



Making financial instruments
work for cities

CSI EUROPE CASE STUDY

THE EVERGREEN FUND EX-ANTE ASSESSMENT

A CSI EUROPE CASE STUDY ON REGULATION

URBACT II



Connecting cities
Building successes



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INTRODUCTION

This case study describes the experience of the Greater Manchester Combined Authority in relation to the carrying out of an ex-ante assessment for the establishment of two financial instruments for the 2014–2020 ESIF programme.

The ex-ante was carried out between October 2013 and January 2014 and concerned two separate funds: a fund for urban development projects; and a fund seeking to support energy efficiency and other low carbon schemes.

BACKGROUND

In September 2013, Greater Manchester's Local Enterprise Partnership (GM LEP) submitted to the UK Managing Authority, the Department for Communities and Local Government (CLG), its draft EU Investment Plan. This formed part of the engagement between CLG and Local Enterprise Partnerships across England under which the LEPs were invited to prepare their own investment plans to CLG, with the intention that CLG would then consolidate the locally developed plans into a single Operational Programme.

This bottom up approach, provide GM LEP and the GMCA with the opportunity to develop an investment strategy that reflected the area's own strategic investment priorities. Following a period of engagement with stakeholders and

In both cases the funds were to be focussed on the geographical area of Greater Manchester.

Although the ex-ante was carried out before the publication of the guidance "Ex-ante assessment methodology for financial instruments in the 2014–2020 programming period" issued jointly by the Commission and European Investment Bank (EIB), the work was undertaken with the involvement of the EIB and its advisers and the experience provides a useful guide to cities and Managing Authorities seeking to undertake similar studies in the future.

discussions with the Managing Authority, the final draft GM EU Investment Plan was submitted in January 2014. As part of the plan, it is proposed to commit £97 million of ESIF funds to financial instruments across several different priority areas. In order to inform the development of the FI proposals and to demonstrate credibility of the plan to the Managing Authority, the GMCA decided to commission, at an early stage, ex-ante assessments. The aim was to ensure that the funds could become operational as soon as possible after approval of the UK Operational Programme. As ex-ante assessments are an essential requirement of the CPR, the completion of this work was an essential early step towards establishing the funds.

THE GM PROPOSALS

The GM EU Investment Plan proposes the establishment of two FIs:

- The Evergreen 2 Fund – a successor fund to the successful North West Evergreen Fund FI that has been supporting projects across Greater Manchester and the wider North West of England since 2012; and
- The GM Low Carbon Fund – a new FI to support energy efficiency and other low carbon schemes in Greater Manchester, initially targeting public sector schemes but in the longer term supporting private sector development.

The proposals were developed in the light of the experience within Greater Manchester of the Evergreen Fund and North West Fund, two financial instruments established in the region under, respectively, the JESSICA and JEREMIE initiatives. Although both funds proved to be, initially difficult to both set up and become operational, over time both FIs have proved to be successful in supporting projects. At the end of March 2014 Evergreen had committed approximately £41 million and the North West Fund [] and both FIs were confidently expecting to invest the remainder of their funds by the end of 2014.

COMMISSIONING PROCESS

The GMCA worked closely with the North West Urban Investment Fund (NWUIF) and its advisers EIB to commission and undertake the ex-ante assessment. This formed part of the on-going support provided by the EIB to the implementation of Evergreen under which a strong tri-partite relationship has developed between the Evergreen Fund (and GMCA); NWUIF (and the Managing Authority); and the EIB. Early engagement with the EIB about the GM EU Investment Plan led to the development of the proposal to carry out an early ex-ante assessment.

PROGRAMME OF WORK

The original programme to undertake the study was based on an 12 week timescale. As the work progressed, a further period was required to consider in more detail options surrounding the low carbon FI. In total the process took approximately 16 weeks from initial inception meeting to delivery of the draft final report. This was followed by a further period of “fine tuning” where the report was further developed to reflect emerging discussions and views, particularly in relation to the Low Carbon project. The draft final report was delivered in May 2014, 7 months after the commencement of the work, although the time

A Steering Group was established, jointly chaired by representatives from GMCA and the MA, with financial, legal and regeneration experts joining EIB colleagues to manage the process. A competitive procurement was undertaken using a framework that had been established by the EIB. Following evaluation of the bids, pwc were appointed to undertake the ex-ante assessments for the Greater Manchester funds. The use of an existing framework ensured that consultancy firms with the necessary expertise were invited to tender. It also simplified the process and as a result it took approximately one month to complete the procurement of the advisor.

required for the process was significantly less. The work was divided into two stages as follows:

- Part 1 – Strategic and Market Needs; and
- Part 2 – Fund Design.

