to be carried out by the HF;
- The list of tasks to be carried out by the MA;
- The rules for appointing the members of the Investment Committee (called "Investment Board" in cases where the EIB acts as a HF), their duties and the main rules that apply for the management of the Investment Committee;
- The amount invested by the MA – or MAs if applicable;
- The rules that apply for the investment strategy;
- The UDF selection procedure and criteria;
- The conditions for the management of the operations, i.e. the principles for the operational agreements between the HF and the UDF;

[12] As indicated previously, the level of management costs has to be set taking into account State aid considerations.

- The rules for the remuneration of the HF;
- The liability principles;
- The references to the monitoring, reporting and auditing rules applicable;
- The date on which the agreement becomes effective and the planned termination date;
- The principles for dispute resolution and the applicable law;
- The final provisions for the agreement.

The model funding agreement developed by the EIB also includes the following annexes:
- The investment strategy;
- The monitoring rules;
- The reporting rules;
- The audit and control rules;
- The exit policy and the winding-up provisions;
- The treasury guidelines;
- The governance rules (i.e. the Investment Board rules);
- The costs letter setting up cost management rules and standard fees.

It is to be noted that in Estonia, a similar contract was signed between the MA and KredEx, the national publicly-owned bank, which is the only case known so far of a HF set up without the EIB.

As required by EC Regulation No 1828/2006, the funding agreement with the HF should set out the terms and conditions for contributions from the OP to the HF. The funding agreement should therefore include the conditions under which resources are provided by referring to the existing legal frameworks under which State aid will be granted or, if the assessment is made directly under the TFEU, all necessary elements and criteria on the basis of which the Commission could make the balancing test.

After the signature of the funding agreement, the Managing Authorities are able to transfer the funds to the Holding Fund. Generally, there is a delay between the moment the HF receives the fund and the moment the UDF benefits from the investment. In such cases, the MA can establish a statement of expenditure for the totality of the amount transferred to the HF once the transfer has gone through and send it to the relevant authority in charge of the reimbursement.

In addition, funds are not disbursed in total at the same moment, and during the whole life of the Holding Fund, inflows (e.g. reimbursements) and outflows (e.g. re-investments) can occur. It creates a need for the Holding Fund to develop appropriate liquidity management procedures and control systems, in order to have the appropriate liquidity available at the right time, for the investment. It also creates a need for treasury management in order to manage temporary liquidity, receive remuneration, and to preserve the value of the funds managed on behalf of the Managing Authority.

The Regulation does not provide any rules on how the Holding Fund has to carry out these two complementary tasks. Where the HF is established within a financial institution, Managing Authorities can rely on the HF's internal practices already in place. In any case the funding agreement should contain clear provisions and information about:
- The prudential management of the fund and the type of products that will be utilised for temporary investment; and
- The frequency and the content of the HF reporting to the Managing Authority.

It is also suggested that the funding agreement contains provisions for the HF to prepare regular liquidity plans according to the investment schedule and products.

If an Investment Committee is set up, the Managing Authority could decide to transfer the authority to supervise HF treasury and liquidity management to that Committee.

Furthermore, the funding agreement defines the remuneration for HF management services (management costs and fees). It is to be noted that the thresholds set out in the Structural Funds Regulation[13] do not automatically exclude State aid to HF managers.

As a consequence, fund management remuneration would have to be assessed in the light of State aid rules. Concerning HF governance rules, and applying the Risk Capital Guidelines by analogy, it is advisable to check that all the necessary criteria are in place to ensure that HF/UDF investments are profit-driven and commercially managed.

3.1.1.2 HF governance rules and set-up of the Investment Committee

The funding agreement provides the rules for regulating the investment decision-making processes.

By analogy with the other existing investment management structures, most of the JESSICA Holding Funds already in place are governed by an Investment Committee, the body that supervises and guides the investment operations managed by the Holding Fund.

The Regulation does not impose any requirement to set up such a committee. However, in order to avoid any potential conflict of interest and to provide the MA's administration with the ability to regularly monitor HF activities, it is recommended that the HF should be organised with such a governance structure.

The following tasks should be carried out by the Investment Committee:
- Performing periodic reviews of the HF's overall performance in implementing the investment strategy and the underlying projects, in accordance with the OP(s) objectives and implementation plan;
- If necessary, issuing recommendations or statements of principle of a general nature (i.e. not relating to individual operations) to the HF and to the MA regarding the performance of the JESSICA initiative, the development of the JESSICA HF's activities and/or other activities directed at optimising the impact on urban development; and
- In consultation with the MA, reviewing the progress and the strategy of the HF, as well as revising the progress reports.

Furthermore, the objective of the Investment Committee aims at supervising the activities carried out within the scope of the funding agreement, including:
- UDF selection;
- UDF contract management;
- Budget, costs and reporting.

During the implementation phase, it is envisaged that the investment strategy be updated or better defined, regarding for example the actual type of investment to be made. If the Holding Fund proposes amendments to the investment strategy, the Investment Committee is requested to approve or reject this proposal.

It is recommended that, at the earliest after the signature of the funding agreement, the Managing Authority – or the MA's coordinator, if any – should provide the Holding Fund with the list of the proposed Investment Committee members, some of whom should be reputable experts in the field of urban or public infrastructure financing, urban planning or other areas of expertise relevant to the HF's investment strategy.

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

Once defined, the Investment Committee members are required to approve the internal rules, including a code of conduct and procedures that reflect best practice in dealing with conflicts of interest, and comply with the provisions of the funding agreement.

As an example, the code of conduct has to contain at least the following elements:

- Compliance with the highest standards of ethical conduct, such as professionalism, integrity, accountability and impartiality;
- A requirement for the members not to take on any role or assignment which may give rise to a conflict of interest with their duties and responsibilities, and to declare any potential conflict of interest which arises in the course of their duties as a member; if such a conflict arises, they shall withdraw from participation in decision-making connected with the matter;
- A requirement for the members not to disclose any confidential information[14] or data that they may become aware of as Investment Committee members to persons outside the Investment Committee. They should be bound by this obligation after their term of office expires unless the information comes into the public domain;
- A requirement that Investment Committee members who, in the context or course of their duties, have direct or indirect access to inside information or are in possession of inside information concerning any UDF, urban project, or any company or body, or relating to transferable securities of any kind, may not make use, either directly or indirectly of this inside information in order to carry out, recommend or advise either in favour of or against transactions involving such UDF, urban project, companies or securities.

Although those rules are to be agreed upon by the HF and the MA, the ultimate responsibility for preparing the Investment Committee's governance rules lies with the Managing Authority (or the coordinator, if any), since the Investment Committee will be the governing body of the Holding Fund and will receive full delegation of powers from the Managing Authority to act on its behalf under the terms of the funding agreement.

3.1.2 Investment decision-making

The extent and scope of HF services is highly dependent on the country or region in which the MA operates. For instance, in some countries, UDF-type entities may already exist, in others, such entities are not yet available. In that respect, the task of the JESSICA Holding Fund will be either to assist the Managing Authority in the establishment of a UDF, or to identify the appropriate entities that could perform UDF functions, and to verify the compliance of those entities with EC Regulations (including the procedures to select UDFs). Encouraging third-party private investors to be involved could also be a key activity at this stage.

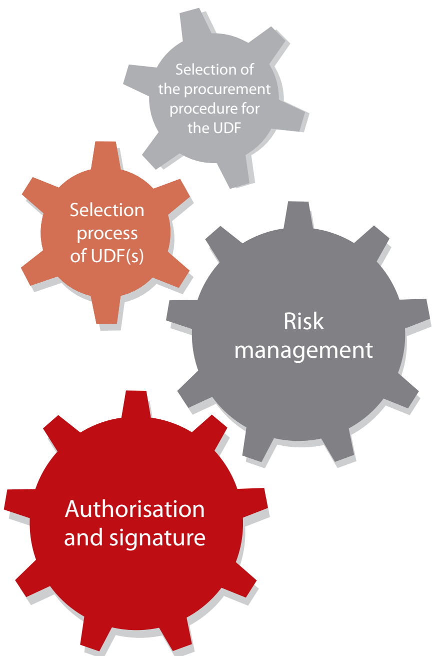

Figure 4: UDF investment decision-making

[14] Information shall mean information which has not been made public which, if made public, would be likely to have a perceptible effect on the value of such companies or bodies or on the transferable securities in question.

3.1.2.1 Step 1: Selection of the procurement procedure for the UDF

The pre-appraisal of UDFs refers to the steps necessary for the preparation of the procurement process, which is necessary before launching any call for Expression of Interest / Tender. The choice of procurement procedure is conditional upon the target of UDF Typology and the level of competition amongst potential candidates. Box 8 below provides an example of types of relevant procurement procedures compliant with the European directive on public procurement. Public procurement procedures existing at the national level, and their consistency with European Regulations, have to be taken into account. In some cases, national procurement rules can be more restrictive than EU ones and may not allow the implementation of all the procedures mentioned below.

Box 8: Types of procurement procedure

Under European Union regulations, procurement may be effected in the following four ways, depending also on the national procurement law of the Member States:

- Open procedure;
- Restricted procedure;
- Negotiated procedure;
- Accelerated procedure.

Of the four procedures presented above, the most commonly used are the open procedure and the restricted procedure. In any case, it is recommended that the Holding Fund should appoint a selection panel[15] according to EU and national procurement rules.

Open Procedure:
Under an open procedure, the selection panel is not permitted to exclude any interested party from the procurement process. Therefore, anyone may apply for and must be given access to the tender documents. The main drawback of this procedure is that it may lead to a situation where the JESSICA Holding Fund panel receives a very large number of tender replies.

Restricted procedure:
The restricted procedure involves an initial shortlist of tenderers based on high-level selection / eligibility criteria, followed by a request for more detailed proposals and business plans for shortlisted UDFs. This approach mirrors the pre-qualification and short listing approach common to most large procurement exercises. The approach allows the JESSICA Holding Fund selection panel to work with shortlisted UDFs to ensure their business plan submissions are as robust as possible.

The choice of procurement procedure for the selection of UDFs ultimately relies on the experience and judgment of the Holding Fund manager. Amongst the various factors affecting the choice of procurement procedure are the number of potential UDF candidates available in the Member State and the specific characteristics of the UDF that JESSICA seeks to obtain.

The selection of the procurement procedure generally concludes the UDF pre-appraisal phase.

3.1.2.2 Step 2: Selection process of UDF(s)

Once the procurement procedure is chosen, the selection and negotiation with UDF(s) begins. It includes the following two main processes:

- The launch of the Call for Tenders (usually via an open or a restricted procedure); and
- The selection of UDF(s).

[15] A selection panel made up of HF representatives – some of whom should be reputable experts in the field of urban or public infrastructure financing or urban planning – will appraise the eligibility as well as the economic, professional and technical capacity of the candidate.

