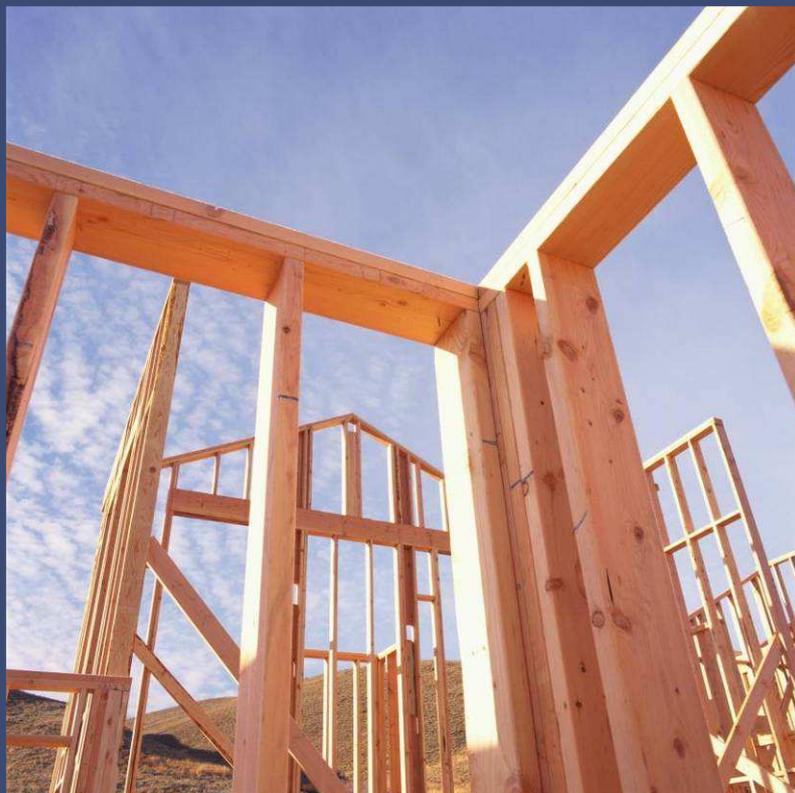


## Ministry for Regional Development of the Czech Republic

# Feasibility study on the implementation of the JESSICA financial instrument in the Czech environment for the 2007-2013 programming period

Final report

2 September 2010



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## 1. Executive summary

### Study objective

The use of financial engineering instruments, which are defined in Article 44 of the General Regulation, are anticipated by both the strategic documents of the Czech Republic in the area of EU funds (National Strategic Reference Framework) and even certain thematic or regional operational programmes.

In the Czech environment, the involvement of regional operational programmes and the Integrated Operational Programme appears to be the most advantageous, especially with regard to thematic concurrence with the areas supported by the JESSICA financial instrument and with regard to the fact that the ROP and IOP have their priority axis or area of intervention aimed at supporting the development of urban areas, which is another condition for the possible implementation of the JESSICA financial instrument. Nevertheless, even the involvement of thematic operation programmes, for example in the form of their contribution to the regional urban development funds, can be desirable in order to ensure the comprehensiveness of intervention.

The main objective of the study was to identify and assess a suitable system for the implementation of the JESSICA financial instrument, which included an assessment of the suitability of involving Czech and European institutions as the holding fund managers. The study also included the following

- Performing an analysis of the legislative environment with a focus on the relevant EU and Czech legal regulations.
- Identifying risks and barriers that may arise in connection with the implementation of the JESSICA financial instrument in the Czech Republic, including proposals to resolve them.
- Preparing a description of financial flows and document flows for the proposed implementation models.
- Performing an analysis and assessing the possibilities for external entities (including Czech banks) to become involved in the implementation of the JESSICA financial instrument in the Czech Republic.

### Legal analysis

From the point of view of legal enshrinement, it is possible to understand the JESSICA financial instrument as an alternative regime for the management of resources from the EU structural funds making use of general principles and procedure for the management of these resources, modified by the use of financial engineering instruments under the rules laid down by EU and Czech law, with a focus on the development of cities. As part of our legal analysis, we identified the EU and Czech legal regulations and methodological and strategic documents relevant from the point of view of implementation of the JESSICA instrument in the Czech Republic. Chapter 3 hereof explains in what way these regulations and documents are relevant and how they should be used.

