COSLA
Brussels Office

POLICY UPDATE

EU Loan Instruments for local economic development and SMEs

Overview:
The purpose of this paper is to provide an overview of the EU backed loan instruments available for local economic development and in particular to SMEs. This follows from a range of meetings held by COSLA with EU and EIB officials over recent weeks and in so doing complements earlier briefings provided on this issue.
Specifically this overview covers:

- EU Juncker Fund (EFSI) – latest Commission guidance for Local and Regional Authorities
- EU Juncker Fund – support for SMEs
- European Investment Bank (EIB) and European Investment Fund (EIF) – loans for SMEs
- Other EIB credit lines for local and regional development

Detail

PART I: Juncker Fund – Guidance for Local and Regional Authorities

The European Fund for Strategic Investments (EFSI), commonly known as the "Juncker Fund" as it was named after the new Commission President who put this as one of the main proposals of its new mandate, has just been open for business.

As you will recall it aims to mobilise €315bn over three years in financial markets. To do so a combined guarantee of €21bn from the EU budget and the European Investment Bank has made available. The purpose of the EFSI is to kick-start projects against the sluggish investment climate. While it aims to finance large projects, smaller and indeed local and regional projects can be financed. In addition to that there is a specific part aimed at SMEs.

In addition to that the contribution of the EU Budget and that of the EIB, there is a role of National Promotional Banks such as the UK Green Investment Bank, the British Business Bank. They would act directly as intermediaries of Juncker Fund loans, contribute or create Investment Platforms (project bundles) or give loans for specific projects alongside Juncker Fund loans.

In addition (and separate from) to the role of National Promotional banks last July the UK agreed that it would will co-finance around €8.5 billion in EFSI projects, the largest national contribution so far to the Juncker Fund.

Earlier in 2015 Member States (and devolved governments such as the Scottish Government) had put forward a series of projects. This was an exercise to assess the investment needs while the legislation to put EFSI was being negotiated, a process that concluded during the summer.

At present EFSI is welcoming bids (and indeed some projects have already been given tentative clearance). There are no geographical quotas and an independent Investment Committee would assess each project on their merits.

European Investment Advisory Hub (EIAH) : this is a platform that aims to provide support in project development by sharing good practices, lessons learnt and real-life case studies on project finance and project management. The EIAH is a joint Commission and EIB initiative.

European Investment Project Portal: like with the initial list to scope possible projects put to gather last January, all projects will be made available in a dedicated portal that both enable transparency and serve as inspiration to other projects in development.

It is important to note that EFSI is aiming to support projects that are riskier to the ones already given loans by the European Investment Bank (which is a promotional bank that is jointly owned by all EU Member States to provide loans to projects on economic development and deliver other commonly agreed EU goals).