The content of the Call for Tenders is prepared by the Holding Fund taking into account local issues and, in particular, the investment strategy incorporated in the funding agreement. Preparation of the tender specifications usually includes drafting technical specifications and a term sheet for the proposed financial instrument, as well as defining the selection / eligibility and exclusion criteria, and the assessment of the financial and technical capacity against the award criteria.

Examples of tender specifications for the selection of the UDF can be found on the webpage of the EIB at this address:

http://www.eib.org/products/technical_assistance/jessica/calls-for-eoi/index.htm.

When launching a call for expression of interest to appraise interested UDFs, the tender specifications should provide reference to State aid clauses – this could range from a general one (UDFs will operate in line with State aid rules) to specific ones if Member States have defined a suitable compatibility framework. In cases where UDFs would be expected to leverage additional private funding in the UDF, the terms offered to the private sector investments in the UDF would have to be assessed in the light of State aid rules.

If there is an Investment Committee in place the Holding Fund may, at this stage, submit the draft tender document for approval to validate the tender specifications and award criteria. If approved, the final version of the tender documentation may be published according to standard procedures, thus remaining compliant with national legislation. Following publication, interested UDF candidates will prepare their proposal and submit it to the Holding Fund.

3.1.2.2.1 Establishing a UDF shortlist

This procedure is only applicable in the case of Calls for Expression of Interest following a restricted tender procedure. In this case, the selection process usually contains two main steps:

- First, the Expressions of Interest, open to all candidates, are assessed against the selection criteria in order to define a shortlist of relevant candidates;
- Second, the shortlisted applicants are invited to submit their offers (including a detailed business plan), which will be evaluated against the award criteria included in the tender specifications.

3.1.2.2.2 Launch of Call for Tenders

The launch of a Call for Tenders is a one-step process under the open procedure. It may start when the UDF shortlist has been defined in the case of a restricted procedure. The JESSICA Holding Fund (or the MA) publishes or sends the final tender document and invitations to tender.

In accordance with tender instructions, candidates should submit their proposals to the Holding Fund. Once the proposals have been received, selection of the UDF(s) is triggered.

3.1.2.2.3 Awards

The bidders are evaluated and selected by the selection panel set up within the Holding Fund structure. The MA (or the Investment Committee where one exists) supervises the regularity of the procedures and their consistency with the defined investment strategy. The evaluation is made according to the award criteria, which may include the UDF's business plan, financial forecast and operating budget as well as its methodology for identifying and evaluating urban projects, its governance structure, its management fees, the co-financing options considered, etc.

One of the main objectives of JESSICA, and more generally of the revolving approach, is also to catalyse and attract additional – mostly private but also public – financial resources. The ability of the UDF to leverage additional resources and the UDF's co-financing capacity must be taken into consideration when identifying and selecting the UDF.

At this stage, based on the proposals received, the Holding Fund should analyse the credit risk of the potential UDF counterpart and proposed investment product, and should also address other risk management issues. Where the HF is a financial institution, it is recommended that this activity should be assigned to the Risk Management department or Risk Committee, if any, of the Holding Fund[16], which would check and validate the quality of the UDFs according to external and / or internal ratings and standard risk management principles.

If the HF is not a financial institution, it is recommended that an external expert should be appointed to carry out due diligence on the UDF counterpart or that the financial body supporting the HF, if any, should perform the necessary analysis.

During the selection, the need for interviews may arise in order to make the final selection of one or more UDFs. The selection panel then interviews the tenderers in order to make the final decision.

After being notified of the selected UDF(s) by the HF, the Investment Committee will be responsible for ratifying (or rejecting) the proposal. Following Investment Committee approval, the Holding Fund notifies both selected and non-selected candidates of the outcome.

The procedure for informing successful and unsuccessful applicants is part of the standard national procurement procedure. The European Union website on Public Procurement provides some guidelines and templates. It is nevertheless recommended that the letter notifying the non-selected candidates should be corroborated by the schedule of criteria used, and also include tables detailing the awards made to all selected candidates, without mentioning any names (as anonymity should be preserved).

3.1.2.3 Step 3: Risk management

JESSICA HF invests in UDFs by supplying the necessary equity, loans or guarantees, and provides incentives to find other investors to fund urban projects. In fact, while traditional grant funding delivers social and economic returns, JESSICA, through its investments in UDFs, aims to deliver financial returns in addition to social and economic ones. JESSICA is therefore targeting urban regeneration initiatives that, despite having the potential to generate benefits that could satisfy the public investors, need additional financial or credit support in order to produce returns meeting not only the financial requirements of the public sector but also attracting private investors in terms of the balance of risk/revenue. Risks related to the implementation of JESSICA have been described throughout this handbook. This section covers some of the main risk management aspects which have to be taken into consideration, particularly when selecting the UDF and before signature of the operational agreement, but also during subsequent steps of the process.

3.1.2.3.1 Credit risks and related processes

The following table outlines the allocation of responsibilities between the HF's operational/technical function and its risk management, throughout the investment life-cycle. However, as previously stated, the Investment Committee should also play a role in the investment decision process.

[16] As illustrated above, the Holding Fund is expected to be a supervised financial institution. This implies that within the HF, a risk management structure and credit supervision body are already in place within the structure and the latter has an important role to play during the UDF selection process.

Table 2: Shared responsibilities between the Investment Committee / HF operational function and the Risk Management function

Investment Committee / HF operational function	HF Risk Management function
• Defining selection and award criteria for UDFs; • Reviewing and analysing business plans submitted by UDFs; • Originating and appraising operations with UDFs, initial credit opinion, negotiations with UDFs; • Managing the relationship with HF counterparts (promoters, borrowers, guarantors, government bodies, co-financiers), including preparing periodic credit reviews; • Preparing and processing all disbursement requests; • Reviewing the UDFs' compliance with contractual obligations before and after disbursement; • Recovering arrears; • Proposing workout plans for credit-impaired operations and overseeing the implementation of these plans; • Reporting regularly on the evolution of the quality of the JESSICA portfolio and its main components (various types of loans, guarantees, equity investments); • Reporting regularly on JESSICA HF exposures that may require closer follow-up on the basis of post signature reviews.	• Issuing independent credit opinions on all new proposals concerning the selection and award criteria for UDFs as regards credit risk principles, so as to ensure their compliance with internal credit guidelines and procedures; • Issuing independent credit opinions on business plans reviewed by the Investment Committee; • Approving counterpart ratings; • If applicable, maintaining and further developing the internal rating system for UDF counterparts; • Reviewing and validating the documentation for operational agreements; • At the Investment Committee's request, reviewing contractual modifications of terms and conditions whenever these entail a substantial change in credit risks.

3.1.2.3.2 Information requirements

In order to proceed with the investment in a specific UDF operation – namely a contribution by the Holding Fund to a UDF for investment in a portfolio or pipeline of urban projects by way of equity, loans and guarantees – it is recommended that the HF should obtain the necessary information to:

- form an independent opinion on the operation's credit quality at the time of appraisal;
- form an independent opinion on its likely evolution during the life of the scheme;
- periodically assess the development of the credit risk profile of a UDF throughout the investment life cycle.

The absence of complete and adequate information will result in a greater degree of uncertainty – and therefore higher transaction risks.

Consequently, the HF should generally ask for historical (i.e. minimum three years, if applicable) financial information on UDFs, usually audited by acceptable external auditors and, wherever possible, compiled under internationally accepted accounting standards, together with appropriately detailed financial forecasts.

Whenever considered necessary, the HF will also seek additional external evaluations in the form of market and technical studies and model audits from specialised and internationally reputable firms. Such firms should be specifically engaged to work on behalf of the HF and its co-lenders in providing such evaluations. Furthermore, in most instances, specific input and analysis from legal advisors will be required in order to adequately assess the legal environment of a scheme, including issues such as the UDF's articles of association, the enforceability of contractual protections, and security / collateral arrangements.

On-going contractual information obligations are also to be set so as to ensure that the HF will regularly be provided with the information it requires to perform regular periodic credit reviews for each operation.

The information requirements must enable the HF to perform its minimum due diligence review as described below.

The HF will carry out a due diligence review of the UDF(s), in order to analyse risks and justifiably determine the measures to be proposed in order to mitigate these risks. In particular, the HF should carry out a due diligence review for future schemes with UDFs in order to:

- Ensure that general criteria for investment evaluation are complied with:
  - Compliance of the UDF's investment strategy with the priorities laid down in the relevant OPs, clear definition of goals, areas of action and implementation period;
  - Credibility of the UDF's ownership structure, including co-financing partners and/or shareholders;
  - Experience, competence and efficiency of the UDF's management;
  - Adequate and appropriate controls, accounting and reporting procedures and, where possible, internal scoring systems.
- Sufficiently understand all the aspects of the investment in UDFs (including its financial and contractual structure):
  - Robustness of the project pipeline and compliance of projects with the objectives;
  - Reference to underlying integrated plans for sustainable urban development;
  - Economic rates of return or performance indicators on the project pipeline, including social and environmental benefits, ideally assessing the net impact of a project in a target area as compared to the situation if the project were not undertaken.
- Ensure that major risks of the investment with UDF(s) are suitably identified and mitigated and that financial aspects are covered:
  - Financial strength of investors and other potential partners in the UDF;
  - Robust cash flow forecasts providing evidence of the financial sustainability of the scheme in terms of repaying the amounts financed to ensure that the HF is financially sustainable;
  - Operational budget of the UDF, including management fees;
  - The policy of the UDF on exiting investments in urban projects;
  - The winding-up provisions for the UDF, including the reuse of resources returned to the UDF from investments or remaining after all guarantees have been met;
  - The potential residual risks in relation to the strength and security of the scheme in the UDFs to be made;
  - Any departure from normal market standards in term of guarantee requirements and/or pricing received by potential UDF(s).

These aspects will be highlighted in the appraisal by the Investment Committee, which will have the final decision on the acceptability of the investment.

3.1.2.3.3 Determination of acceptable counterparts

There are two options when selecting UDF(s) within a JESSICA structure:

- The UDF does not already exist, hence the HF facilitates the creation of appropriate UDFs;
- The UDF already exists, hence the HF procures existing UDFs.

There are few existing financial or other vehicles on the market which are currently in a position to act as UDFs. Hence, the HF might have to embark upon operations with newly established entities/ structures. This will impact the scope and the depth of the due diligence review performed on the UDF in order to appraise its acceptability.

Furthermore, it is worth mentioning that UDFs are channelling funds to Final Recipients who bear the ultimate risk. In such circumstances, the acceptability of counterparts may be adjusted downward as a result of explicit requests from the MA, given the characteristics of HF investments which aim to combine urban development objectives with financially sustainable schemes with UDFs. When selecting UDFs through public procurement, it is recommended that the HF should apply its own rating methodology, where one exists.

Although important differences exist between UDFs and the counterparts usually included within the portfolio of the HF, these can be incorporated within the existing HF rating framework.

