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MODELS AND POTENTIAL STRUCTURE FOR URBAN DEVELOPMENT FUNDS (UDFS)

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1 URBAN DEVELOPMENT FUNDS (UDFs)

1.1 The basic models for UDFs

Under the Community's "urban regeneration" policy for revitalising critical urban and suburban areas, the initiative that goes by the name of JESSICA (Joint European Support for Sustainable Investments in City Areas) is aimed at promoting the creation of Urban Development Funds (UDFs), that is, "funds investing in public-private partnerships and other projects included in an integrated plan for sustainable urban development" (Article 44 of Council Regulation (EC) No 1083/2006).

The resources come from the financial assets of individual Managing Authorities (MAs), which can use part of their funding from the ERDF and the ESF in this way. The aim is to establish and operate a revolving financing mechanism that makes it possible to implement projects involving public and private actors.

The innovation therefore consists in the replacement of grants by revolving financial mechanisms, essentially equity, guarantees and loans. Repaid credits can be reinvested via the UDFs or returned to the MA to support other urban projects, including those financed by means of conventional grants.

The UDF does not have a privileged legal form under primary Community legislation, but it must be an independent entity or a separately managed block of finance within a financial institution and it can invest directly in Public-Private Partnerships (PPPs) or in "other" urban projects eligible for financing by means of equity, loans or guarantees.

The MAs could decide to invest directly in UDFs or, given the complexity of managing financial instruments other than grants, could deal with the UDFs via Holding Funds.

The principle underlying such instruments is to develop urban regeneration projects by forming a long-term fund that is economically viable thanks to the combination of various elements, such as contributions in kind of public property with high development potential, contributions of public property producing income, the construction of infrastructure producing cash flow and in turn using public funds, energy, transport, etc. In addition, it is plausible for the UDF to derive part of its income from public works and part from commercial projects.

For this to function, it is beneficial to involve long-term ethical and/or public-sector investors (government bodies, Cassa Depositi e Prestiti and banking foundations, amenable to returns that are adequate but not speculative) as well as private-sector investors earning market-related returns.

The UDF is designed to support the realisation of projects to do with urban development in a particular area or areas or on the territorial scale best suited to attaining the city's sustainable development objectives. The goals may be of various kinds; by way of example, they may relate to different objects, separately or in combination, such as basic public infrastructure, parks, public

spaces, transport and sustainable mobility systems, office and commercial premises, university and scientific research premises, equipment, leisure facilities, measures for protection of the land and prevention of natural risks, and more besides. They may also relate, again by way of example, to various kinds of measure, such as modification, conversion and exploitation/management of premises vacated by firms, scientific and technological activities, research and development, industrial archaeology, redundant barracks; improvements to transport systems, networks in general and local infrastructure, measures to ensure better liveability and better energy and environmental compatibility; measures to support incubators of technology firms.

In some cases measures involving objects situated away from the main site of interest have also been approved where their contribution may benefit implementation of the integrated programme of urban regeneration.

Under Article 46(2) of Council Regulation (EC) No 1828/2006, UDFs may invest by means of equity, loans and guarantees and urban projects receiving grant assistance from an operational programme may also be supported by UDFs.

The two possible forms of UDF that can be created in Italy stem from the ability/willingness to involve the private financial sector in the relevant market. There are two basic models: the equity or universal model, and the non-equity model, or simplified rotating loan fund.

The equity model satisfies the requirement of investors in the UDF for a minimum guaranteed medium-to-long-term return on their investment. By contrast, as pointed out above, the non-equity model is suitable in situations where the financial market is underdeveloped and public resources are sufficient and need no further leverage (particularly for underutilised areas).

From the point of view of economic and financial viability, the UDF must be sufficiently profitable to permit repayment and re-utilisation of the investment (non-equity fund) or to remunerate the equity and repay the debt (equity fund).

1.2 The equity model

In the majority of cases this model entails a shareholding in the capital of public-private partnerships (PPPs). The fund will have to manage its shareholdings in vehicle companies formed specifically to carry out and manage the project.

The instrument best suited to this type of fund is undoubtedly a regulated entity, and under Italian legislation the most appropriate form is the closed-end fund, and in particular real estate funds.

The use of a real estate investment fund as a UDF

From the technical point of view, the use of a real estate investment fund as an urban development fund certainly appears possible, offering considerable flexibility as regards both the investment needs (through the use of umbrella funds, for example) and the possibility of involving investors with different investment objectives.

The closed-end umbrella real estate fund will be established by an asset management company, which will participate in calls for tender issued by authorities managing structural funds (regional authorities) in order to obtain regional co-financing, which could consist in non-interest-bearing revolving funds.

1.3 Non-equity model

Without a doubt this is the simplest model, based essentially on revolving funds of concessional loans in the form of a separate block of capital within a financial institution, selected on the basis of open competition.

A UDF may decide to invest its capital exclusively in activities such as the funding of PPPs, formed as vehicles for investment in Integrated Plans for Urban Development.

The fund, which may also be financed exclusively by the region, takes the form of a revolving fund of concessional loans remunerated at a weighted concessional interest rate.

The other fund units may be subscribed by the financial institution responsible for management or by other institutions at market rates.

The rate on the fund's loans to projects would be the weighted average of the rates on the resources it raises.

The financial institution managing the fund must remain independent and autonomous during the assessment of creditworthiness, subject to the general eligibility criteria set out in the funding agreement signed with the regional authorities.