Some of the key issues considered during the ex-ante are described below. The Case Study is based on the ex ante assessment carried out for the Evergreen 2 Fund although, where additional lessons have been drawn from the Low Carbon work they have been identified separately.

PART 1 – STRATEGIC AND MARKET NEEDS

This part of the ex-ante was divided into six sections as follows:

BACKGROUND TO EU STRUCTURAL FUNDS

This section mapped out the transition from the 2007–2013 programme (and the JESSICA initiative) to the current 2014–2020 programme. It summarised the governance arrangements for ESIF funds in the UK and identified the proposed commitment of £97 million towards FIs in Greater Manchester of which £50 million is allocated to the Evergreen 2 Fund. The relevant provisions in the CPR and Delegated Act were also highlighted.

STRATEGIC PRIORITIES

In this section the relevant strategy documents were identified to produce a coherent narrative linking the Europe 2020 objectives, National Strategy and Greater Manchester Strategy to produce a single framework which supports the proposed operation of the Evergreen 2 Fund. In the UK, each area (such as Greater Manchester) has produced an EU Investment Plan as part of the National ESIF governance arrangements. The ex-ante describes how the GM EU Investment Plan is consistent with the European, national and local strategic priorities.

THE EVERGREEN EX-ANTE ASSESSMENT

A CSI EUROPE CASE STUDY

COMPLEMENTARY FUNDING SOURCES

The study describes the national, regional and European funding sources that are or may be available to act as complementary or match funding for the ESIF funds committed to the FI. This included reviewing the limited number of national funding programmes administered by UK government, together with other sources such as commercial banks, private sector equity and pension funds and insurance companies.

In addition, the potential for local government to provide match funding either from borrowings from sources such as the EIB and Public Works Loan Board or cash reserves was considered. In the case of Evergreen 2, the track record of Evergreen 1 in attracting private sector match from developer equity and Commercial Banks, together with the prospect of an EIB framework loan, provided confidence sufficient match would be available.

KEY FINDINGS FROM OTHER UK FIS

An important part of the ex-ante assessment is to learn lessons from previous operations.

This section considered the position of two further FIS with similar objectives to the Evergreen Fund 2: the Chrysalis Fund based in Merseyside and SPRUCE a UDF established by the Scottish Government. In this case the review highlighted how the success of the funds depends upon the fund and its promoters developing a pipeline of projects and noted the allocation of technical Assistance within the GM EU Investment Plan to a project development unit.

The Low Carbon study went further in this regard as it identified how similar funds in that sector had struggled significantly in identifying suitable investment ready projects, reinforcing the need for investing in the development of a pipeline.

MARKET GAPS AND FAILURES

The most important element of Part 1 of the study is the identification of the market gaps and failures the FI is designed to address. The preceding sections provide the

framework for an analysis of the available funding for the priority sectors identified in the relevant strategies.

In the case of Evergreen 2, the following market failures were identified: funding for upfront preparatory work and preconstruction period; difficulty in securing pre-let commitments and associated absence of commercial lending; absence of commercial finance for regeneration areas perceived as high risk; and lack of project viability in deprived urban areas. Two case studies were then used to highlight how the Evergreen 1 Fund had been able to address similar failures.

Following the identification of relevant market failures, the study considered the likely demand for products offered by the proposed FI. This drew on engagement with private sector developers (including the members of the Manchester Urbact Local Support Group) and recent publications which identified renewed optimism in development in the area.

In the case of the Low Carbon Fund, this work was more challenging due to the absence of a strong pipeline of projects. This absence of demand led to a conclusion that the critical market failure for Low Carbon projects in Greater Manchester was the lack of funding and capacity to develop projects. This in turn led to a recommendation to focus initial operations on a project development unit using ESIF Technical Assistance, local funding and, where possible, technical support provided through the FI operation.

STRATEGIC AND MARKET NEEDS KEY FINDINGS

The Conclusion of Part 1 of the study brings together the findings of Part 1 into a framework to inform Part 2 of the study. In the case of the Evergreen 2 study, it concluded how the success of the Evergreen 1 fund provide strong evidence of the need for the fund to address market failures to deliver GM's strategic priorities, in particular the growth agenda. The report did note, however, that the new FI should seek greater agility and flexibility to enable it to adapt to changing market conditions during the 2014–2020 programme.

PART 2 – FUND DESIGN

This part built from Part 1 of the report to consider the likely design of the fund. It was divided into the following sections:

PROJECT PIPELINE

This part of the report provides a detailed review of likely projects and potential match funding sources.