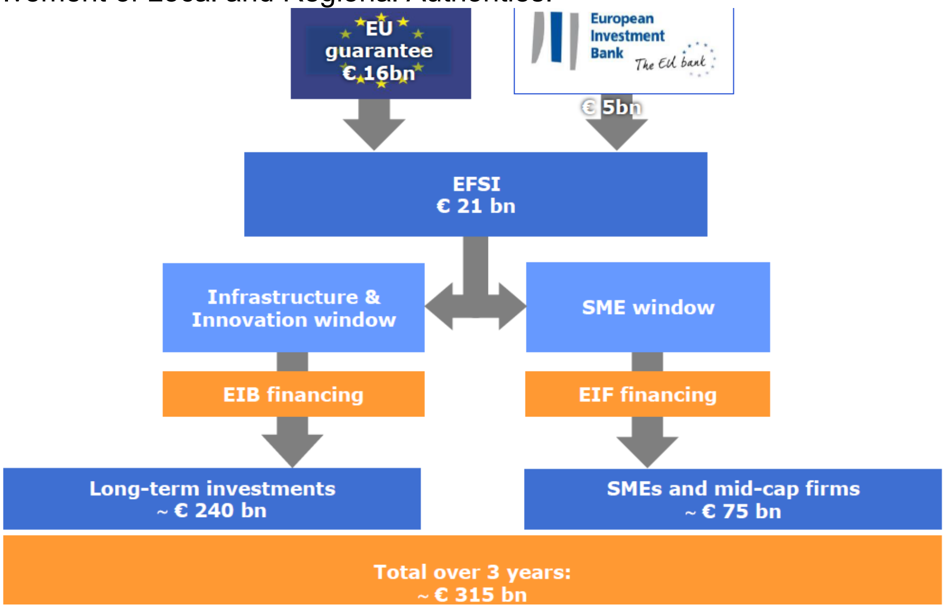
Role of Councils

While in many meetings with national and EU officials it was clear that Councils, be that together or forming larger partnerships (including the private sector) could submit bids (this joint bids are known as "Investment Platforms") there was no formal guidance that could provide assurances to Councils on the added value of the EFSI.

One particular issue is that of project size. There are successive guidance notes from the European Investment Bank that they do not finance projects of less than €25m (could be several projects combined). Given the role that the EIB plays in the Juncker Fund the same applies.

New EU Guidance

Following calls from many actors including COSLA the Commission has now made available some (draft) Guidance on EFSI and EU structural funds that addresses some of the issues regarding the possible involvement of Local and Regional Authorities.



EFSI (Juncker Fund) and ESIF (Structural Funds)

The rationale of EFSI is to allow EIB to provide additional catalytic, risk-bearing capacity and unlock additional sources of financing in delivering greater societal and economic value. Structural Funds resources (such as the Financial Engineering/Loans instruments available in Scotland such as SPRUCE, the Local Authorities Loan Funds and the new Business Loans Scotland Limited) cannot be directly transferred to EFSI, which is an additional and separate mechanism.
. EFSI and ESIF should therefore be deployed so as to be complementary to each other and not to duplicate or compete with each other. Structural Funds and its national match funding will have to be clearly distinguished from EFSI. Is possible to consider that any additional resources leveraged and triggered by the combined ESIF and EFSI interventions are treated as national co-financing for the ESIF programme.

EFSI and ESIF combinations:

The Structural Funds and the Juncker Fund can be combined a) at Project level and b) at an Investment Platform

a) **At project level**

EFSI and ESIF programmes may support different or same parts of the capital structure of a project (provided that in the second case separate records are maintained showing the use of the different financial streams thus evidencing the absence of any doubling up) and may cover different risks.

Examples:
1) EFSI and ESIF both contribute to a transport infrastructure project, thereby increasing the total number of kilometres funded (either separate parts of the project, or EFSI funds the revenue-generating part of the infrastructure project);
2) EFSI support for parts of projects which are not eligible under an ESIF programme but which are part of a bigger investment.

b) **combination at financial instrument / investment platform level**

ESIF programme and EFSI may also be combined at a higher level than individual projects, such as through a financial instrument and/or an investment platform such financial instruments and investment platforms could be set up at national, regional or supra-regional level.

They can take form of special purpose vehicles, managed accounts, contract-based co-financing or risk-sharing arrangements or arrangements established by any other means by which entities channel a financial contribution in order to finance a number of investment projects, and which may include:

1. UK, Scottish, sub-national platforms that group together several investment projects on the territory of a given Member State;
2. platforms that group together partners from several Member States or third countries interested in projects in a given geographic area;
3. thematic platforms that group together investment projects in a given sector;

For instance in the initial set of proposals put forward by the Scottish Government they put forward bundles of projects (including the explicit contribution of Local Authorities)_that pretty much amounted to a Scotland wide investment platform as suggested by the EFSI rules and guidance.

