Annex 1

# Conclusions and Recommendations of Expert Working Group on European Investment Bank (EIB) loan finance for building sustainable cities and communities

**Leipzig – 24 and 25 May 2007**

## Section 1 Conclusions.

The EU Members States (MS), the European Commission (COM), and the European Investment Bank (EIB) share the common objectives to support the transition to a knowledge based economy, to promote territorial and social cohesion and environmental protection and to foster sustainable communities. In order to fulfil these aims for the future, to cope with the challenges of globalisation and to meet Lisbon goals, cities and towns must be places that foster enterprise and investment, create growth and jobs, provide attractive living conditions and strengthen social cohesion for their citizens. This means that cities and towns will need to invest substantially in upgrading their economic, social and technical infrastructure and must find ways to raise funds for these investments. COM's (DG Regio) recent Communication on Cohesion and Cities (COM/2006-385) emphasises the importance of mainstreaming urban policies and objectives into wider structural assistance programmes and territorial policies.

Despite substantial investment needs and substantial funds available through capital markets and financial institutions, there is a widespread perception of an investment gap in cities and towns. This includes a perceived failure to translate investment needs into effective demand (bankable projects and propositions) and a failure to attract effective supply, in the form of readily available financial products and instruments, for sustainable urban development. The challenges are especially acutely felt in the new MS and accession countries, which can however count on support from the EU Structural Funds as well as on the transfer of know-how from the EU institutions and other MS.

The EIB is a policy driven bank and the lending arm of the EU. It does not seek to maximise profits, but rather to optimise EU policy outcomes within sound banking disciplines. It accesses capital in large quantities on behalf of the EU MS and lends it at attractive conditions. It seeks to help finance policy priorities and to spread best practices. Its capital assets are extensive and it is the largest international financial institution (IFI) in the world by lending volume.

The EIB's role has grown since its urban development mandate was formally reinforced at the Amsterdam Summit in 1997, in particular regarding social housing. Ten years on appears to be a good time to review progress. This is especially relevant given the substantial changes over the last decade:

- Introduction of the Euro and increased integration of the EU wide banking system;
- Enlargement of the EU from 15 to 27 MS, and subsequent redistribution of EU Structural Fund support across an increased EU territory; and
- New economic, environmental and social challenges, as a result of which cities and towns have emerged as key actors in the global Knowledge Economy, and the major nodes of dynamic population change in an enlarged EU.

In view of the changed conditions and new challenges, it was logical then, that - beginning at the Ministerial Meeting in Bristol in December 2005 and ending with the Leipzig Ministerial meeting in May 2007 - the UK-chaired expert working group (EWG) of interested MS has looked into the current and potential roles of loan finance and other contributions provided by the EIB for promoting the development of cities and towns as sustainable communities. The EWG also examined what the EIB along with other IFIs (including CEB), the MS and the

Commission should do to tap the potential of loan-financed urban programmes and projects; in particular the potential of the new EU initiative, JESSICA.

The initial conclusion of the EWG is that loan finance and other banking products are important tools for urban development programmes and projects. Availability of grants is insufficient to cover investment needs. The group believes there is potential for loan finance and other banking products to play an even more important role in meeting the investment gap in EU cities and towns. Loan finance and other banking products can have a number of advantages over public grants:

- Thorough assessment of a programme or project's long-term viability, combined with prudent long-term management to guarantee adequate revenue, can result in a valuable contribution to the quality and sustainability of urban development projects.
- Loan financing imposes long term external discipline upon projects which can create greater control, value for money and predictability of outcome.
- Innovative loan financing can also serve a ‘demonstration’ function highlighting sound returns from urban investments, helping to foster new markets or investment niches, and encouraging replicability of the best projects across national borders.
- Loan finance has different requirements from grant aid or from equity investment for cities and towns. It requires sustained revenue to service debt and a transparent and so a highly disciplined approach to project delivery and performance.

The EWG found that EIB’s particular role in financing urban development projects in different MS is driven by two key factors: the EIB's policy orientation and the particular national context the EIB is required to operate within. Whether an EIB loan is a favourable option in a MS depends on the apparent opportunities in the markets (e.g through PPPs) and on the availability of other financial sources, such as subsidies, as well as the relative attractiveness of other forms of loan finance and other banking products. In countries that have their own public banks or very large commercial banks the comparative advantage of EIB loans may be less favourable in price terms. However, even in these countries, public and commercial financial institutions often act as intermediaries for EIB loans, or as co-financiers, thereby facilitating or encouraging the loan by the EIB.