## 1. Executive summary (continued)

In connection with the legal analysis, we have identified the following areas as problematic and in need of further attention. A detailed description of each is provided in Chapter 3.2.1 hereof.

- **Public procurement**

It will be necessary to specify the need to observe the Mandatory Guidelines for Public Procurement when awarding contracts co-financed from EU resources up to the level of the project implementer. The need to proceed according to the Public Procurement Act when selecting the financial services provider is showing to be another barrier in the event that the project implementer is an institution with the status of a public contracting authority.

- **State aid**

In particular, it will be necessary to specify that the aid grantor will be the Managing Authority of the operational programme from which the financial contributions are transferred in favour of the financial engineering instrument.

At the same time, the Managing Authority can consider notifying the European Commission of those areas of support that the urban development funds will focus on.

- **Co-financing**

Implementation of the JESSICA financing instrument can be executed on a number of levels (holding fund, urban development fund, etc.). It will thus be necessary to monitor maximum possible adherence to co-financing on all implementation levels to ensure that the Managing Authority adheres to the stipulated rules on the level of the entire programme.

- **Verification and utilisation of applications**

In this connection, it will be necessary to examine the need for changes and modifications to the information systems used in the framework of implementation of the EU structural funds in the Czech Republic. At the same time, it will be necessary to carry out modification of the recommended procedures for working with these systems in the event that financial engineering instruments are utilised.

- **Expenditure reporting and certification**

In this area, it is of particular necessity to provide examples of documents to be submitted in the framework of proving realised costs as the basis for payment requests, subsequent certification of expenditure, etc.

- **Management of resources outside of the Czech Republic**

It will be especially necessary to make a clear interpretation of Section 33(7) of the State Budgetary Rules in relation to the possible involvement of foreign institutions in the implementation of the JESSICA financial instrument in the Czech Republic.

## 1. Executive summary (continued)

- **Status of returns on investment**

In this case, it will be necessary to clearly specify who will be authorised to dispose of the returns on investment that have been released from the financial engineering instruments (e.g., after the end of the programming period, termination of the operations of the HF/UDF, and so on). These facts should be dealt with in the respective funding agreements concluded by and between the Managing Authority and the HF/UDF manager and the HF manager and the UDF. Nevertheless, it should generally be specified that the resources will be returned to the Managing Authority that contributed them (or to its successor). If the JESSICA financial instrument is implemented by any of the regional operational programmes, it should be stipulated that the funds will be reinvested in the NUTS II region in question.

As a solution to problematic areas, the issuance of methodological guidelines for the implementation of the JESSICA financial instrument in the Czech Republic can be recommended. These guidelines will contain those cross-sectional issues that are not in the purview of the various Management Authorities. At the same time, amendment of certain regulations, which are listed in table 1, can also be recommended.

Legal regulation	Area requiring amendment
Act No. 218/2000 Coll., on Budgetary Rules, as amended	<ul style="list-style-type: none"> <li>• In relation to the management of resources outside accounts subordinated to the state treasury in the event that the fund manager (HF or UDF) is a foreign institution</li> <li>• In relation to the legal nature of a decision to grant aid in order for it to be clear that a decision to grant aid can be part of a funding agreement in conjunction with an agreement concluded under the Commercial Code</li> </ul>
Act No. 250/2000 Coll., on Budgetary Rules of Regional Budgets, as amended	<ul style="list-style-type: none"> <li>• In relation to the nature of agreements on granting aid in order for it to be clear that the such agreements can be part of a funding agreement in conjunction with an agreement concluded under the Commercial Code</li> </ul>
Act No. 248/2000 Coll., on Support for Regional Development, as amended	<ul style="list-style-type: none"> <li>• In relation to the establishment of new legal persons by the regional councils of the cohesion regions</li> </ul>
Act No. 137/2006 Coll., on Public Procurement, as amended	<ul style="list-style-type: none"> <li>• In relation to obtaining financial assistance from urban development funds by public contracting authorities</li> </ul>
Legislation regulating the creation of public institutions	<ul style="list-style-type: none"> <li>• In relation to the subject matter of the work of these institutions</li> </ul>

**Table 1 Overview of regulations and the amendments required**

## 1. Executive summary (continued)

Attention needs to be called to the fact that when preparing amendments of the above-listed legislation, it is necessary to ensure that the changes are in compliance with the relevant EU legislation and generally binding Czech legal regulations. At the same time, it may also become necessary to amend other regulations tied to the amended regulations.