Traditional methodologies, developed by financial institutions, are based on a system of scoring sheets tailored for each major credit counterpart type (e.g. corporates, banks, public sector entities, etc.). UDFs are generally counterparts falling into one of the following categories:

- Financial institutions (e.g. commercial banks, development banks, insurance companies, leasing companies, non-deposit taking finance companies);
- Public institutions (i.e. public sector companies with explicit public sector support);
- Corporates (i.e. limited liability companies, including public sector companies and utilities without implicit Public Sector support); and
- Investment funds (e.g. venture capital funds, equity funds).

Financial institutions as Counterparts

When evaluating UDFs belonging to banks and other financial institutions, the rating process for UDFs and conventional banks considers roughly the same factors. The main factors to be evaluated include an in-depth analysis of aspects of risk management – particularly credit and operational risks in UDFs – and consideration of a UDF's specific funding and liquidity profile, its asset size and portfolio diversification, as well as its capital adequacy. In addition, management quality, corporate governance, and transparency / disclosure are given particular attention. However, in view of the specialised scope of UDF activities, their specific ownership profiles, legal structures and operating and regulatory environments, certain factors are of different significance in comparison with the standard analytical process. The features listed below are typically seen as "best practice" criteria when assessing the acceptability of a financial institution:

- Regulatory and supervisory framework – Banks are subject to competent supervision, whether inspection or rule based. The regulators are independent so as not to be subjected to political pressure;
- Operating environment – The Member State's financial system is properly structured and displays signs of openness to foreign competition;
- Size and franchise – The counterpart holds an established market share and a customer base not susceptible to rapid erosion in the foreseeable future;
- Capital – Capital adequacy ratio is robust. The returns generated on its assets are commensurate with the risks underwritten;
- Credit risk – Credit policy and controls are structured and adequately documented. Provisions are raised for their risks in a prudent and conservative manner;
- Management, strategy and corporate governance – Experienced and reputable executives with proven abilities in managing a financial institution. Management displays a culture of prudence, high business ethics and independence. It has demonstrated the capacity to develop and implement sound business strategies. It is able to control risks through appropriate checks and balances.

However, it has to be noted that, particularly in new Member States whose economy is weaker, the creditworthiness of financial institutions is generally low. In such circumstances, the selection procedure, which takes the form of a public tendering process, has to be constructed in such a way as to highlight those specific features, and to place particular emphasis on the furtherance of public sector interests.

For financial institutions with weaker credit standing but showing sufficient potential to further public sector interests, the criteria below will be adapted on a case-by-case basis to produce a credit opinion on various types of financial institution. In all cases, Holding Funds have to alert the Managing Authority or Investment Committee clearly to the fact that UDFs are not fully in line with general credit risk principles for JESSICA.

- Operating environment: for example, level of development of the banking system; sovereign credit rating of the country in which it operates; political and economic volatility; etc.;
- Regulatory and supervisory framework: for example, legal structure of the UDFs (regulated vs. unregulated; submission to prudential regulation; accounting standards used; etc.);
- Risk Management structure and organisation: for example, level of sophistication of risk monitoring system; access to the parent company's centralised risk management function; etc.;
- Credit risk: for example, level of past-due loans, restructured loans and written-off loans; loan-loss provisioning policies; percentage of secured lending in the loan portfolio; etc.;
- Operational risk: labour intensive vs. automated processes (e.g. credit scoring); staff turnover; adequacy of management information systems and software systems; etc.;
- Funding and liquidity: for example, diversification of funding base; level of liquid assets; access to bank credit lines for unforeseen liquidity gaps or access to "last resort" lenders; etc.;
- Earnings and performance: for example, interest income from lending vs. fee income, level of operating costs; trends in net interest income; etc.;
- Capital: for example, capital adequacy ratio; nature of capital sources; etc.;
- Size and franchise: for example, absolute size; strength of local franchise; granularity of portfolio and client base; average disbursed loan amount; etc.;
- Management, strategy and corporate governance: for example, dependence of management team on one person (key person risk); presence of adequate know-how; level of corporate governance; etc.

Counterparts other than financial institutions

Where UDFs are newly-established structures created outside the scope of financial institutions, by virtue of their characteristics – small absolute size, relatively limited track record or lack of geographical diversification – their ratings will generally be fairly low. It is therefore necessary to understand counterbalancing features that may help support their overall ratings, such as low leverage (i.e. debt-to-equity ratio), stability of financial performance, low level of competition, stakeholder structure, support by shareholders, etc.

Public Institutions

There is usually no minimum rating restriction for public sector counterparts. In such cases, the UDF analysis should also cover, in addition to typical financial indicators (e.g. financial performance and position, debt and capital investment needs, etc.):
- A legal opinion to evaluate the articles of association and the implicit (and/or explicit) support from state/local entities;
- Institutional and administrative framework: for example, statutory or constitutional authority to manage services, raise revenues, issue debt; pending legislative / judicial actions; authority exercising financial / administrative oversight.

Corporates

This type of UDF usually consists of an independent legal vehicle contractually managed by financial institutions. In such cases, the acceptability criteria set out for financial institutions will apply.

Investment funds

The acceptability criteria for investment funds are presented below for the two following cases:

- Investments in regulated venture capital vehicles;
- Investments in unregulated vehicles.

Regarding investments in regulated venture capital vehicles, these investments should be considered if most of the following characteristics/requirements are met:

- The fund investment guidelines/the guidelines of the intermediary meet the investment strategy of the HF;
- The fund manager/the intermediary is experienced and has a good track record, and there is an appropriate incentive scheme for the fund manager/intermediary. Nevertheless, "First time teams" may also be accepted for JESSICA investments;
- The envisaged investment fund would target urban development sectors (e.g. infrastructure, etc.);
- The investment fund / the investment with the intermediary would offer co-investing or co-financing opportunities.

Regarding investments in unregulated vehicles, these investments should be considered if most of the following characteristics/requirements are met:

- The investee company shows strong quantitative and qualitative investment characteristics or a security structure which bears the ultimate risk;
- Adequate monitoring is made possible by a regulated environment (e.g. financial institutions) or by in-depth knowledge of the investee;
- There is a reasonably clear and realistic exit route;
- The Holding Fund would co-invest with other reputable financial and/or strategic investors;
- In the case of investments with an intermediary (other than a fund), in order to reduce adverse selection, any investment by a HF will generally be subject to a concomitant co-investment by the intermediary for an adequate amount of risk.

3.1.2.3.4 Delegation approach

The general principle of funds invested in JESSICA schemes is that repayment is dependent on the performance of the underlying portfolio of eligible urban projects (i.e. Final Recipients). This implies that the credit risk principally refers to the quality of the underlying urban projects rather than to the creditworthiness of the UDF itself. However, UDFs channelling JESSICA revolving funds should demonstrate their own insolvency remoteness in order to avoid any potential commingling of own risk and under-performance of the operation. Hence, on the one hand, the Holding Fund must ensure that the UDF's creditworthiness is sufficiently high to fulfil its obligations and, on the other, it must adopt a portfolio approach on the underlying exposures.

As a consequence, the HF should invest only when it is possible to assess the credit risk – and therefore the performance – of the underlying portfolio using both quantitative and qualitative methods. This requires portfolio composition requirements to be laid down, in terms of minimum financial standing of the individual Final Recipients and, where possible, overall portfolio diversification limits. The type of requirements will vary significantly depending, amongst other things, on product type and size of the scheme. The UDF will therefore need to keep detailed accounts on an allocation-by-allocation basis and be prepared to make these accounts available to the HF upon request.

The HF generally delegates the origination and servicing of the portfolio of eligible Urban Projects to the UDF, subject to mutually agreed eligibility criteria as defined in the operational agreement. In particular, in order for the JESSICA investments to be viable, certain credit, due diligence and risk management tasks will have to be delegated to the UDF. As a pre-condition for the HF to delegate its credit approval, the UDF's counterparts should be deemed acceptable.

In this context, the HF will particularly welcome internal scoring systems in line with Basel II, though the absence of such systems would not be regarded as an exclusion criterion.

With regard to the actual procedures for delegation, the HF must set up specific principles. The choice of the relevant delegation scheme will be driven by the expected project size as well as the number of underlying exposures.

In the management of risks involved in a delegation arrangement, it is understood that in a delegation scheme, the HF would rely on credit assessment and risk controls based on the UDF's appraisal and monitoring standards. Due diligence prior to delegation will provide the HF with comfort regarding the risk management policies and processes of the UDF as well as a mapping of its rating scale and pricing methodology. Despite this due diligence, delegation exposes the HF to specific risks. In fact, if investments are deemed too risky for private sector funding, the HF should be ready to accept a situation in which its contribution could constitute the full estimated investment value, given the objective of promoting investments in urban development areas. This may however create additional risk exposure from UDFs that has to be appropriately mitigated.

In order to mitigate this risk, adequate contractual provisions for the alignment of interests, e.g. through a balanced risk and reward allocation between the parties, should be set out in the operational agreement with each UDF. The contractual documentation has to consider:

- The relationship between the HF and the UDF (as borrower and/or Agent);
- The contractual relationship between the UDF and the entity(ies) on which the HF is assuming the ultimate risk, i.e. the underlying urban projects; and
- If applicable, definition of the scope and quality of the delegated tasks.

Adequate performance standards and incentives for the UDF will be set, including information covenants relating to any material changes to the UDF's internal policies/processes, and penalties for underperforming portfolios.

The HF will concentrate on avoiding excessive risk-taking by the UDF, to limit the risk profile of the underlying portfolio, and to maintain a minimum level of credit quality over the life of the investment.

Furthermore, the operational agreement between the HF and the UDF(s) should outline in adequate detail the requirements of JESSICA in relation to the credit assessment, risk management and reporting standards, in order to ensure that the service is being performed by the UDF in accordance with best industry practice.

Finally, the decision on whether the HF's Investment Committee representatives should be represented on the board of a UDF in which the HF intends to make an investment will be approved on a case by case basis by the Investment Committee.

Regarding the requirements for a pre-delegation due diligence on the UDF, a thorough initial delegation due diligence should address both the structural/operational aspects and the risk profile of the exposure(s) to be financed.

The delegation due diligence will be performed jointly by the HF's operational function and the risk management function in association, if applicable, with legal advisors. The report and the risk management opinion will be finalised before UDFs are recommended to the Investment Committee.

A partial or full due diligence review may be required in the event of material changes to the UDF's internal procedures, policies and systems, or if a higher level of delegation is sought.

In addition, several measures may be introduced in the tendering procedure to reinforce the delegation model. These measures include:

- Introduction within the tendering process of specific exclusion criteria related to the financial standing of the prospective UDF;
- Obligation imposed on the prospective UDFs to make various declarations as regards their financial position[17];
- Introduction of award criteria that indirectly capture the UDF's creditworthiness. With these criteria, it should be possible to attribute more points to potential financial intermediaries which demonstrate most effectively that they have:
  – The relevant organisational capacity;
  – Management, administration, accounting and control procedures; and
  – Creditworthiness assessment procedures, risk managing procedures, etc.