The use of ESIF programme resources would have to be in line with the ESIF regulatory framework and the priorities of the agreed Operational Programmes (which would generally imply inter alia national or sub-national ring-fencing). In addition, other investor contributions may be foreseen at financial instrument level, for example by national promotional banks

In general, the possible modalities for such Platforms could be as follows:

1. the managing authority (e.g. Scottish Government) could set up a **new** investment platform which can have a contribution from the Juncker Fund
2. the managing authority could make an ESIF programme contribution into an **existing** investment platform (e.g. Local Authority backed Business Loans Scotland Ltd) that already uses Structural Funds The investment platform would then invest Juncker Fund and distinct EU Structural funds contributions in final recipients (other investors may participate)
3. the managing authority could set up a financial instrument (with or without a Fund of Funds) in which the investment platform set up with the support of the Juncker Fund acts as an investor

Legal basis of Investment Platforms:

There is no exhaustive list of eligible legal structures under which investment platforms can be set up. They can be, inter alia:

a) Special Purpose Vehicle: A dedicated investment fund or other similar corporate structure form is established with a specific investment strategy, diversification obligations, and target financial return. The fund's Special Purpose Vehicle can take various legal formats depending on the country of domiciliation: SICAV, FCPR, ELTIF, investment trust, etc.

b) Managed account: The various providers of funding decide together on an investment strategy and entrust their funds directly with an entrusted a separate entity / manager. There is no need to create a new legal entity or vehicle. The entrusted entity then deploys the funds in line with investment strategy. The entrusted entity does not necessarily need to provide financing along the funds made available to it nor does it need to share into the risk.

c) Contract-based co-financing: The various providers of funding decide together on an investment strategy and by the way of a contract make their funds available to an entity active in the financing market. Each time that the entity will finance an eligible project, a portion of the finance will come from the funds made available (co-financing). There is no need to create a new legal entity or vehicle. The entity active in the financing market deploys the funds in line with investment strategy and has to deploy some of the financing (sharing of risk).

d) Risk-sharing arrangement: The various providers of funding decide together on an investment strategy and entrust their funds directly with an entrusted entity / manager on a risk-sharing basis. The risk sharing could be tailor made. There is no need to create a new legal entity or vehicle. The entrusted entity then deploys the funds in line with investment strategy and shares into the risk of the investment platform's operations

Juncker Fund contribution: However, the current EIB investment guidelines for infrastructure funds could serve as an indication. EIB's investment in a fund is limited to 25% of a fund, with a target participation of between 10% to 20%.

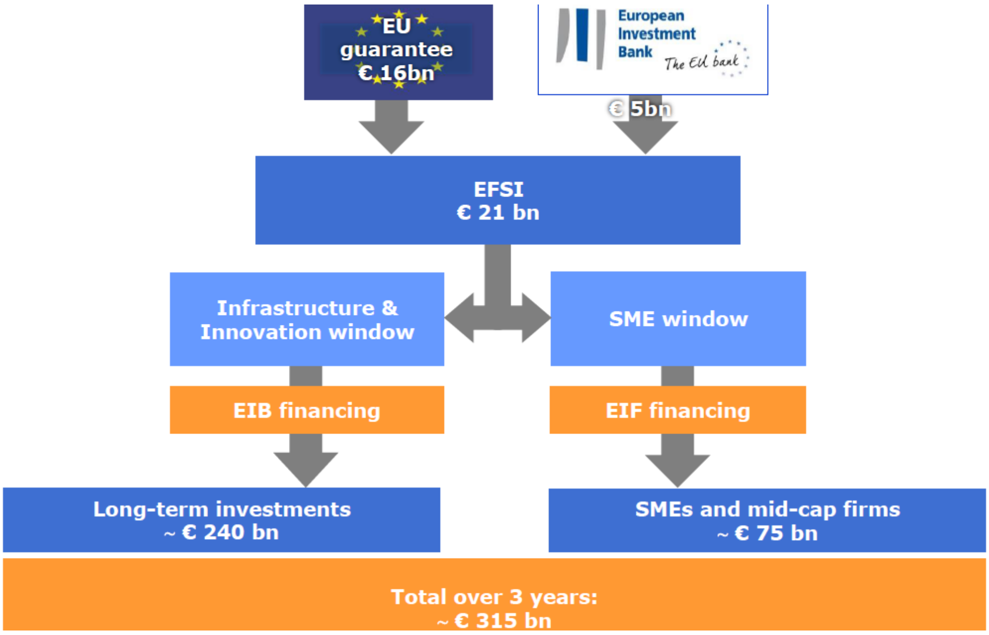
In its normal project lending activity, the EIB usually does not exceed 50% of the eligible costs.