### **Analysing suitable projects and involving external partners**

For the purpose of identifying suitable types of projects, a survey was conducted among potential beneficiaries. At the time it was conducted, the survey did not demonstrate sufficient demand for this type of financing, however. This could be due to the novelty of this financing method and the lack of sufficient information available to potential beneficiaries (namely representatives of municipalities) about the way it works and its rules and terms and conditions. Nevertheless, experience from other regions (such as Moravskoslezsko) has shown that suitable projects for financing via the JESSICA instruments can be found.

For this reason, it will be necessary to continue with the information campaign to ensure that the cities are informed about the rules for obtaining assistance via the JESSICA financial instrument, the terms and conditions of this instrument, the types of projects that it applies to, and experience with it from abroad.

Private partners can become involved in the implementation of the JESSICA financial instruments on three levels:

- Holding fund/urban development fund manager
- Holding fund/urban development fund investor
- Project execution partner

It is apparent that each of the above forms of involvement of private partners has its benefits. As a different type of institution will be involved in each of the above forms (for example a bank in the case of the fund manager or investor and a developer or other type of institution in the case of the project execution partner), the use of a number of forms of cooperation with private partners in connection with the implementation of the JESSICA financial instrument at one time is not mutually exclusive. In case of interest on the part of private partners, all three options can be recommended.

In relation to the possible involvement of external entities in the implementation of the JESSICA financial instrument, generally these entities are interested in entering the implementation structure as fund managers (be it the HF or UDF). Private entities (namely banking institutions active on the Czech market) are interested in becoming involved in the funds (HF or UDF) through capital.

## 1. Executive summary (continued)

### Risks and barriers

Chapter 5 of this study lists the identified risks and barriers that can affect the implementation of the JESSICA financial instrument in the Czech Republic and makes proposals for their elimination. The following areas of risk can be considered as the main ones:

- **Lack of financial resources**

This is mainly due to the fact that a substantial part of the financial allocation is bound contractually (i.e., covered by grant agreements/decisions) under suitable operational programmes. Another reason can be the lack of willingness on the part of monitoring committee representatives to approve the transfer of the financial resources in favour of the JESSICA financial instrument.

In this connection, clear and open communication between the Managing Authorities and political representatives is recommended, so that the political representatives have enough information to make decisions. With regard to the insufficient amount of available resources, their possible re-allocation – either among priority axes/operational programme areas of intervention or among each of the various operational programmes – can be considered.

- **Lack of suitable projects – low absorption capacity**

In this area, the problem is the fairly low level of interest shown by potential beneficiaries due to their distorted perception of the JESSICA financial instrument. At the same time, potential applicants perceive the current setup of the IUDP rules as restrictive.

As regards potential beneficiaries, it will be necessary to organise an information campaign and consultation platform to ensure the transfer of information and experience.

As regards the IUDP, one can recommend simplifying the existing rules and specifying that the document prepared by the municipalities as their development strategy can be deemed to be their IUDP.

- **Limited timeframe for implementing the JESSICA financial instrument**

As the programming period is already in its second half, there is a limited time to implement JESSICA financial instrument to allow for the financial resources to be invested into projects in time.

For this reason, it is necessary, on the one hand, to draw up an action plan for implementing the financial instrument and ensure that it is duly observed and, on the other, to ensure that beneficiaries receive the proper support and information to allow them to prepare their projects in parallel with the establishment of the instrument implementation structures.

## 1. Executive summary (continued)

- **Incorrect setup of the implementation structure**

There is also the risk that the implementation structure will be set up in a way that will lead to discouraging terms and conditions for receiving assistance under the JESSICA financial instrument or incongruity between supply and demand.

The involvement of potential beneficiaries (namely municipalities) in the process of setting up the terms and conditions of the financial instrument to reflect the beneficiaries' actual needs and ensure that the conditions set up to be significantly more advantageous than regular commercial loans is clearly appropriate.

- **Lack of interest on the part of the Managing Authorities**

The fact that this instrument is a new way of utilising resources from EU funds, which also means there is little experience with it at this time, can be reason for the Managing Authorities' passive approach to it.