The result of the risk analysis carried out by the HF has to be shared with and presented to the Investment Committee (or the MA). Indeed, it is not the responsibility of the Holding Fund to determine the acceptable risk level to be taken in the JESSICA investment, but it is the MA's role to determine its risk appetite (evaluated within the Investment Committee, if applicable) in relation to the investment strategy objectives.

3.1.2.4 Step 4: Authorisation and Signature

Although the draft contract is usually included in the tender specifications, after the awarding and before signature of the contract, negotiations may take place in order to translate all the specific proposals selected into contractual arrangements, and to clarify all the issues necessary for the sound implementation of the HF's investment in the UDF.

If there is an Investment Committee in place, it is recommended that the contract should be submitted to that Committee before signature in order to validate at least the following aspects:

- Consistency of the selection process with the investment strategy and its implementation plan; and
- Approval of the selection of Urban Development Funds.

Before signing the operational agreement with UDFs, HFs must ensure that appropriate governance and decision-making principles are in place, ensuring compliance with the principles of the Risk Capital Guidelines. Investment terms offered to the private sector investors in the UDF should also be covered in the operational agreement – it must be ensured that private investor returns do not exceed a so-called fair/market rate of return on investment, which could possibly ensure the proportionality of the aid.

Following the negotiations and after the selection of one or more UDF(s) has been validated, the UDF receives an operational agreement for signature.

Before the official signature, the UDF is generally requested to provide the Holding Fund with a statement of authorised signatories[18], which may vary according to the nature of the counterpart, the applicable laws and the circumstances of the case. The HF may decide to use its own legal service or

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[17] Including for instance a declaration that they have complied with prudential requirements compulsory to financial institutions, that during the previous 12 months no liquidity maintenance loan has been granted to them by the relevant Central Bank or other regulator, and whether the auditor's reports on their financial statements for the last three financial years have been qualified or modified.

[18] The sending of a statement of authorised signatories aims to identify the vested individuals (via their signatures) who are authorised to bind the UDF.

external legal advisor to perform a legal due diligence on the documentation ensuring that the proposed signatories are authorised to bind the party they represent before the agreement is signed.

The operational agreement is then signed by the UDF and JESSICA Holding Fund. Upon the signature of the agreement by all parties, the Holding Fund should ensure the provision of a detailed record of the signature process for future reference, follow-up, and audit inquiries.

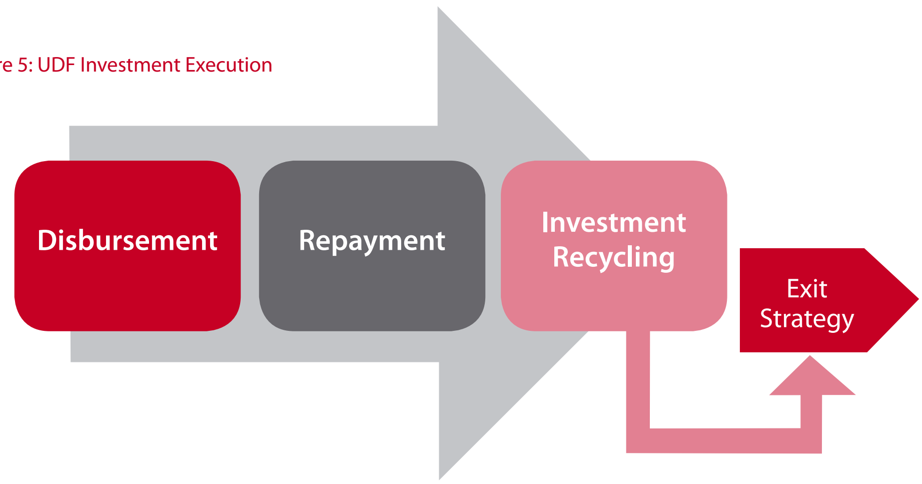
3.2 Investment processes

The investment process refers to the processes for implementing the investments in UDFs. The main processes at this stage include the authorisation of payments, the administration of repayments between the UDFs and the Holding Funds, the recycling of the investment, etc.

The following part of the JESSICA lifecycle is the Investment Process. It includes the following steps:
- Disbursement;
- Repayment;
- Investment recycling.

If the Holding Fund is a financial institution, the above-mentioned sub-phase can be carried out according to the existing procedure for similar actions within the institution, provided that duties and tasks are properly segregated. If the HF is selected via a public procurement procedure, it is good practice for the disbursement and loan servicing procedures to be analysed and assessed by the MA before selecting the HF[19].

Figure 5: UDF Investment Execution



3.2.1 Disbursement

The conformity of disbursements with the operational agreement, the management of disbursement flows and the proper recording of relevant back office data are the responsibility of the Holding Fund.

If the investment is in the form of a loan or equity, the HF is responsible for the conformity of the investments with both national regulations and the agreed investment strategy. It is likely that for these two types of investment, national jurisdictions will contain particular requirements that will have to be taken into account.

[19] Based on the assumption that a HF is a regulated financial institution or will work in association with a financial institution and has experience of managing similar investments.

Regarding guarantee schemes, national regulations are usually stricter, and the guarantor may have to be an authorised entity subject to specific prudential regulation.

As a rule, the disbursement process is carried out according to the HF's existing back office process and procedures.

After the disbursement, the HF is responsible for the financial monitoring of the implementation of the investment agreement and of the UDF counterpart. These activities represent the counterpart/transaction monitoring usually carried out by a financial institution's middle/back-office (i.e. proposing, negotiating and implementing waivers, contract amendments, prepayments, refinancing or restructuring). They are additional to the monitoring activities required by EU Structural Fund regulations.

The logic of the financial engineering and revolving instruments requires that financial monitoring and risk management issues be considered during the implementation of the investment. In the EU, all supervised financial institutions have the obligation to put structures and procedures in place in order to comply with those functions. The Managing Authority has to ensure that the selected Holding Fund carries out those tasks when managing the UDF investment. For this reason, it is recommended that procedures and responsibilities in the area of financial monitoring form part of the funding agreement.

3.2.2 Repayment

This process relates to the management of the repayments deriving from the investment previously realised from the HF into the UDF. Such repayments usually depend on the repayment from the underlying urban projects. In general, during the investment phase, three sources of inflows can be identified, according to the form of investment selected:
- Loan interest and reimbursements of principal;
- Dividends and capital gains;
- Guarantee fees.

From a Holding Fund perspective typical loan/equity servicing activities may include:
- Identification and allocation of funds received;
- Follow-up of payment of amounts overdue;
- Monitoring of payment advices and provision of amortisation tables to borrowers;
- Solving payment problems.

These repayments have to be defined in the contractual terms of both:
- the operational agreement, for the funds to be repaid from the UDFs to the HF;
- the funding agreement, for the funds to be repaid from the HF to the MA.

As very few UDFs have been set up to date, there is virtually no experience worth mentioning in this Handbook in terms of repayments. Nevertheless, in theory, once the projects start to generate revenues, the mechanism enables the interest earned to be upstreamed through each stage / entity (namely the UDF and, if applicable the HF), separating the project's revenues from the Managing Authority very quickly. Depending on the re-investment strategy (as explained in the next section regarding the investment recycling), interest earned should quickly be made available to the MA as soon as projects generate revenues.

Indeed, it is not necessary to wait for the completion of an investment cycle to receive the interest on the monies invested in the first place: once a profit has been generated by a project (e.g. dividends on equity), both the operational agreement and the funding agreement define how revenues should be upstreamed quickly to the MA or to the HF.

In other words, the contractual documents defining the relationship between the MA, the HF and the UDF must set out how cash-flow is to be managed within these three parties. Elements such as the tenor and maturity of the investment provided by the HF to the UDF and by the UDF to projects have to be taken into account. An amortisation table and reimbursement schedule have to be part of the contractual documentation, as well as fees and conditions for cash deposits under a guarantee schemes.

Managing Authorities can decide to reinvest the amount received into new or existing schemes. In this case, the pre-defined process covering investment recycling has to be followed. Nevertheless, if the funds are returned to the HF, the repayment flows are usually first reinvested under the treasury scheme as set up in the funding agreement or in accordance with other instructions provided to the HF by the competent authority[20].

3.2.3 Investment recycling

This step concerns reinvesting revenues generated by the investments (i.e. interests/dividends) and from the reimbursement of principal in order to enable a new allocation of Holding Fund resources to be made. It is up to the Managing Authority to determine the preferred mechanism for the re-use of returned resources.

As there is no investment recycling policy defined in any legislation, it is the duty and the responsibility of the MA to decide what the recycling backflow mechanism should be. Recycling, can take place:

– at UDF level;
– at HF level; or
– at MA level, by way of exit from UDF and HF.

In order to determine what could be the best recycling approach, it is advisable that the evaluation studies and/or the investment strategy establish the possible recycling scenarios in order to evaluate the different recycling possibilities offered to project financing by tailored funding solutions. The most appropriate option may be then chosen by the MA or other competent authorities.

When monies are repaid to the Holding Fund, via the UDFs, the Holding Fund:

- implements the possible recycling policy already established in the investment strategy;
- requests instructions from the Managing Authority (or Investment Committee) regarding the recycling policy to be implemented.

The aim of all capital invested is to support the implementation of urban projects, and in that sense should be used at all times throughout the investment period.

As illustrated in Figure 6, the JESSICA approach offers the possibility to pursue the activities of the Holding Fund, refinance the already selected UDFs or initiate a new cycle of investment and identify new additional UDFs. This approach enables, in principle, the incorporation of future changes to national/regional regeneration priorities over time, and gives other sectors or target areas a fair chance to bid for follow-up investments.

The Managing Authority is solely responsible for deciding on the recycling of the funds. The MA has to establish whether the HF provision and the generated revenues should be returned to the MA or if they should be re-invested at the appropriate levels. Best practice indicates that it is preferable to address this issue when the funding agreement is being drafted.