Juncker Fund - SME Window (SMEW)
As part of its contribution to the Juncker Fund, the EIB is providing additional EUR 5 billion backed by the EU guarantee to support a number of products managed by the European Investment Fund (which is a subsidiary of the EIF that provides loans to SMEs –see below) . In particular in the first phase of the Juncker Fund implementation, EIF has so far been engaged in the following:

- EUR 1.3 billion have been made available to the EIF in a form of front – loading (i.e. anticipate as of 2015 the 2016-2020 investment capacity) for EU level financial instruments InnovFin SME Guarantee ("InnovFin SMEG") and COSME Loan Guarantee Facility ("COSME LGF"); and
- EUR 2.5 billion provided by the EIB, under its own risk, to a risk capital mandate managed by the EIF. This aims to provide accelerated and additional financing support to SMEs and mid-cap, new capacity to invest into private equity / venture capital funds and remove market gap to reach €75bn of investments at SME and mid-caps level

Juncker Fund - *Infrastructure and Innovation Window (IIW)*
Under the IIW, the EIB is expected to support viable strategic infrastructure and innovation projects taking on higher risk, where necessary, or meeting the additionality principle in line with the EU Structural Fund Regulations. The EIB's first EFSI projects include investment in healthcare research in Spain, energy efficiency in France, the construction of 14 new healthcare centres across Ireland and backing for industrial innovation in Italy.

ESIF programme support may cover a portion of the project cost. For example, a project has the commitment of the project promoter and/or other investors for the provision of an initial investment amount. In order to close the remaining funding gap, the ESIF programme contribution, in the form of a grant, and an EFSI loan may cover the remaining part of the project cost



Juncker Fund - State Aid Issues:

Both the Juncker Fund and the Structural Funds loans and grants would also have to ensure that potential State aid elements are properly addressed. Thus projects need to be argued in terms of addressing market failures and mobilising private investment.

Projects supported by EFSI may also benefit from financial support (co-funding) by EU Member States, for instance through ESI Funds or financing provided by NPBs. Such co-funding provided to undertakings, unless granted on market terms, may entail State aid which is subject to EU State aid rules.

The Commission will assess Juncker Fund projects with Member State co-funding entailing State aid on the basis of its modernised State aid framework. To facilitate the deployment of the Juncker Fund the Commission "promises" to assess these projects as a matter of priority, and give it fast-track treatment. The Commission aims to complete its assessment within six weeks of receiving the complete notification from the Member State.

The manner in which State aid rules apply to interventions of National Promotional Banks has been clarified in the Commission specific guidance on NPB (see link on page 1)

<u>EFSI Tentative Timeline</u>
4 July 2015: EFSI regulation enters into force
By 1 October 2015: first EFSI guarantees have been extended to NPBs
1 October 2015: First investment platforms established
30 June 2018: Completion of EFSI investment programme
After June 2018: EFSI evaluation, including role of and cooperation among NPBs

<u>PART II European Investment Bank (EIB) financing to SMEs</u>

In addition to the Juncker Fund the European Investment Bank has dedicated credit lines to finance local authorities and SMEs. While it is understandable the interest of the Juncker Fund the existing and well-trodden (as well as less risky) loan instruments from the EIB (or its subsidiary for SMEs, the European Investment Fund) can provide more useful in meeting demands for loan financing from Councils

The EIB is the EU's long-term lending bank set up in 1958 by the Treaty of Rome, headquarter in Luxembourg, owned by the 28 EU Member States. It is therefore a public investment bank whose purpose is Objectives Providing finance and expertise for sound and sustainable investment projects in support of EU policy objectives (such as the EU 2020 targets on small, sustainable and Inclusive growth)

Akin to the World Bank globally it is one of the largest public lenders (AAA-rated) which last year alone lent €77bn (to put into perspective this equals the combined UK Devolved Administration budgets of last year) plus 3,3bn by the EIF

SME support: EIB defines Small and medium-sized enterprises (SMEs) as enterprises with fewer than 250 employees. The so called Mid-caps are enterprises with a minimum of 250 and maximum of 3000 employees