In this case, it is necessary to emphasise the role of the MfRD, as the National Coordination Authority, to provide the Managing Authorities with information and coordination and, in cooperation with other institutions, ensure the resolution of those issues that exceed the remit of the various Managing Authorities.

- **Insufficient administrative capacity**

Like the previous point, due to the novelty of the method of utilising resources contributed from the structural funds and the related lack of sufficient information and experience, there can also be a certain risk of insufficient administrative capacity in the current implementation structures.

A solution to this can be the involvement of those institutions that already have experience with financial engineering instruments (e.g., from abroad) or the creation of platforms that allow information to be shared among institutions that become involved in the implementation of the JESSICA financial instrument in the Czech Republic.

- **Lack of interest on the part of external entities**

At this time, the rules of operation of the JESSICA financial instrument in the Czech Republic are not entirely clear and, thus, it is not possible to determine the scope and terms and conditions of involvement of external entities, and this can lead to these entities losing interest in participating in the implementation of the financial instrument.

It would be appropriate in this case as well to ensure a communication platform that will allow the involvement of external entities already at the time that the conditions are being defined.

## 1. Executive summary (continued)

- **Lack of experience of the municipalities with managing similar types of projects as those under the JESSICA financial instrument**

The JESSICA financial instrument should allow for the execution of comprehensive urban zone development projects. This approach will require that the municipalities take a different approach to the implementation of projects (even with regard to the possible involvement of private partners, something that the municipalities do not have much experience with).

It will be necessary for either the urban development fund or the Managing Authorities to provide assistance to the municipalities with preparing and implementing the projects to ensure that the projects are executed successfully.

- **Legislative and procedural barriers**

The main legislative barriers have been defined in the Legal Analysis section. In terms of procedural barriers, it is possible to name in particular the programme financing rules in relation to the possible execution of the pilot project where the NCA, as the beneficiary, does not have the status of programme manager and cannot issue decisions to grant aid. One possible solution could be the creation of a sub-programme under the OPTA whose manager would be the NCA.

Another barrier could be the current setup of the rules for financial flows within the OPPC, which are based on principle of ex-post financing. It will probably be necessary to consider changing the method of financing to ex-ante financing with regard to the involvement of external entities (be they Czech or foreign).

### Implementation models

Due to the possibility to set up the JESSICA financial instrument implementation structure in a way that is flexible to the needs of the Member State in question, it is possible to arrive at a number of implementation options. Chapter 6 sets out a number of options for implementing the JESSICA financial instrument through the ROP/TOP (Chapter 6.5.) or the OPTA (Chapter 6.6.). The final decision on how the implementation structure is to look is in the remit of the operational programme from whose allocation the financial instrument is to be funded. When assessing the various options, one should take into account the following criteria:

- Simplicity of the structure and administrative burden
- Quality of use of resources and assurance of OP objectives
- Safety of use of resources
- Flexibility of provision of resources
- Adequacy of volume of disposable funds and number of projects
- Independence and viability

## 1. Executive summary (continued)

Generally speaking, at this time, those implementation structures that have fewer levels of management appear to be the most appropriate, namely due to the need to establish the implementation structure within a limited period of time, so that the projects receive financing by the end of 2015. At the same time, each level of management carries with it certain costs, which, with regard to the limited amount of available financial resources for this pilot phase, may not be bearable.

If we disregarded the financial aspects, we would recommend making use of an implementation structure that would be composed of one holding fund on the national level and a regionally focused urban development fund. Involving a holding fund will ensure, on the one hand, coordination between the involved Managing Authorities and, on the other, assistance to the Managing Authorities that would otherwise have to devote a part of their capacity to identifying and subsequently managing the actions of all urban development funds financed from their operational programmes. At the same time, the involvement of those operational programmes that would not be creating their own urban development funds but could transfer a part of their allocation to the urban development funds financed from other operational programmes could occur at this level.

In this section, the appropriateness of involving the EIB as the holding fund manager was also assessed. In this case, the particular benefit would be that the EIB, as the HF manager in a number of other EU Member States, already has certain experience with the JESSICA financial instrument. Conversely, however, it would be necessary to resolve the issue of the State Budgetary Rules in relation to the management of financial resources from the State treasury outside of accounts subordinated to the State treasury. This issue would arise with respect to thematic operational programmes, which are governed by the State Budgetary Rules, and regional operational programmes, which are governed by Municipal Budgetary Rules.