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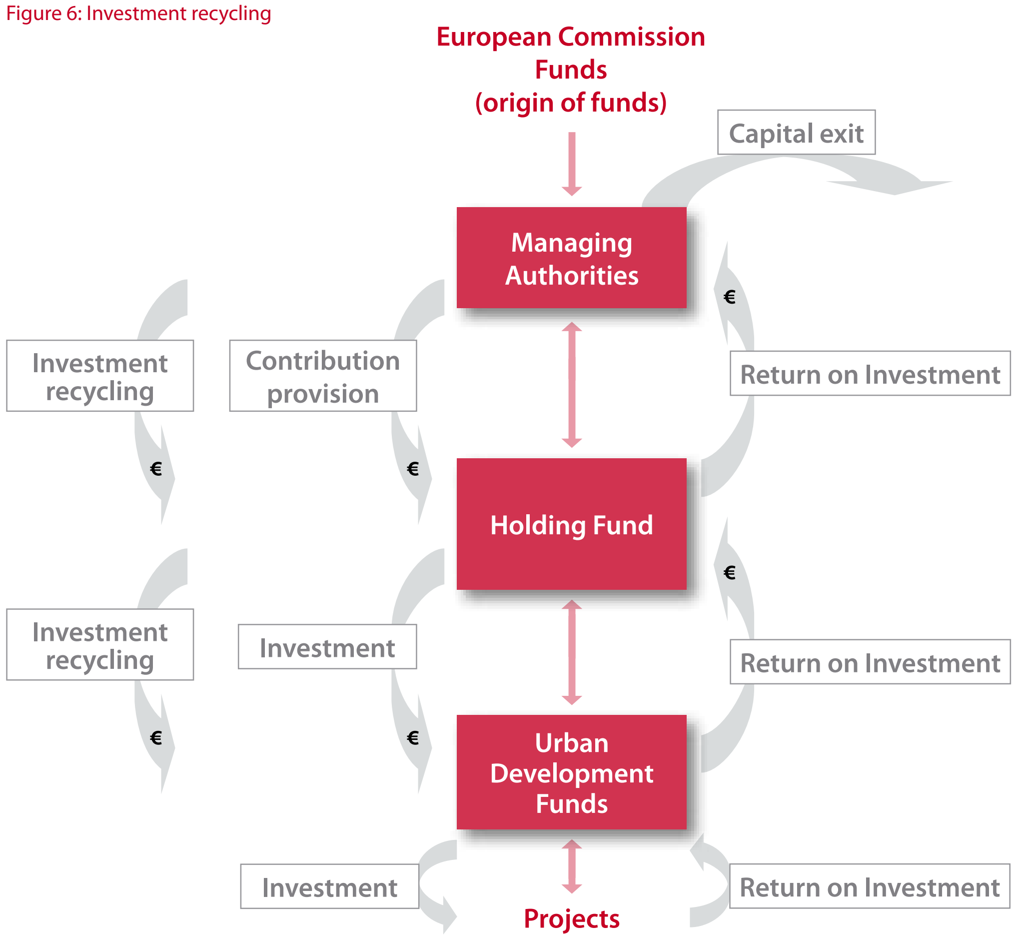
[20] If an Investment committee has been set up, the decision on the modification of the Treasury Guidance could be devolved by the Managing Authority to the IC. The FA has to include a provision on the modification of the Treasury Guidance.

Figure 6: Investment recycling



In conclusion, the investment recycling process can be summarised as follows:

1. Financial resources are to be recycled in line with an investment recycling policy to be defined by the Managing Authority;
2. Repayments are placed in a separate deposit account;
3. A proposal is presented to the Managing Authority (or Investment Committee) for the re-investment of the financial resources:
   a) If accepted, the financial resources are re-invested from the Holding Fund into already selected UDFs (or new UDFs to be selected) and a new cycle of UDF investment is initiated;
   b) If refused, the investment is redeemed and the financial resources returned to the MA.

An exit strategy must therefore be defined.

The exit strategy has to be set out in one or two documents depending on the mechanism selected (with or without a HF):

- The funding agreement should define a “general exit strategy” between the HF / UDF (if no HF) and the MA;
- The operational agreement should define an exit strategy between the HF and the UDF.

At a certain stage, which has to be determined in the funding agreement, the exit strategy will have to be defined between the parties and will have to involve winding up all schemes. The Holding Fund will have to be wound-up and all funds available transferred to the MA.

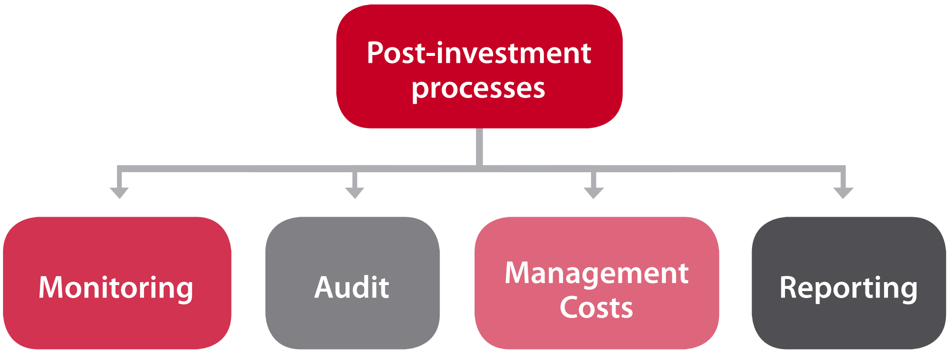
3.3 Post-investment processes

The post-investment process includes a set of activities commencing after the funding agreement has been signed, and particularly after signature of the operational agreement and the investment into the UDF. In particular, monitoring and controlling post-disbursement events, and reporting to the MA and governing body of the HF, also entail aspects of financial reporting. These procedures take into account specific requirements of the Member States and / or Managing Authorities and the need to comply with the Structural Funds Regulations.

Treasury Management, which is the responsibility of the HF, has already been illustrated. As a manager of the funds on behalf of the MA, the Holding Fund is responsible for investing and preserving the value of the funds, and managing liquidity according to the investment schedule, as well as dealing with aspects linked to the general issues of monitoring, reporting and audit under Structural Funds management, throughout the entire investment life cycle.

We have illustrated in this section the recurrent post-investment activities related to the management of the Holding Fund. These activities include monitoring, management costs calculation, reporting and audit.

Figure 7: Post-investment processes



3.3.1 Monitoring

Monitoring is the process of financial and non-financial data collection and analysis aiming at evaluating UDF performance in relation to the Holding Fund's objectives, investment strategy, budget and work plan. The objective of the monitoring process is also to further verify the UDF's compliance with legal and contractual requirements. Monitoring may also provide the MA and Investment Committee – when one has been established – with the data necessary to enable the authorities responsible for the operations to certify that:

- The implementation of JESSICA operations complies with applicable requirements (e.g. with the EU Structural Funds Regulations and applicable laws) and includes necessary applicable arrangements to collect relevant information under the State aid rules;
- The established JESSICA investment strategy objectives are being pursued.

The monitoring process may also include regular checking and progress measurement using appropriate instruments for deviation, risks and non-compliance identification so that corrective actions can be taken by the Managing Authority or Investment Committee when necessary.

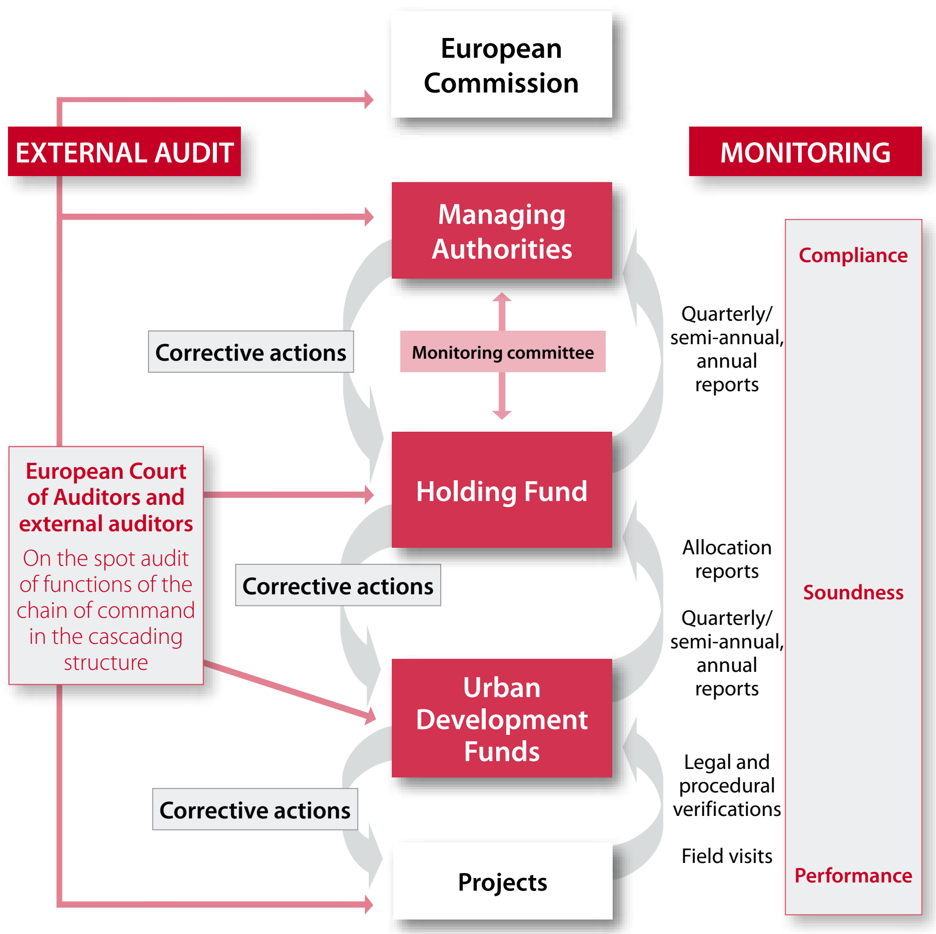
According to Art. 35 of the Regulation[21], "each community support framework or single programming document and each Operational Programme shall be supervised by a Monitoring Committee. Monitoring Committees shall be set up by the Member State, in agreement with the Managing Authority after consultation with the partners. The Monitoring Committees shall be set up no more than three months after the decision on the contribution of the Funds. Indeed, Member States are required to appoint Monitoring Committees to check that Operational Programmes which use Structural and Cohesion funding are being correctly implemented.

These committees are chaired by the relevant Member State or Managing Authority and comprise regional, economic and social partners."

The JESSICA monitoring process has to consider the two dimensions of the monitoring structure envisaged by the regulation and the specific monitoring requirement necessary for the specific investment strategy being implemented.

Implementation of the HF's monitoring processes is based on a cascade of decisions and actions in which several parties are sequentially involved: the European Commission, the Managing Authority, the Holding Fund, UDFs, and urban projects.