Assistance for SMEs is a top priority for the EIB Group (31% of EIB's annual financing) 22bn was provided in loans for SMEs in 2014. Across the EU-28, on average 11% of SMEs report access to finance as their main problem yet significant country disparities persist

EIB cooperates with over 200 financial intermediaries and partnering with the EU institutions and Member States. In the UK they are two dedicated teams of **Santander UK Ltd and Lloyds** (contact here) improving financing terms and access to finance and providing a wide range of debt-financing, risk-sharing and venture capital instruments

Scope of EIB loans for SMEs and MidCaps
Most types of investment (including in working capital) promoted by SMEs and MidCaps are eligible for EIB loans. Support is mainly provided via the above mentioned financial intermediaries.
It can be targeted (e.g. Jobs for Youth, agriculture, national / regional support schemes)
Through investment in loan substitutes (covered bonds and securitisation) or Innovative financing options (blending and advising) such as:

- InnovFin MidCap Growth Finance (direct lending to innovative MidCaps)
- InnovFin MidCap Guarantee (portfolio guarantees benefitting innovative MidCaps)
- SME Initiative (portfolio guarantees and securitisation instrument to encourage new SME lending)
- Contribution to the Juncker Fund (discussed above)

PART III European Investment Fund (EIF) for SMEs

The EIF is a subsidiary of the European Investment Bank (61% shares) the European Commission (25%) and Public and Private Financial institutions (12%)

The role of the EIF is to support the start-up and expansion of SMEs across the EU. Specifically it provides risk-sharing guarantees, credit enhancement, intermediated equity, venture and growth capital, mezzanine finance, microfinance, social impact finance.

It has a volume of around €3,3bn in in equity, guarantees, securitisation and microfinance Partners and works with 500 venture and growth funds and 400 banks and SME promotional bodies. Taken together this mobilises last year 14bn euros in SME loans (175.000 SMEs supported last year).

A substantive part of the EIF work is to manage financial engineering (loan instruments) that have been set up by the EIB , the European Commission and national/regional bodies to provide loans to SMEs:

The EIF manages the following European Investment Bank loan instruments

- EIB Risk Capital Resources (RCR)
- EIB Group Risk Enhancement Mandate (EREM)