As sufficient financial resources for use in favour of the JESSICA financial instrument are not available in the appropriate operational programmes (TOP/ROP), it was decided by the Client while this study was being drawn up that the resources in favour of the JESSICA financial instrument will be released from the Operational Programme Technical Assistance, either through a pilot project, whose beneficiary and implementer would be the NCA, or directly from the OPTA, provided the European Commission approves modification of the OPTA to allow for this. The overall amount of resources that will be able to be used in favour of the JESSICA financial instrument is estimated at CZK 700 – 800 million. In this phase, the implementation structure should comprise one urban development fund.

With regard to the above criteria, the most suitable method of implementation of the JESSICA financial instrument in the Czech Republic in the 2007-2013 programming period (i.e., implementation of the JESSICA financial instrument as a pilot verification) is the pilot verification of the financial mechanism funded from the OPTA (i.e., option five in Chapter 6.6.2.).

## 1. Executive summary (continued)

### Financial flows

For the option of the pilot verification funded from the OPTA, draft financial flows and document flows have been drawn up, and these are set out in Chapter 7.3.3 hereof. Financial flows and the relationships between each entity involved in the implementation of the JESSICA financial instrument will be governed by general binding legal regulations.

The relationship between the Managing Authority and the fund manager (HF or UDF) will be regulated by a funding agreement composed of the decision to grant aid according to the State Budgetary Rules (in the case of the ROP, by an agreement to grant aid according to the Municipal Budgetary Rules) and a business agreement under the Commercial Code. The resources from the operational programme will be transferred to the fund manager for management by way of the decision to grant aid (or the agreement to grant aid), and the business agreement will govern the remuneration to be awarded to the fund manager for rendering its services. Both documents, i.e., the agreement/decision to grant aid and the business agreement should be legally linked (e.g., they should enter into force on the same date).

The relationship between the holding fund and the urban development fund and the relationship between the urban development fund and the project implementer will be governed by a business agreement.

### Steps leading to implementation

In order for the JESSICA financial instrument to be implemented in the Czech Republic, it will be necessary to carry out a number of basic steps:

- Decision on the implementation of the JESSICA financial instrument and on the implementation structure option.
- Modification of the operational programme (in terms of content, possible financial re-allocation or modification of procedures), including approval of changes by the programme monitoring committee and, if relevant, the European Commission.
- Preparation and execution of a request to submit a pilot project (if option 4 is chosen), including any revision of the assessment criteria and OPTA implementation procedures.
- Establishment of an investment council (in the case of options 4 and 5).
- Conclusion of a funding agreement with the EIB (in the case of option 6).
- Selection of an urban development fund manager, either by public procurement or directly (provided the rules of the Public Procurement Act are observed).
- Organisation of communication platforms (for potential beneficiaries, entities involved in implementation of the financial instruments, and external entities).
- Resolution of horizontal issues, such as the IUDP rules, State Budgetary Rules, programme funding rules, and so on.

## 1. Executive summary (continued)

A detailed description of each step as well as the related recommendations are set out in Chapter 8 hereof.

In order to implement each of the above steps, a certain period of time will be necessary. At the same time, the implementation of some steps is a prerequisite to the implementation of others. For this reason, it is necessary to set up a detailed time schedule at the beginning and make use that it is adhered to. Sample time schedules have been prepared for all of the implementation structure options described in Chapter 6.6 and are set out in Chapter 8.1. From the time perspective, option 5 again appears to be the most suitable.

## 2. Introduction

### 2.1. Introduction to the JESSICA financial instrument

The JESSICA (Joint European Support for Sustainable Investment in City Areas) financial instrument is an initiative of the European Commission and the European Investment Bank in cooperation with the Council of Europe Development Bank. Its objective is to provide assistance to urban development projects in the following areas:

- Development of urban infrastructure
- Sustainability of cultural and architectural monuments
- Redevelopment and decontamination of former industrial grounds
- Construction of office space for small and mid-size businesses
- Construction of university buildings, including facilities for medicine, biotechnology etc.
- Improvement of the energy efficiency of buildings and increase in renewable energy in the area of housing

JESSICA is not a new source of financing, but a new method for utilising resources from the EU structural funds. Through this instrument, it will be possible to finance urban development projects/investment plans in the form of **loans, guarantees** or **equity**.