As a result, the EIB can be:

- **Lead financier,** leading and catalysing financing consortia for major transactions
- **Co-financier**, lending to the same large scale projects
- **Wholesale bank,** where EIB lends to a financial institution (public or commercial) which then lends to the urban development programmes or project
- **Technical assistance provider**

In each case the EIB can contribute to the financial structuring of a project. In addition to these four models there is potential for EIB to act as **intermediary** for other funding (eg. as proposed for JESSICA holding funds). As regards potential competition between EIB and other financial institutions, the EIB´s intention is to avoid it and all EIB loan acitivity is intended to complement and not to compete with loans from other financial institutions.

Different roles for EIB dominate in different national contexts. The value added of EIB in financing urban development can therefore consist of:

- Attractive interest rates, including when acting as wholesale financier through local and national public and commercial intermediaries.
- Large scale of capital available.
- The 'patient approach', which may enable EIB to give rise to longer payback periods.

- The promotion of innovation and best practice across the EU.
- The technical role of helping MS to develop bankable urban development propositions.
- The introductory role through which the EIB brings in other financiers.
- EIB´s risk pricing which may be lower than comparable financing alternatives particularly in cases of moderate risk levels.

The comparative advantage of EIB loans to EU-15, in price terms alone, has diminished in the recent period due to lower interest rates overall across the EU. By contrast, EIB loans to public entities in the new MS are particularly attractive as EIB does not differentiate between MS, although the capital markets still charge a premium on some new MS sovereign risk. Moreover borrowers are aided in developing viable project structures by EIB expert evaluations. On the grounds of urban development plans these evaluations take account not only of the direct monetary revenue and costs, but also the indirect monetary and non monetary costs and benefits, including the project`s environmental impact and its effects on social cohesion. Thus urban investments are assessed, ensuring that lending optimises social, environmental and other developmental objectives. In this way the EIB is able to provide multiple forms of added value in MS.

The EWG also concluded that there were opportunities for EIB loan finance to make an important difference on 4 geographical levels:

- **Neighbourhood Level**: where deprived urban areas that need to attract long term investment, from public and commercial sources, as part of a process of urban regeneration, and where previously used land might need investment to be converted for modern social and economic usages, and/or improved environmental performance.
- **Local, City and Metropolitan level:** initiatives where the long term regional growth rates might be positively impacted by improvements in urban and metropolitan infrastructure and the science/knowledge base of cities.
- **Regional level:** where specific economic and social problems in urban areas concentrate and loans are needed as a source of finance in particular to support structural economic policy.
- **Supra-regional level**: where aggregation of local projects might occur to provide a portfolio of assets which can attract a combined package of external finance on a large scale (or a consortium of similar projects in different locations).

In deprived urban areas, where investments generally exhibit unfavourable risk profiles and thus sufficient investment funds are not readily available, the EIB may be able to deliver a high level of financial value added, as sustained investment markets are not a feature of such areas. JESSICA has potential to become an important catalyst here. The EWG is of the opinion that this could support the EIB in achieving one of its goals as set out in Article 267 of the EC Treaty - to contribute to the development of less-developed regions including deprived urban areas and provide financing tools in conjunction with assistance from the EU Structural Funds.

The JESSICA initiative – turning grants from the Operational Programmes into loans and risk-reducing tools like guarantees, venture and mezzanine capital etc. through urban development funds – could provide an important tool for supplementing EIB and other public and private financing activity and widening the range of financing available for urban development projects. In addition the EWG believes that, in areas without Structural Funds support, urban development funds could also be financed purely from national resources.

The main conclusion drawn by the EWG is that there are multiple roles required by different players in order to build the role of the EIB in urban development investment. In other words, it is for all actors to adapt in order to optimise the potential of EIB in support of sustainable urban development across the EU.