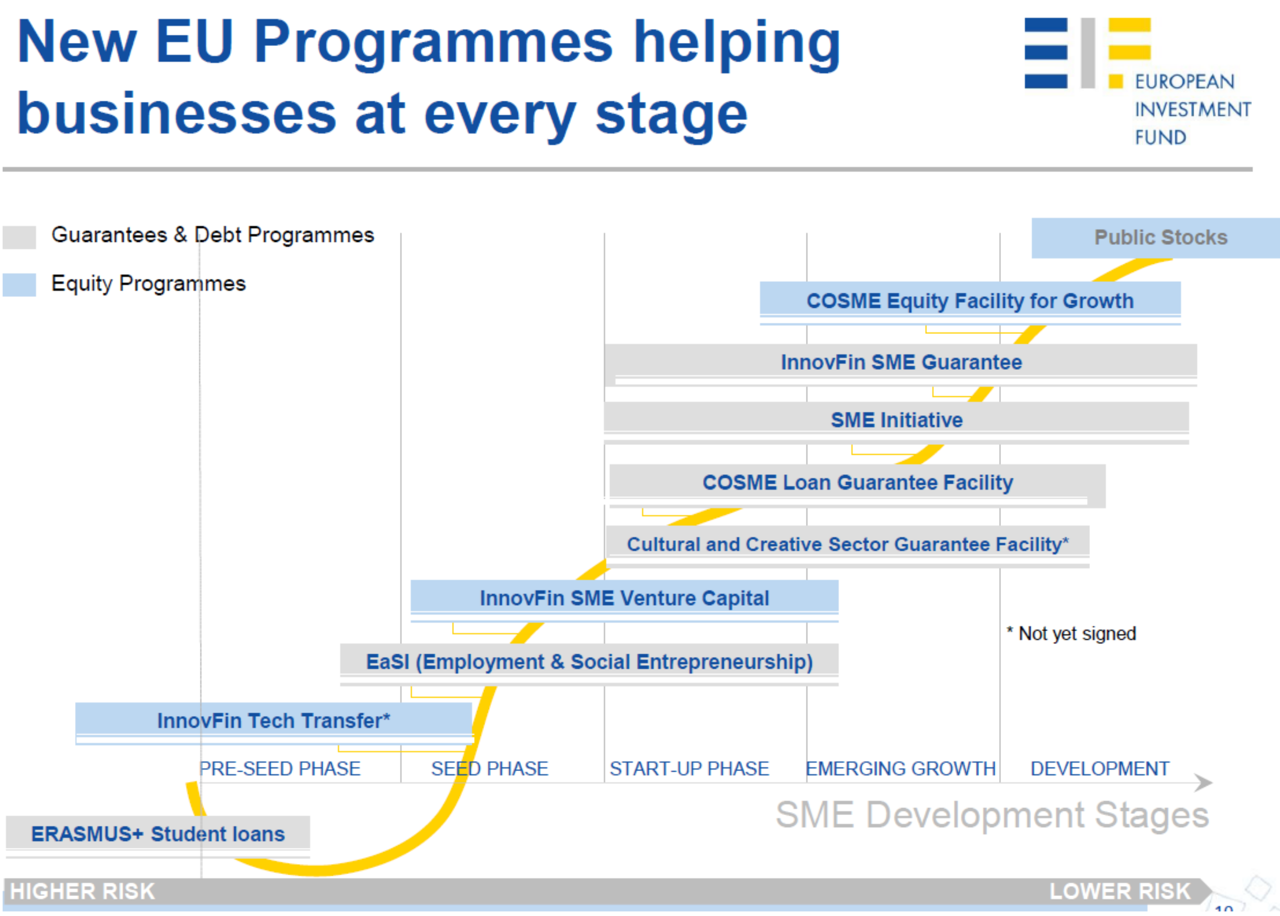
EIF manages on behalf of the European Commission the following funds:

- COSME (EU SME fund)
- InnovFin – EU Finance for Innovators

EIF support of National & Regional Funds

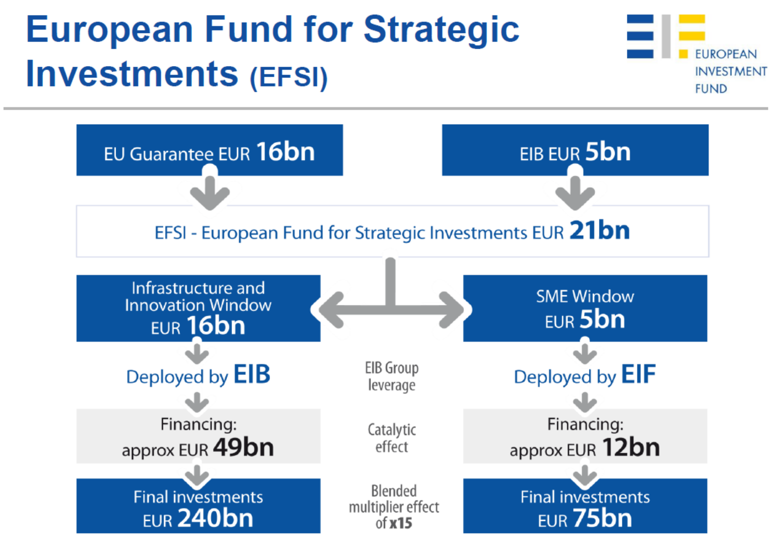
- Funds-of-Funds including in the Balkans, Germany, Poland, Portugal, Spain, Turkey, UK
- Holding Funds supported by structural funds (such as JESSICA, JEREMIE, etc.)