Figure 8: Monitoring

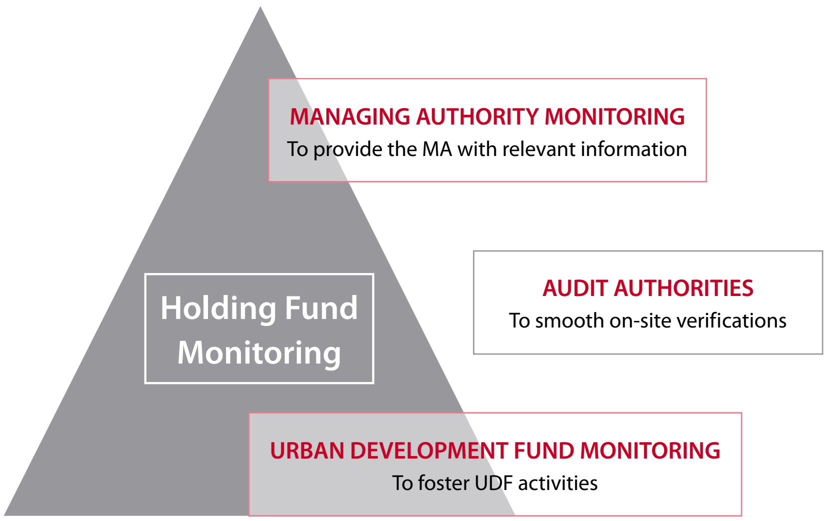


21 Council Regulation (EC) No 1260/1999 of 21 June 1999.

The monitoring of HF schemes will include activities carried out internally and/or externally by different parties in a cascading structure which ensures that the implementation of each stage is controlled by a party at a higher level.

- The monitoring related to the investment strategy and the implementation plan of JESSICA Holding Funds is to be carried out by the Investment Committee, where one exists;
- Monitoring the Implementation of JESSICA schemes/urban projects is to be carried out by the Holding Fund and by the Managing Authority[22];
- The Holding Fund has to make sure that operational agreements encompass the necessary provisions to collect relevant information from the UDFs in order to ensure that schemes/urban projects can be monitored appropriately. Furthermore, the operational agreements might acknowledge the right of the Holding Fund and the Managing Authority to carry out monitoring visits to the UDFs and Urban Projects receiving financial support from the Holding Fund.

Figure 9: Holding Fund Monitoring



Three different but interrelated levels of monitoring are mandatory for the Holding Fund:

- UDF (and Urban Project) Monitoring: monitoring UDF activities refers to all activities undertaken by the Holding Fund on the basis of reports and other information related to and provided by UDFs, and any aspect of their operating environment. The purpose is to enable the Holding Fund to take actions that will enhance the value of its operations;

- Monitoring obligations towards the MA: the process by which the JESSICA Holding Fund, based on the indicators included in the relevant Operational Programme, as established by the Monitoring Committee, provides the MA with the relevant information it requires to fulfil its obligation under Structural Funds regulations;

- On-the-spot verifications by Audit Authorities (AA): As part of their audit activities, authorised auditing representatives (EC, European Court of Auditors, etc) may carry out on-the-spot verifications.

[22] NB: The Managing Authority is ultimately responsible for Operational Programme management and implementation. It may choose to entrust the Holding Fund with some of these tasks. However, full delegation of the overall responsibility to the Holding Fund is not recommended to ensure that the tasks are properly carried out.

3.3.1.1. *General UDFs and underlying urban projects monitoring activities*

It is advisable that the following activities should be performed by the Holding Fund to ensure proper monitoring of operations:

- Reviewing reports submitted by the UDF;
- Establishing and maintaining direct contact with the UDF; and
- Carrying out management verifications.

Relevant monitoring information on the operations may be captured from post-signature material events (including pre-payments), monitoring reports, and accounting information provided by the UDF.

Common practice is for the Holding Fund to rely on the reports provided by the UDFs to produce summary reports reflecting the UDFs' performance, progress, and effectiveness in the implementation of its operations. For this reason it is recommended that the structure and content of the reports are discussed beforehand with the UDF and included in the operational agreement signed with the UDF. The results of this reporting process are to be reflected in the Holding Fund reporting to the Managing Authority.

Box 9: First and Second Level verifications[23]

In line with the European Union's Structural Funds Regulations, JESSICA operating procedures are designed to ensure the correctness and regularity of the expenditure declared under the Operational Programme. This can be considered as the "first level" of verification. Under these procedures, all expenses declared by a project have to be checked by responsible control bodies. These bodies will have to verify the delivery of the products and services co-financed, the soundness of the expenditure declared and the compliance of this expenditure with EC, national and programme rules.

1. "First level" verifications are suited to the nature of "revolving" funds and are based on the procedures for first level verifications on subsidies.
2. "First level" verifications are based on the delegation (cascade) model involving several parties in the disbursement, approval, monitoring and authorisation phases.
3. "First level" verifications take place at the following levels:
   - At Managing Authority level, when the funding agreement is signed: the disbursement is checked, verifying compliance with the required payment certification procedure;
   - At the Holding Fund level: through the segregation of tasks within the HF in the selection, identification, disbursement and repayment process for investment in UDFs;
   - At the UDF and urban project level: the UDF must check all conditions as indicated by the JESSICA Holding Fund in the operational agreement prior to disbursement to the urban project.

The Holding Fund will request the UDF to apply segregation of duties in the approval phase and ensure compliance with conditions prior to disbursement to projects, including a pre-disbursement verification that eligible project costs are capable of absorbing UDF funding to urban projects from Operational Programme resources.

The UDF needs to keep all supporting documentation[24]. The HF should check the expenditure documentation at least once a year. Where a check on supporting documents would involve an inordinately large volume of documentation, an alternative approach may involve requesting only the supporting documentation in respect of the sample expenditure items selected for verification.

The Holding Fund is advised to perform second level verification by itself, or to delegate it to an independent external provider. Generally, the second level verification should contain the following:

- **Administrative checks** (including checks on documentation for the appraisal of operations in order to evaluate their eligibility under Structural Fund regulations, as well as proposals and formalisation, fund follow-up reports, and audit reports on the fund);
- **Financial checks** (including verifications of account transactions, operation payments, reimbursements, register and investment tracking, etc.);
- **Technical checks** (including verifications of technical reports on the operations, etc.); and
- **Physical checks** (including proof of necessary registrations, accounting, existence of operations, etc).

[23] Check of all expenses and certification of eligible ones referred to in Art. 60 b) of EC Regulation 1083/2006 and Art. 16 of EC Regulation 1080/2006.

[24] Supporting documentation involves the establishment of an adequate audit trail, usually including a schedule of the individual expenditure items, totalled and showing the expenditure amount, the references of the invoices, the date of payment and the reference number. Ideally, copies of invoices and proof of payment are provided for all expenditure items.

The aim of the UDF's reports is to allow the Holding Fund to assess the progress of the UDF from an operational perspective. The results of these reports are then reflected in the annual, quarterly and/or semi-annual progress reports submitted to the Managing Authority.

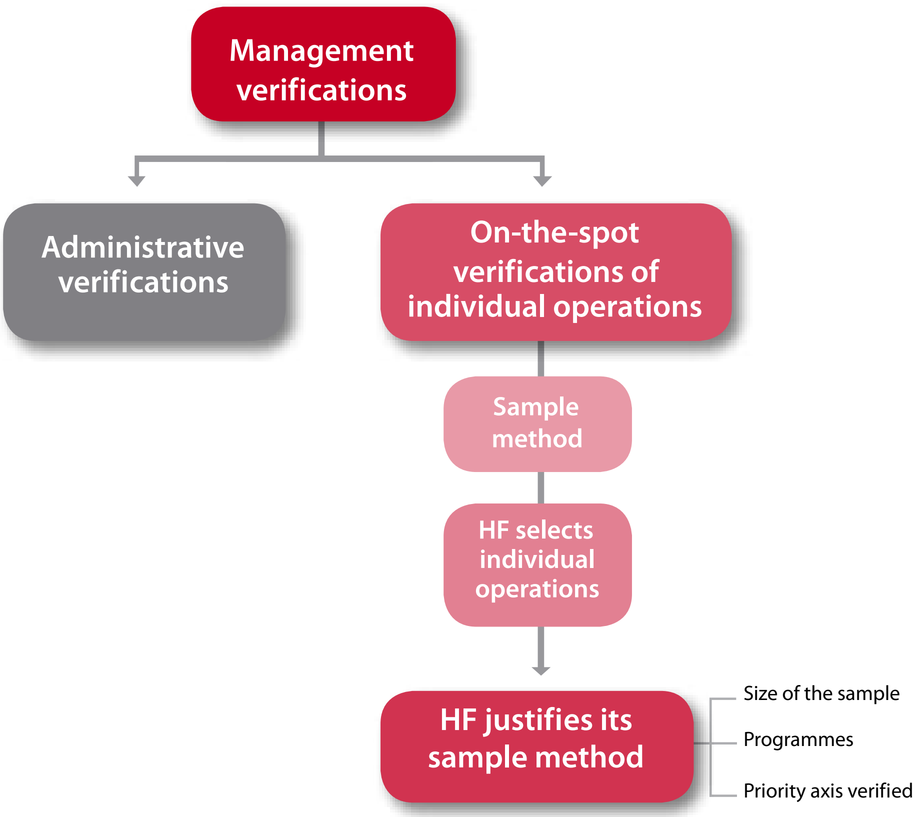
It is recommended that the above-mentioned reports allow an assessment of the degree of implementation of JESSICA in terms of:

- Material and financial progress made versus the established objectives, based on measurable financial and material performance indicators specified in the tender documentation and/or investment strategy;
- Implementation of EC horizontal policies;
- Implementation of various financial instruments;
- Implementation issues; and
- Income generated as a result of project implementation.

The Holding Fund should also maintain regular contact with the UDFs in order to ensure smooth implementation of the operational agreement, identify any obstacles observed in the implementation of the schemes, and provide advice on the most appropriate solutions to any difficulties encountered.

Experience suggests that verifications are usually undertaken in the course of visits to UDFs. In exceptional cases, visits may also concern the underlying Urban Projects, to ensure accuracy in the reporting of administrative, financial, technical, and physical aspects.

Figure 10: Management verifications



Management verifications should be part of the HF's internal control[25] system. It should be noted that the objectives of management verifications are different from those of audits carried out under the responsibility of the audit authority. The objectives of audits are to assess whether the internal controls are operating effectively, whereas management verifications form part of internal controls. It is therefore recommended that the two types of work be clearly distinguished[26] in their planning, organisation, execution, content and documentation.

According to Article 13(2) of EC Regulation 1828/2006 as amended by EC Regulation 848/2009, verifications comprise two key elements[27], namely, administrative verifications (i.e. desk-based verifications) and on-the-spot verifications (field visits) of individual operations. These verifications can be carried out on a sample basis, based on a risk analysis. Where sampling is used for the selection of individual operations, the Holding Fund is advised to keep records describing and justifying the sampling method, and a record of the operations selected for verification.

No operation can be excluded from the possibility of being subject to management verification through field visits. Indeed, in practice, for programmes or priority axes having a large number of small operations, administrative verifications may provide some high-level assurance and can be complemented by field visits for a sample of these operations to provide confirmation of the assurance. If some issues are identified, the size of the sample can be increased in order to determine whether similar issues exist in the unverified operations. The existing practice suggests two major types of field visits – scheduled and special. Table 3 below provides more details on their characteristics.