The aim of this section was to test whether the products to be offered by the FI will be suitable to meet the needs of the projects (and thus address market failure) and to ascertain whether the proposed allocation of resources can be deployed within a reasonable time. The work reviewed both the existing pipeline of products developed for Evergreen 1 and the likely future pipeline based on analysis of strategic sites in the area and associated development proposals.

The study also considered the additional investment capacity in the area provided by Evergreen 1 once it starts reinvesting funds from 2016 onwards. This capacity was overlaid with Evergreen 2 resources and mapped onto the likely funding requirements of the identified strategic sites to support the conclusion that the pipeline was of sufficient size and scale to support the proposed £50million investment in Evergreen 2 and that it was robust enough to generate sufficient match funding to enable the investments to be made.

INVESTMENT STRATEGY

The proposed investment strategy for the fund was described and mapped to the strategic framework identified in Part 1. This section also considered at a high level, the likely loan underwriting and appraisal processes to be undertaken by the Fund Manager in recommending investments. Part of the conclusion of this section was to recommend certain exclusions including a minimum investment of £2 million and maximum commitment of 30% of funds to a single private sector body.

FUND DESIGN

This looked at two key aspects of the design of the fund: the Governance arrangements of the fund; and how the fund will interface with other products.

In relation to governance, three options were considered, reflecting the experience of Evergreen 1. As it had been established prior to carrying out the ex-ante assessment that the City would be entrusted with establishing the fund, a fund led by the Managing Authority was not considered. The options reviewed were: an “in-house” option where the City would be directly responsible; a model where the City would control the fund subject to external fund management; and the establishment of the fund as a block of finance within a financial institution. In this case the second option was identified as being optimal, based largely on the successful use of a similar model for Evergreen 1.

The interface with other funds, including Evergreen 1 and the proposed Low Carbon Fund was also considered to ensure ongoing complementarity of the FIs. This highlighted the need to identify measures to address potential conflicts of interest and ensure the proposed Low Carbon Fund was designed to offer different products than the Evergreen 2 Fund.

NON-FINANCIAL OUTCOMES

This part of the study identified the likely outcomes to be achieved through the operation. In addition to confirming likely minimum output levels, the study identified the potential benefits from including other voluntary targets such as BREEAM “Excellent” floor space and clearly defined “research and innovation” measures.

FUND DESIGN: KEY FINDINGS

The conclusion of the report which summarised the findings of each section.

THE EVERGREEN EX-ANTE ASSESSMENT

A CSI EUROPE CASE STUDY

REVIEW AND UPDATE OF STUDY

Following completion of the study, Greater Manchester has used the study in the discussions with National Government around the establishment of the fund. As these discussions are ongoing, the study has been left open to enable any developments in the strategic and/or operational framework to be accommodated before the fund becomes operational. This will include the inclusion of the final Operational programme and Partnership Agreement once finalised and the National requirements currently being developed by the Managing Authority.

In addition, other cities and areas of the Northwest have indicated a desire to participate in the Evergreen 2 FI, probably through providing ring-fenced funds which will be administered by the fund separately for the contributing

area, albeit within a single governance structure. These partner cities are currently undertaking their own ex-ante assessments and once finalised the GM ex-ante will be updated to consider the impact of the proposals on the GM structure.

The ongoing work is, however, shaped and informed by the comprehensive study undertaken. This demonstrates how the ex-ante assessment can, if used properly be an extremely important tool in developing the strategic and governance framework for FIs. The study will be finalised prior to going to market to appoint a private sector fund manager for the fund, although even at this point, there will be scope to update further to reflect the proposals submitted by the private sector partner appointed to administer the fund.

LESSONS LEARNED

From the perspective of a City the following lessons were learnt from the exercise:

- 1. Selection of advisers** – the process for the selection of advisers must comply with applicable procurement rules which, unless well managed, will lead to significant additional time. In the case of the GM study, a framework was used which allowed suitable advisers to be appointed within a three week time period;
- 2. Management of process** – a Steering Group was established by the City with senior representatives from both the City and other agencies including the national agency that had set up the previous Northwest JESSICA Holding Fund. Close links with the Managing Authority were also maintained throughout the process to ensure there were “no surprises” in the study.
- 3. Technical Support** – the EIB, who are the Holding Fund manager for the Northwest JESSICA fund, provided technical support to the work including in relation to the selection of advisers and the evidence in relation to market failure. This brought significant additional
- 4. Supporting Information** – in order to deliver the study within a relatively short timescale it was essential to provide the advisers with information to support the study. In particular cities should be able to supply details of its strategic framework, project pipeline, evidence and experience of market failure and views around fund design. In the case of the Evergreen 2 study much of this information was readily available due to the operation of the existing Evergreen 1 fund. The work was more challenging for the Low Carbon fund where information was not at a single location.
- 5. Fine tuning** – initially the input of the City to the work was largely to ensure the advisers received the necessary information in a timely way. As the work developed, the need for input from the Steering Group increased significantly to ensure the governance arrangements were fully informed. Therefore Cities should ensure that their teams are fully resourced to support the work.