This table shows the range of EIF provided/supporting products at each stage of SME development:



In addition to that, as discussed the EIF manages part of the Juncker Fund (see table below)

EIF contribution to EFSI



EIF Microfinance

The EIF also runs the Microfinance tool from the **EU Programme for Employment and Social Innovation (EaSI)** – previously known as PROGRESS). Precisely only 10 days ago on 19 October a tranche of EASI loans worth €237m open to 20.000 European micro-enterprises was launched by the Commission. The European Investment Fund (EIF), which manages the EaSI guarantee on behalf of the European Commission, and six microfinance institutions are signing guarantee agreements that will open up access to finance for microenterprises. This will include loans of up to €25 000, in particular for vulnerable persons and micro-enterprises and for the first time loans for social enterprises through investments of up to €500 000.

PART IV: Other EU Loan Instruments for SMEs

As described in the above tables there is a vast array of loan instruments available for SMEs. Some of them are loan instruments that are mainstreamed into EU funding programmes to support specific EU policies be that Cohesion or Environment.

EU Structural Funds Financial Engineering:

This is the one that is best known by Scottish Council practitioners. The European Commission is encouraging Managing Authorities and indeed other bodies to convert EU grants into loans that can be recycled. The new Juncker Commission is making a strong push for this and is expected that it will feature heavily in the Mid Term Review of the EU Budget foreseen for next year.

Up till 2014 this was done via the JASPERS, JEREMIE, JESSICA loan instruments (in Scotland JESSICA fund for urban regeneration was known as SPRUCE). Post 2014 the new EU Regulations have common rules for Financial Engineering. In Scotland there will be part of the Scottish Structural Funds programme dedicated to Financial Engineering. Local Authorities are playing a big role as the West and East of Scotland Local Authority Loan Fund that used to draw EU Structural Funds and convert it into loans will be progressively replaced by a new pan Scotland Local Authority led loan body the Business Loans Scotland Ltd. For the first time the Rural Development Fund, including the Scottish Rural Development Fund has a small component on Financial Engineering.
Finally it is worth remembering the advisory role that the Commission has set up in the Fi-Compass platform. https://www.fi-compass.eu/

COSME

In addition to the EU Structural Funds, EIB loans etc. there has been for many years a dedicated EU funding program me to support SMEs. It is currently known as the program me for the Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME) whose role is improving access to finance for SMEs through two financial instruments that have been available since August 2014.

COSME aims to make it easier for small and medium-sized enterprises (SMEs) to access finance in all phases of their lifecycle – creation, expansion, or business transfer. Thanks to EU support, businesses have easier access to guarantees, loans and equity capital. EU 'financial instruments' are channeled through local financial institutions in EU countries. To find a financial institution in your country, visit the Access to Finance portal. You can find here the COSME 2015 Work Programme, financing decision and eligible support measures

COSME has a budget of over EUR 1.3 billion (aiming to raise 25bn via financial intermediaries) to fund these financial instruments that facilitate access to loans and equity finance for SMEs where market gaps have been identified.
As discussed above these COSLA financial instruments are managed by the European Investment Fund (EIF) in cooperation with financial intermediaries in EU countries. They are the:

- **The Loan Guarantee Facility (LGF)**

Part of the COSME budget will fund **guarantees** and **counter-guarantees** for financial intermediaries (e.g. guarantee organizations, banks, leasing companies) to help them provide more loan and lease finance to SMEs. This facility will also include the securitisation of SME debt-finance portfolios.

- **The Equity Facility for Growth (EFG)**
  Part of the COSME budget will be dedicated to investments in risk-capital funds that provide venture capital and mezzanine finance to expansion and growth-stage SMEs, in particular those operating across borders.

Fund managers working on a commercial basis will ensure that investments are focused on SMEs with the greatest growth potential. It is expected that some 500 firms will receive equity financing through the programme, with overall investment reaching up to EUR 4 billion. It is also anticipated that further finance will be attracted through co-investments from other public and private sources. You can see in the table in the previous page where COSME instruments fits in the large portfolio of available EU instruments for SMEs

Horizon 2020

Horizon 2020 is the large EU Research and Innovation fund, worth €80bn till 2020. It is open to EU-wide bids based on excellent. However contrary to perception such large budget is not available only to pure research, ICT or natural or applied sciences. Indeed even social sciences projects are supported by Horizon 2020.