Table 3: Types of field visit

Type	Description
Scheduled field visit:	
Regular monitoring visit	The frequency of these visits is defined in the operational agreement between the HF and the UDF. Usually these visits are conducted at least once during the lifetime of the contract.
Visit at completion	This visit is made upon termination of the operational agreement.
Special field visit:	
Visit following poor performance	These visits are made in the event that poor performance is detected (e.g. if within two years of the operations starting, no significant progress has been made in the deployment of funds and/or in the development of Urban Projects) or if such a visit is deemed necessary by the Holding Fund.
Visit following material event	This visit is usually conducted following a material event that may have an impact on the implementation of schemes.

25 The Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines internal control as follows: process designed to provide reasonable assurance regarding the achievement of objectives in terms of effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations.

26 Although management verifications and audits are the responsibility of the Audit Authority, the staff carrying out these controls should be separated. For example, the staff involved in management verifications should inform it of the results of audits and may well look to the Audit Authority for advice, while the latter should take account of the results of management verifications in its risk analysis and audit strategy.

27 The Managing Authority, when determining the extent of the verifications to be carried out under point (a) of Article 13(2) may take account of the control procedures of the beneficiary where this is justified.

In addition to the regular monitoring activities described above, the Holding Fund may monitor the implementation of schemes by using the following mechanisms:

Information on post-signature material events

During the life of its investment, the HF is informed of any material post-signature event which could influence the implementation of the schemes.

Monitoring reports

After each field visit, the Holding Fund should normally prepare a monitoring report detailing the main issues discussed during the visit and the findings of the visit. Among other necessary areas of information, the report may contain:

- Date of the visit;
- Work performed;
- Results of the verification (including the overall level of achievements and errors detected);
- If errors have been detected:
  - Full description of irregularities detected with a clear identification of the related EC or national legal rules infringed; and
  - Measures taken to correct the irregularities.

Accounting information for monitoring purposes

Under the operational agreement, the UDF is required to submit annual accounts for the operations, and/or to take responsibility for the provision of the accounting information. This accounting information is necessary to correctly assess the value of the investments and is delivered to the Holding Fund at a certain frequency (e.g. in the case of equity, this information may contain the valuation of the equity holdings of the HF in the UDF).

Management verifications of State aid schemes

Best practice would include a detailed examination of each individual operation or of the aid scheme itself, in order to ensure that the verifications are made in compliance with State aid regulations.

Depending upon the Holding Fund's judgment concerning the level of regulatory risk, this assurance could be provided by regular reporting delivered by the body granting the aid. This regular reporting process can be combined with on-the-spot verifications at the urban project level[28]. In any case, monitoring rules on State aid should be complied with.

3.3.1.2. UDF Monitoring

In order to facilitate the fulfilment of the UDF obligations towards the Holding Fund under the operational agreement, it is suggested that the Holding Fund should design and proposes a standard Reporting template to UDFs. The reports suggested in Box 10 below may be used by UDFs.

Usually, the Holding Fund is responsible for ensuring that the UDF reports are received on time and in the form required under the operational agreement.

Best practice dictates that the reports issued by UDFs should provide information about the promoters (i.e. entities in charge of carrying out the investment such as private contractors, special purpose

[28] Management verifications of State aid schemes are in the Guidance document on management verifications to be carried out by MS on operations co-financed by the Structural Funds and the Cohesion Fund for the 2007-2013 programming period.

vehicles, etc.) and the Urban Projects, thus offering a comprehensive view of the impact of the Holding Fund, and of the activity of the UDF on an aggregated basis. The UDF(s) may also need to collect the relevant indicators at project level (this information could be consolidated for all projects at UDF level), and submit the annual accounts and the accounting information for the scheme and relevant auditing procedures[29] to the Holding Fund (see "Accounting information for monitoring purposes" above).

Box 10: UDF Reporting to the Holding Fund

Allocation Report
The UDF may establish and maintain an internal reporting system for the monitoring of allocations of funds to operations. This report is to be provided to the Holding Fund upon request.

Quarterly/Semi-Annual Reports
These reports include the analysis of the progress made with regard to the agreed investment strategy and implementation plans. They also provide detailed information on the progress of the operations.

Annual Report
This report may offer a detailed analysis of the activities performed during the previous calendar year, an analysis of the progress made in implementing the investment strategy and detailed information on the progress of the operations.

The Holding Fund should also review the data received on legal aspects and risk related issues – for instance the Holding Fund may review the fair value of an equity participation. Additional information may be requested from the UDF if the Holding Fund considers it necessary. If the additional information turns out to be insufficient, the Holding Fund may decide to carry out field visits and/or specific audits and will notify the UDF accordingly.

3.3.1.3. Reporting irregularities

If, during the monitoring process, including field visits, one or more irregularities are identified, it is advisable for the Holding Fund to compile information on them and notify both the UDF and the Investment Committee.

Article 28 of EC Regulation 1828/2006[30] indicates the information on irregularities to be collected by the Managing Authority with assistance from the Holding Fund.

A few elements are listed below:
- The provision which has been infringed;
- The practices employed in committing the irregularity;
- The manner in which the irregularity was discovered;
- The period during which, or the moment at which, the irregularity was committed;
- The national authorities or bodies that drew up the official report on the irregularity and the authorities responsible for administrative or judicial follow-up;
- The identity of the legal persons involved or of any other participating entity, except where this information is irrelevant for the purposes of combating irregularities, given the nature of the irregularity concerned;
- The total eligible expenditure and the public contribution approved for the scheme together with the corresponding amount of the Community contribution calculated by application of the co-financing rate of the priority axis;

[29] According to EC Regulations, the UDF, and all parties involved in UDF projects, are to retain relevant documentation for inspection purposes for a period of three years after completion of the Operational Programme.
[30] As amended by EC Regulation 846/2009.

- The expenditure and the public contribution certified to the Commission which are affected by the irregularity and the corresponding amount of the Community contribution at risk calculated by application of the co-financing rate of the priority axis;
- In the event of a "suspected fraud"[31] and where no payment of the public contribution has been made, the amounts which would have been unduly paid had the irregularity not been identified;
- The nature of the irregular expenditure.

The correction of irregularities identified is primarily the responsibility of the Holding Fund which can work directly with the UDFs to solve existing issues. If the investment period or the scheme period is ongoing, the Holding Fund may consider the subsequent options following a proposal from the UDFs:
- Exclude the Final Recipient from its portfolio if the irregularity which has been detected is significant or perceived as an obstacle to the successful completion of the scheme; and/or
- Replace the irregular Final Recipient by another Final Recipient in line with the investment strategy, the business plan and all relevant criteria included in the operational agreement.

Irrespective of the option chosen, the Holding Fund is advised to estimate the losses caused by the irregularities and send a request for recovery of any sums wrongly paid (together with interest on late payment where appropriate). The recovery request is submitted to the UDFs, which should then contact the Final Recipient to obtain the reclaimed amount.

In line with the recent amendment to EC Regulation 1828/2008 (i.e. EC Regulation 846/2009), the information about irregularities listed below is usually not required but may be requested (in writing) from the Member State by the Commission:
- The amounts which have been or are expected to be recovered;
- Any interim measures taken by the MS to ensure the recovery of sums unduly paid;
- Any legal and administrative procedures instituted with a view to recovering sums unduly paid and to imposing sanctions;
- The reasons for any abandonment of recovery procedures;
- Any abandonment of criminal prosecutions.

Any information on the amount not recovered and on the facts relevant to the decision on apportionment of the loss under Article 70(2) of Regulation (EC) No 1083/2006 is required to include at least:
- A copy of the award decision;
- The date of the last payment made to the Final Recipient;
- A copy of the recovery order;
- In the event of bankruptcies subject to reporting under Article 28(2), a copy of the document attesting to the Recipient's insolvency;
- An outline description of the measures taken by the MS, with an indication of their dates, to recover the relevant amount.

3.3.1.4. Monitoring obligations towards Managing Authorities

The Managing Authority is responsible for managing and implementing the Operational Programme. Its core responsibilities include[32]:
- Verifying that the co-financed products and services are delivered and that the expenditure declared by the Final Recipients, i.e. Urban Projects has actually been incurred and complies with Community and national laws;

[31] "Suspected fraud" means an irregularity giving rise to the initiation of administrative and/or judicial proceedings at national level in order to establish the presence of intentional behaviour, in particular fraud, such as is referred to in Article 1(1), point (a), of the Convention on the protection of the European Communities' financial interests.

[32] EC Regulation 1083/2006, Art. 60.

- Ensuring that Recipients and other bodies involved in the implementation of Urban Projects maintain a separate accounting system or an adequate accounting code for all transactions relating to the Urban Project;
- Guiding the work of the Monitoring Committee and providing it with the documents required to permit the quality of the Operational Programme to be monitored in the light of its specific goals; and
- Drawing up the annual and the final reports on implementation and, after their approval by the Monitoring Committee, submitting them to the Commission.

In accordance with Art. 63 of EC Regulation 1083/2006, Member States have to set up, for each Operational Programme, a Monitoring Committee in agreement with the Managing Authority, to ensure the quality of the implementation of the Operational Programme and to control the correct implementation of the tasks of the Managing Authority. Member States may set up a single Monitoring Committee for several Operational Programmes where applicable.

The main task of a Monitoring Committee is to review the degree to which the quantified targets associated with each of the priorities have been achieved. More specifically:

- Approve criteria for selecting the projects financed ensuring their consistency with the programming needs;
- Review progress towards achieving specific targets of the Operational Programme;
- Examine results of implementation, particularly the achievement of the targets set for each priority axis;
- Approve the annual and final reports on implementation;
- Propose, if appropriate, any revision or examination of the Operational Programme to the Managing Authority.

A Holding Fund representative may participate in the Monitoring Committee in an advisory capacity for Operational Programmes involving the investment of funds through the JESSICA mechanism. The Holding Fund representative thus attends the Monitoring Committee as an observer. Therefore, responsibility both for monitoring the Operational Programme (and thus the schemes) and for the quality of its implementation remains at Managing Authority and Monitoring Committee levels, as stated in Article 65 of EC Regulation 1083/2006 (defining the Monitoring Committee's tasks).

The Managing Authority and the Monitoring Committee monitor[33] on the basis of the agreed financial indicators and other indicators referred to in Art. 37(1)(c) and specified in the Operational Programme. To fulfil its monitoring obligations, the Managing Authority may request the Holding Fund to collect the required information for its monitoring activity. The type, frequency and format required by the MA should be defined at the very early stage of the HF's creation, and it is recommended that provisions on these aspects should be included in the funding agreement. In any case, information should be based on the monitoring indicators defined in the Operational Programme.

The monitoring information that the Holding Fund compiles from different sources might include all relevant data requested by the Managing Authority to fulfil its monitoring and reporting obligations to the European Commission. The Managing Authority, however, usually remains accountable for monitoring the Operational Programme and the operations.