There are three main advantages of the JESSICA financial instrument. First is the instrument's **flexibility** – either on the level of the instrument itself, where it is possible to respond in a flexible manner to the needs of the region in question, for example, through a broader definition of possible aid beneficiaries or thematic focus, or on the project level, where use of the instruments allows for the structure to be set up in such a way as to best correspond to the project conditions (e.g., ownership structure, use of various funding sources, various involvement of private partners).

Second is the **leveraging effect**. Because it will be possible to involve private partners when utilising resources through this instrument, it will be possible to making use of such partners' financial resources on each implementation level as well as their experience with project implementation and management.

Last but not least, there is the principle of **recycling of resources**, as the contributions will be returned to the urban development fund. Such returned resources can be used again to finance investment projects even once the 2007-2013 programming period ends for the reason that the funds will no longer be perceived as resources from the structural funds. It will also be possible to use the returned resources for other urban development projects without having to take into account the structural fund implementation rules. Thus, there is the possibility to prepare for a time when there will be fewer resources available from the EU structural funds. At the same time, the European Commission will be placing greater emphasis in the following programming period (2014+) on providing assistance under the cohesion policy using financial engineering instruments instead of classic grant funding.

## 2. Introduction (continued)

### 2.2. Study objectives

The main objective of this study was to assess the possibility of implementing the JESSICA financial instrument defined in Article 44 of General Regulation No 1083/2006. The study should have first and foremost assessed the legislative background of the JESSICA financial instrument in the Czech environment and, at the same time, assess and compare the benefits of implementation using the possibilities laid down in Article 44(2) of the General Regulation: implementation through the national route or through the use of the European Investment Bank or European Investment Fund.

The secondary objectives of the study were as follows:

- General analysis of the legislative environment, identification of possible barriers and risks connected to implementation of financial engineering instruments pursuant to Article 44 of the General Regulation in the area of EU funds (the JESSICA financial instrument), including proposals for dealing with them and identification of the basic implementation models.
- Preparation of a detailed description of the financial flows and document flows for the proposed implementation models, analysis of the possibilities provided by Czech banks and the involvement of private sector partner (PPP), including specific implementation recommendations.

This study was prepared based on an agreement concluded between the Ministry for Regional Development (the “Client”) and PricewaterhouseCoopers Česká republika, s.r.o. (the “Company”) concluded on 6 April 2010.

This study by the Company is addressed to, and intended exclusively for the needs of, the Client. The Company bears no responsibility to any third party to whom this study is presented or who becomes acquainted with it in any way.

### 2.3. Situation in the Czech Republic and starting points for implementation of the financial instrument

Use of the financial engineering instruments defined in Article 44 of the General Regulation is anticipated by both the strategic documents of the Czech Republic on EU funds (National Strategic Reference Framework) and even some thematic or regional operational programmes.

From the point of view of thematic congruity with the areas supported by the JESSICA financial instrument, it is possible to portray the suitability of the involvement of operational programmes in the way indicated in diagram 1.

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## 2. Introduction (continued)



**Legend**

- Financed by ERDF
- Financed by ERDF and another fund
- Financed by ESF, not possible to use with JESSICA
- Thematic congruity with JESSICA
- OP already involved in JESSICA

**Diagram 1 Overview of operational programmes**

With regard to the condition that a priority axis or area of intervention aimed at urban development should be set aside within an operational programme, the inclusion of regional operational programmes and the Integrated Operational Programme appears to be the most appropriate. Nevertheless, even thematic operational programmes, such as the OPEI, can become involved in the form of their contribution to regional urban development funds. This can be desired to ensure the comprehensiveness of intervention.

## 2. Introduction (continued)

At this time, the Managing Authority of one of the regional operational programmes (ROP Moravia-Silesia) is undertaking specific steps to implement the JESSICA financial instrument. The regional council of the cohesion region of Moravskoslezsko has already signed a funding agreement with the European Investment Bank to establish a holding fund in this region. Even other selected regional operational programmes ROP Southeast and Northeast are having evaluation studies conducted via the EIB to map absorption capacity in relation to the possible implementation of the JESSICA financial instrument. In September 2010, work on the evaluation study for ROP Central Moravia will begin. This study will also be executed through the EIB.