For that reason it is not surprising that Horizon 2020 also has a small SME Instrument of the Horizon 2020 Framework Programme for Research and Innovation offers funding and support for innovation projects that help SMEs grow and expand their activities into other countries.

The SME Instrument offers small and medium-sized businesses the following:

- Business innovation grants for feasibility assessment purposes (optional phase I): EUR 50,000 (lump sum) per project (70% of total cost of the project);
- Business innovation grants for innovation development & demonstration purposes (possible phase II): an amount in the indicative range of EUR 500,000 and 2,5 million (70% of total cost of the project as a general rule);
- Free-of-charge business coaching, in order to support and enhance the firm's innovation capacity and help align the project to strategic business needs;
- Access to a wide range of innovation support services and facilitated access to risk finance (mostly in optional phase III), to facilitate the commercial exploitation of the innovation.

PART V Other existing EIB loan instruments for local and regional development

While most of this update focused on the Juncker Fund and the EIB/EIF/EU instruments to support SMEs it seems useful for completeness sake to briefly list other existing financing opportunities for Local and Regional Authorities that have long existed in the European Investment Bank portfolio. In many countries very often these are the only non-commercial source of finance that local authorities have to finance

EIB provides loans on the following areas:

Urban Environment

- Urban renewal – improving the quality of life and aiding social cohesion
- Heritage – preserving the social, architectural and historical fabric of towns and cities
- Buildings – renovation and renewal
- Infrastructure – promotion sustainable transport, energy, ICT etc.

- Mobility – helping people move around while cutting noise and air pollution

A recent tweak of these longstanding lending policies for urban areas are the EIB policies on Smart Cities (NB like the ones investigated by the Scottish Cities Alliance and the small strategic intervention of the Scottish ERDF Operational Programme)

Sustainable transport

EIB funds loans that shift away from private transport, by supporting efficient public transport networks in order to:

- Facilitate growth and job creation
- Cut greenhouse gas emissions
- Reduce noise pollution
- Minimise the damage to air quality
- Promote safety
- Research on cleaner and safer private vehicles

The European Investment Bank has a dedicated Transport Lending Policy that sets out the details on how these loans are provided.

We also strive for cleaner and safer private vehicles by backing research and development in the automotive industry.

Sustainable energy project advice

Many EU towns and regions lack the necessary technical expertise and organisational capacity to implement large energy efficiency and renewables projects. ELENA (“European Local Energy Assistance”) is there to help. It covers up to 90% of the technical support cost needed to prepare, implement and finance the investment program me. Run by the EIB, it is funded by the European Commission.

Structural Funds – Financial Engineering

As mentioned above the EIB helped the Commission set up the first EU Structural Funds backed financial instruments JESSICA JEREMIE JASPERS which you can find summarised here

European Energy Efficiency Fund:

The European Energy Efficiency Fund (EEEF) was launched in 2011 by the European Commission in cooperation with the European Investment Bank and private banks (notably Deutsche Bank) to support EU member states (including to local, regional public authorities or public or private entities acting on their behalf) in meeting their objective to, by 2020, reduce greenhouse gas emissions by 20%, increase renewable energy usage by 20%, and lower energy consumption through a 20% improvement in energy efficiency. It will target the substantial potential for energy efficiency and small scale renewable energy in the European public sector.

The Fund will pursue a two track investment approach, either investing directly in projects or via financial institutions. It has a layered risk/return structure to stimulate private investment with a fixed commitment of EU budget funds. Together they put over 2650m aiming to raise €800 million by attracting further investors. A technical assistance facility is also available to support investments pursued under the EEEF

Marguerite Fund:

The 2020 European Fund for Energy, Climate Change and Infrastructure (“Marguerite”) was established with the backing of six major European financial institutions including the EIB to make capital-intensive infrastructure investments and will target attractive long-term and stable riskadjusted returns. Each of the six Core Sponsors has committed €100 million to the Fund. In addition, three further investors (including the European Commission) have committed an incremental €110 million to the Fund, bringing current commitments to €710 million.

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