## Section 2 Recommendations.

On the basis of the above conclusions, the EWG issues the following recommendations in order to improve the supply of finance and the value added of EIB for urban development investments:

1. MS and COM should encourage greater commercial financing of urban development as a way to attract additional funds and increase the efficiency of the sector. This would enable the EIB and other financiers to play a more pro-active role within the wide range of urban investment markets in the EU.
2. Interested MS, EIB and COM should establish a working group of representatives to contribute to the further development and implementation of the JESSICA initiative and to discuss national urban development funds.
3. The MS should support the implementation of integrated urban plans, following the Bristol Accord and the Leipzig Charter, and could review how well their individual systems of public finance enable the growth of a strong loan financing element as part of their broader efforts to promote sustainable urban development. MS should also encourage local and regional authorities to improve the quality and consistency of the propositions that are developed and promote PPPs in the urban sector. For this purpose a comparison of best practices in different MS would be helpful.
4. MS and Local and Regional Authorities should pay particular attention to opportunities of building a pipeline of high quality and bankable projects within the urban development field including integrated urban plans. Given such potential efforts should be made in order to build a strong and consistent demand for loan finance and other banking products for urban development. EIB should support MS in this process by making more urban development projects ‘bankable’ and attractive to loan finance and other banking products, which can complement grant aid, equity investment or other sources of investment.
5. The COM could encourage the use of EU Structural Funds to support and reinforce loan finance. In particular, the potential of the JESSICA initiative should be fully elaborated so as to develop this approach quickly.
6. In future the EIB should attach greater importance to the quality of urban development outcomes and less to the size of the loan. This should help to achieve EU and EIB objectives through funding of more urban development programmes - which often achieve economic, social and environmental goals by virtue of their composite nature.
7. The EIB could further enhance its role in financing sustainable urban development programmes and projects in EU cities by: extending its eligibility to cover social cohesion investments; embracing greater risk; encouraging innovation; and increasing marketing and promotion of its services which were found not to be sufficiently known by promoters of urban development projects.
8. EIB should continue to focus on creating financial value added, including risk sharing, by the development of innovative financing products - including guarantees, mezzanine debt and similar products - tailored to investment needs and risk profiles in the urban context. A main objective of these activities should be the support of investments in deprived urban areas. In particular EIB should more extensively use the Structured Finance Facility - a financing scheme for higher risk investments for the finance of urban development projects.

9. The EIB should publish guidelines in order to provide more transparency and awareness regarding its project financing criteria and to support improved integrated urban development planning. The most crucial information with respect to urban development would be that on eligibility or scope as well as the required content of the integrated urban development plans that are required by the EIB.
10. The EIB could also take a key role in technical assistance (using the potential of JESSICA and JASPERS) and help to build the competence of MS, local and regional intermediaries, including local and metropolitan governments; and to work actively with MS to stimulate a consistent and high quality pipeline of projects that can benefit from loan and other forms of financing, particularly in those MS with less developed loan finance operations.
11. The EIB should give MS greater access to its wealth of experience regarding the assessment of projects that are considered a 'plus' for urban development. The MS can only use the available loans and complementary risk-reducing tools if they are put in a position that enables them to develop projects suitable for loan financing. For this reason best practice in the planning and financing of urban development projects should be disseminated in each MS and between MS, a task that possibly could be taken on by urban development funds. The EIB should be encouraged to undertake regular marketing, communication, and information giving activities to better improve understanding of its role. One option would be to carry out informative ‘road shows’.
12. The EIB should investigate trends in the volume of loans they provide for urban development programmes and projects. The EIB should also 'map' disbursement of their loans and investigate reasons for non-disbursement/cancellation.
13. The operation of JESSICA in urban development financing, including the role of the EIB, should be clarified rapidly. In particular the following issues should be addressed:
    i. The role that JESSICA could play in different national contexts to build the financial market in urban development and to meet urban investment needs.
    ii. How to build on the experience of existing urban development or similar funds.
    iii. The clarification of projects that would be eligible for funding under the JESSICA initiative.
    iv. The role and management of the proposed holding funds.
    v. The implied means to achieve social and environmental as well as physical outcomes.
    vi. The extent to which JESSICA can contribute to meeting the housing reinvestment challenges in particular in the new MS.
    vii. The scope and scale of the financial instruments that might be developed.
    viii. The potential role of IFIs and other public and commercial banks.
    ix. The long term requirements to meet the flexibility needed to make JESSICA work.
14. The COM and the EIB should respond to the EWG recommendations (as set out above) at the next Informal meeting of Urban Policy Ministers but not later than 2008.