While this study was being drawn up, it was discovered that there are insufficient resources in the operational programmes (other than those that have become involved in the financial instrument through evaluation studies or specific steps leading to its implementation) for use in favour of the JESSICA financial instrument: operational programmes (namely ROPs) have already been through a number of rounds of calls for proposals in which they allocated a significant amount of available financial allocations for the 2007 – 2013 programming period and, at this time, they no longer have sufficient resources available for use in favour of the financial instrument.

For this reason, we used the following starting points (after consultation with, and approval by, the Client) to arrive at the principal recommendations. Resources in favour of the JESSICA financial instrument will be released from the Operational Programme Technical Assistance, either via the pilot project, whose beneficiary and implementer will be the NCA, or directly out of the OPTA. It is clear that the OPTA will have to undergo fundamental changes for this to happen, and this will require the consent and approval of the European Commission. The total estimated resources that can be used in favour of the JESSICA financial instrument amount to CZK 700 – 800 million crowns. The implementation structure should comprise one urban development fund.

### 3. Legal analysis

#### 3.1. Rules for implementing the JESSICA financial instrument in the Czech Republic

The legal analysis comprises Section 3.1 (Rules for implementing the JESSICA financial instrument in the Czech Republic) and Section 3.2 (Inadequacies of the rules for implementing the JESSICA financial instrument in the Czech Republic). The first part, which deals with the implementation rules, is further divided up into: rules laid down at the level of the EU (3.1.1), rules laid down at the level of the Czech Republic (3.1.2), State aid rules (3.1.3), and public procurement rules (3.1.4).

This first part of the legal analysis identifies EU and Czech legal regulations and methodological and strategic documents that are relevant from the point of view of implementation of the JESSICA financial instrument in the Czech Republic. A clear explanation is then given on why these regulations and documents are relevant and how they should be used.

The legal analysis is based on the definition of the JESSICA financial instrument provided in the pertinent programme and information documents issued by the EU authorities<sup>1</sup>. The JESSICA financial instruments is thus understood as an *alternative regime for the management of financial resources from the EU funds utilising the general principles and procedures for managing these resources, modified by the use of financial engineering instruments under conditions stipulated by EU and Czech law, with a focus on urban development*.

The subject of the legal analysis includes (i) legal regulations and documents governing the JESSICA instrument directly and (ii) legal regulations and documents having a direct impact on the implementation of this instrument in the Czech Republic. The analysis thus deals with the JESSICA instrument rules, their application, and the effect that utilisation of the JESSICA instrument will have on the application of the general regime for managing resources from EU funds. Although even the legal regulations and documents governing the general regime for managing resources from EU Funds are mentioned for practical purposes, the subject of this legal analysis is not the general regime for managing resources from EU Funds or alternative regimes for managing these resources, but the JESSICA instrument.<sup>2</sup> Finally, the subject of this analysis is also not an assessment of the legal regulations applicable regardless of the method of management of EU fund resources (tax regulations, the Criminal Code, Act on the Protection of Competition, and so on) that will have to be applied in specific situations connected to the use of the JESSICA instrument.

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<sup>1</sup> The documents in question are as follows: “Memorandum of understanding in respect of a coordinated approach to the financing of urban renewal and development for the programming period 2007-2013 of the Community structural funds between the European Commission, the European Investment Bank and the Council of Europe Development Bank” of 30 May 2006; the information document issue by the European Commission “JESSICA: Joint European Support for Sustainable Investment in City Areas” of 22 November 2006 (documents available on the EC website [www.jessica.europa.eu](http://www.jessica.europa.eu)); and the EIB study “JESSICA – Preliminary Evaluation Study” from January 2007 (available on the EIB website [www.eib.org](http://www.eib.org)).

<sup>2</sup> Thus, the subject of this analysis is not, for example, legal regulations and documents on the use of financial engineering instruments focused on the development of small and mid-size businesses under the JEREMIE initiative or on the execution of major projects in new EU Member States under the JASPERS initiative.