3.3.2 Audit verifications

Since EU Structural Funds are part of the contribution into the Holding Fund, the European Commission, its authorised representatives and/or the European Court of Auditors, as well as the Audit Authority of the Member State are entitled to verify how the EC contribution is used.

[33] Art. 66(2) of EC Regulation 1083/2006.

For the purposes of Article 60(f) of Regulation (EC) No 1083/2006, an audit trail shall be considered adequate where, for the Operational Programme concerned, it complies with the following criteria:

(a) It permits the aggregate amounts certified to the Commission to be reconciled with the detailed accounting records and supporting documents held by the Certifying Authority, Managing Authority, intermediate bodies and recipients as regards operations co-financed under the Operational Programme;
(b) It permits verification of payment of the public contribution to the Recipient;
(c) It permits verification of application of the selection criteria established by the Monitoring Committee for the Operational Programme;
(d) It contains in respect of each scheme, as appropriate, the technical specifications and financing plan, documents concerning the grant approval, documents relating to public procurement procedures, progress reports and reports on verifications and audits carried out.

Furthermore, it is advisable that any audit in connection with the Holding Fund shall be carried out in accordance with the terms of the funding agreement between the Managing Authority and the Holding Fund so as to minimise any potential disruption to the activities of all parties involved and with appropriate advance notice of inspections being given.

In light of the above, the funding agreement may consider that:

- The Managing Authority and the Commission reserve the right to send representatives of the competent
- Audit Authorities, or their duly authorised representatives, to carry out any audit and/or controls they consider necessary with respect to the Holding Fund, the UDFs and, in duly justified circumstances, underlying Urban Projects, provided that the Holding Fund shall be informed of any such audit and/or controls with reasonable prior notice;
- In this respect, operational agreements should ensure that appropriate provisions are included in any subsequent agreement supporting Urban Projects under JESSICA;
- The operational agreements could also provide for monitoring visits by the Holding Fund and the above-mentioned authorised entities to the UDFs and Urban Projects receiving support from the Holding Fund.

Appropriate arrangements are usually signed between the Holding Fund and UDFs to enable the Commission, its authorised representatives, the European Court of Auditors, all other Community institutions or Community bodies, as well as any duly authorised national entities (Audit Authority, Certifying and Paying Authority, Managing Authority) to verify the use of the contributions to the Holding Fund, and to have access to information along the entire chain so as to enable them to discharge their responsibilities.

In accordance with Article 13(2) of EC Regulation 1828/2006 as amended by EC Regulation 848/2009, the verifications to be carried out on the UDF usually cover, as appropriate, administrative, financial, technical and physical aspects of operations.

Where problems are detected that appear to be systemic in nature and therefore entail a risk for other schemes under the Operational Programme[34], the Audit Authority is required to ensure that further examination is carried out, including additional audits where necessary, to establish the scale of such problems. The necessary preventive and corrective actions must be taken by the relevant authorities.

The Audit Authority, or any other relevant controllers, shall keep records of each verification carried out[35], stating the work performed, the date and the results of the verification, and the measures taken in respect of irregularities detected.

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34 Art. 16(3) of EC Regulation 1828/2006.

35 Art. 13 (4) of EC Regulation 1828/2006 as amended by EC Regulation 846/2009.

It has to be emphasised that the operational agreement between the HF and the UDF could include specific audit requirements if necessary. It is also important to note that the DG REGIO Audit Unit is preparing specific guidelines establishing principles for the audit trail for financial engineering instruments under the SF Regulation, and it is reasonable to expect that further, more specific indications concerning audit requirements for JESSICA schemes will become available once these guidelines are finalised.

3.3.3 Management costs

This section outlines procedures for the calculation, reporting and payment of the Holding Fund management costs, as these may be predefined under the funding agreement. Appropriate management fees aim to recover the costs associated with the management of a HF. These include all costs incurred and/or expected to be incurred by the HF for its operations and for potential additional tasks defined in the funding agreement.

The detailed description of the type of eligible costs (including staff costs, overheads, etc.) and their calculation methods are usually provided in the funding agreement.

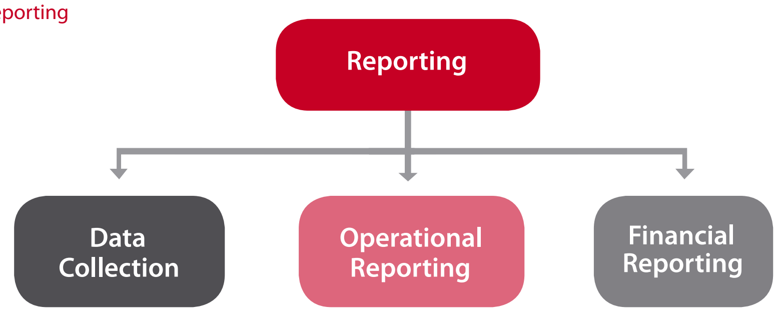
For the accounting year-end, the HF will prepare the annual statements of management costs to be included in the Holding Fund's financial statements.

In addition, it is recommended that the funding agreement should set deadlines (e.g. 31 March of each year) by which the Holding Fund is to submit to both the Managing Authority and the Investment Committee a statement of costs incurred during the previous year and provide evidence of reconciliation, where applicable.

3.3.4 Reporting

The reporting procedure is an essential element of the HF's monitoring system and should thus be designed to ensure appropriate management of the initiative and to contribute to the reporting obligations of the Managing Authority as defined by the Commission.

Figure 11: Reporting



3.3.4.1. Data collection at HF level

It is recommended that the Holding Fund and Managing Authority agree on the details of the reporting procedures applied as part of the monitoring system of the Holding Fund, also taking into account the corresponding system implemented for the Operational Programme. On the basis of this negotiation, it is advisable that a standard reporting template be used; this could also be prescribed in the funding agreement.

Once deadlines for data contributions have been set, it is recommended that all parties concerned (i.e. Urban Projects, UDF, etc.) submit the necessary data to the HF in line with pre-determined deadlines. The HF should then consolidate the information and be responsible for reviewing its completeness and accuracy before reporting to the MA.

The final data are to be recorded in the HF's database available for financial and progress reporting purposes, in line with the HF's monitoring obligations to the Managing Authority.

3.3.4.2. Operational reporting

The goal of operational reporting is to document the progress made in implementing HF and JESSICA related activities over the preceding period. Progress reports should include elements such as analyses of progress made in comparison with the established investment strategy.

It is recommended that the Holding Fund should ensure that operational agreements include the necessary provisions enabling the collection of relevant information from UDFs (and also from underlying Urban Projects receiving financial support under JESSICA), in order to facilitate the adequate reporting and monitoring of Operations.

Furthermore, the Holding Fund should generally be able to combine internal information (e.g. accounting data) with all other information collected from UDFs in order to contribute to the reporting obligations of the Managing Authority.

The funding agreement may include a timetable detailing the HF's progress report milestones to be achieved (e.g. quarterly, semi-annually, and annually).

It is also recommended that progress reports should be submitted to the Investment Committee, where such a body has been established. The report reviews the progress of the Holding Fund's operations in comparison with the provisions of the funding agreement. After obtaining the necessary approval on the Progress Reports – when required – from the Managing Authority, the Investment Committee also approves the reports by pre-established deadlines.

3.3.4.3. Financial reporting

The HF should prepare a complete set of financial statements on the HF account. The financial statements typically encompass:
1. Economic Outturn Account;
2. Balance sheet and P&L;
3. Management costs statement;
4. Various notes to financial statements.

It is recommended that the HF's accounting department should reconcile accounting dates, total assets at year end, liabilities, revenues and expenses attributable to the HF on a regular basis (e.g. quarterly).

Finally, the HF has to appoint an independent external audit firm to certify the financial statements. Depending on the provisions of the funding agreement, the MA may or may not be required to pay for the costs of any external auditors engaged to audit the HF.

4. Technical Assistance

The JESSICA initiative is a new approach to Structural Fund management. The financial engineering approach calls for an innovative attitude by the Managing Authority and requires new expertise and skills.

As illustrated in this document, the structure selected as a HF should provide the MA with the different skills and infrastructure in order to carry out its tasks and ensure that the investment strategy can be implemented efficiently and effectively.

However, other particular needs may arise from time to time at the level of the MA, the HF or the UDF for which specific technical support could be necessary (e.g. legal advice on specific issues relating to the national jurisdiction).

The Regulation envisages the possibility for the MA to utilise part of the funds allocated in the context of cohesion policy to finance this kind of support. Art. 46 of Regulation 1083/2006 states that "at the initiative of the Member State, the Funds may finance the preparatory, management, monitoring, evaluation, and information and control activities of Operational Programmes together with activities to reinforce the administrative capacity for implementing the Funds".

It is possible to identify several services/types of technical assistance that could be valuable to complement the skills and expertise of the various players involved in the JESSICA process. Five categories of services can be indentified:

1. Methodological and operational support:
   - Identification of urban strategic investment options and definition of the UDF's role;
   - Risk management techniques and analysis;
   - Improvement of integrated plans for sustainable urban development;
   - Project assessment and financial modelling;
   - Treasury management guidance;
   - Preparation of an annual action plan for JESSICA implementation;
   - Other advisory services (e.g.: setting up of an investment strategy, advice on the implementation of energy efficiency programmes, etc.).

2. Assistance in the tendering process:
   - Assistance in preparing requirements for business plans and/or business plan appraisal;
   - Assistance in preparing a tender for selection of UDF(s) (e.g.: selection and award criteria) and advice on negotiation with the UDF(s);
   - Evaluation of offers.

3. Legal support:
   - Assistance to the MA with respect to regulatory issues, tax and other national regulations;
   - State aid guidance, if required;
   - Assistance in preparing the operational agreement with the selected UDF(s).

4. Marketing and communication:
   - Assistance in promoting JESSICA among potential project promoters (e.g. raising awareness on the UDF's role in the local context, answering questions that arise during project preparation).

5. Training
   - Providing training modules to support MA, HF and UDF staff.

Technical assistance services can be provided by different bodies:

- In the first place and as previously stated, the Holding Fund can act also as a technical assistance provider, if it has the required expertise. Thanks to management fees, its position within the overall fund architecture potentially enables it to provide tailored services to better address any issues and interests. Once again, if this is considered a priority by the MA, the HF should be selected according to its ability to provide such technical assistance.

- Technical assistance can also be provided by the EIB, whether it acts as a Holding Fund or not. The in-depth experience of the JESSICA Task Force and the EIB services regarding the technical and financial aspects of urban renewal and development projects has been referred to previously. Once again, EC Regulation 1083/2006 mentions in its preamble (point 53) that the EIB has a role to play in undertaking technical assistance actions in the area of sustainable urban development or in supporting restructuring measures for sustainable economic activity in regions significantly affected by the economic crisis.

- Private consultants and national/local bodies (e.g.: those specialised in urban development, legal advisory work, etc.) can also provide technical assistance services for UDF development.

JESSICA – Holding Fund Handbook

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European Union
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