6. **Update and review** – as already indicated it is vital that once the study is concluded, the report is left open pending final negotiation with Managing Authorities. The

final report should only be produced immediately before the promoting city or Managing Authority commences the work to establish the fund.

GUIDANCE – EX ANTE ASSESSMENT METHODOLOGY FOR FINANCIAL INSTRUMENTS IN THE 2014-2020 PROGRAMMING PERIOD

The Commission and EIB have jointly published comprehensive guidance on the ex-ante assessment methodology. The guidance which has a quick reference guide and five detailed volumes provides a comprehensive source for Managing Authorities, Cities and their advisers who are seeking to carry out an ex-ante assessment. The guidance can be found at the following link:

http://ec.europa.eu/regional_policy/thefunds/fin_inst/index_en.cfm

Although the GM Case Study was carried out before the guidance was finalised the work was carried out by pwc who were also commissioned to develop the guidance. There is, therefore, a consistency in approach between the model in the guidance and the GM study.

Under the guidance it recommends the work is carried out in two parts or “Building Blocks”: Market assessment and Delivery and management. These are consistent with the two parts of the Greater Manchester study and the issues considered and evidence used to support the conclusions in the GM study are consistent with the detailed guidance.

CONCLUSIONS

The ex-ante assessment carried out for the FIs in Greater Manchester demonstrate how, if used properly and conducted at the right time, the study can play an important role in the development of Urban Development Funds by Managing Authorities and Cities. The work was delivered in a period of approximately 16 weeks although has been left open pending finalisation of the UK Operational Programme and negotiations with the Managing Authority.

By investing in this work, however, the City of Manchester has established the evidence and business case for a fund and demonstrated that it has the capacity to maintain an operation in its own area. This has contributed to making the case to the Managing Authority to entrust the establishment of the fund to the City.

The study will also provide the foundation for the procurement of a fund manager and has already been used by the City in the procurement of its advisory team to support the process.

In the case of the Evergreen 2 study, the study is 46 pages long, excluding appendices. This allowed for sufficient detailed analysis to support robust conclusions without allowing the study to become a project in itself. The guidance issued by the Commission is extremely lengthy, Volume 1 (of five) has over 100 pages, for example. It is to be hoped that this does not result in future assessments becoming unduly lengthy to the detriment of clarity of thinking and analysis and cost of undertaking assessments.



The aim of CSI Europe is to build on the different experiences of the partners in relation to financial instruments and urban investment. By working together we will seek to: identify common issues that affect financial instruments and work together to identify solutions; work at a local level to translate our experience to the delivery of projects and act as a voice for cities in the development of future investment models at both a local and EU level.

The key themes that the network will seek to explore are: Governance, State Aid, Technical Assistance and Regulation and through this work we will seek to identify new models for investment through financial instruments.

The URBACT II Operational programme will support the partners' work over the next three years, providing a framework

for joint working and supporting the partners' local activities. The partners will work together through thematic partnerships where two or more partners will work together to explore, in depth, a key theme; transnational conferences where all the partners will come together to consider the key themes, share experiences, celebrate success and exchange ideas; and URBACT Local Support Groups established in each city, bringing together key public and private sector stakeholders to deliver a Local Action Plan reflecting the city's priorities for the network.

The network will also seek to develop links with the European Commission, Managing Authorities and other organisations who will help shape the role of financial instruments in the next Structural Fund programme. This may allow CSI Europe to play a constructive role in the development of financial instruments for the future support of urban development across the EU area.

URBACT II

URBACT is a European exchange and learning programme promoting sustainable urban development. It enables cities to work together to develop solutions to major urban challenges, reaffirming the key role they play in facing increasingly complex societal challenges. It helps them to develop pragmatic solutions that are new and sustainable, and that integrate economic, social and environmental dimensions. It enables cities to share good practices and lessons learned with all professionals involved in urban policy throughout Europe. URBACT is 181 cities, 29 countries, and 5,000 active participants.

www.urbact.eu/csieurope