### 3. Legal analysis (continued)

In accordance with the assignment and for the purpose of the practical utilisation of the JESSICA financial instrument, the analysis does not copy verbatim the wording of the pertinent legal provisions or documents, nor does it list them in the same order as they appear in the legal regulations and documents in question. Instead, the relevant rules are to a certain extent reformulated, their order changed, and then put into mutual context. For this reason, this analysis should not be used instead of the pertinent legal regulations and documents, but should be used in conjunction with them as a guide to understanding them. The application of the pertinent legal regulations then has to correspond to the conditions of the specific situation. For this reason, it is not possible to preclude other interpretations than the general interpretations provided below when applying the pertinent legal regulations.

This analysis is based on the most recent promulgated legal regulations and methodological and strategic documents widely available on the websites of the European Commission, MfRD, and MF as well as on consultations with the EIB. This analysis takes into account the current interpretations of the respective legal regulations, namely by the EC and EIB. With regard to the characteristics of the JESSICA instrument (new instrument, special regime for managing resources from EU funds under the general regime, and intentional variety of possible implementation structures – see below), one cannot preclude a future change in the interpretation of the relevant legal regulations (namely the reasonable application of the general regime for managing resources from EU funds – see below) and the procedures recommended by the EC and EIB, be it for the reason of specifying the legal framework behind this instrument or with regard to the practical experience that is still only being gained with regard to this instrument.

#### 3.1.1. JESSICA – EU legal regulations and documents

Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999, as amended <sup>3</sup>	<b>“General Regulation”</b>
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, as amended	<b>“Implementing Regulation”</b>
Regulation (EC) No 1080/2006 of the European Parliament and of the Council of 5 July 2006 on the European Regional Development fund and repealing Regulation (EC) No 1783/1999, as amended	

<sup>3</sup> At the time that this study was being drawn up, the proposed amendment to General Regulation COM (2009) 384 final was being discussed. This amendment aims to simplify the management of resources from EU funds and accelerate the absorption of these resources. The adoption and force of this amendment is expected in the second half of 2010, with its wording apparently still likely to be changed under the legislative process.

### 3. Legal analysis (continued)

Regulation (EC) No 1081/2006 of the European Parliament and of the Council of 5 July 2006 on the European Social Fund and repealing Regulation (EC) No 1784/1999, as amended	
Note of the Commission services in Financial Engineering in the 2007-13 programming period No DOC COCOF/07/0018/01-EN FINAL, 16 July 2007	“Note from 2007”
Guidance Note on Financial Engineering No COCOF 08/0002/03-EN, 22 December 2008 <sup>4</sup>	“Note from 2008”
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	“Note from 2009”

At the European level, the JESSICA instrument is governed by the General Regulation and the Implementing Regulation in terms of their application to financial engineering instruments<sup>5</sup>. The General Regulation defines the basic principles of the JESSICA instrument, i.e., the general rules of operation and the general deviations from the general regime for managing resources from EU funds. The Implementing Regulation then elaborates on these general principles.

The regulation framework of the JESSICA instrument overrides the general regulatory framework of the management of resources from EU funds. EU law defines the JESSICA instrument and certain exceptions to the application of the general regime for managing resources from EU funds. The other provisions of the general regime thus have to be applied *mutatis mutandis*, i.e., commensurately to the rules of the JESSICA instrument. In other words, the obligation, for example, to provide publicity about how resources from the EU funds were used etc. will have to be fulfilled even in connection with the use of the JESSICA instrument and commensurately to the conditions of the JESSICA instrument. The European Commission has issued a number of notices on the application of certain provisions of the general regime for managing resources from the EU funds in which it clarifies its interpretation of the pertinent provisions.

<sup>4</sup> In connection with the amendment of the General Regulation, it is expected that the Note from 2007 and Note from 2008 will also be updated.

<sup>5</sup> EU law does not use the term JESSICA; instead, it regulates the possibly to use financial engineering instruments for the purpose of urban development. The EC and EIB are striving for the practical application of this regulation as part of the Joint European Support for Sustainable Investment in City Areas – JESSICA initiative.

### 3. Legal analysis (continued)

As some of the interpretational issues discussed in the Commission’s notice were later legislatively addressed by amendments to the pertinent legal regulations, here we state only those EC interpretations that have not been addressed subsequently in legislation. For the purpose of attaining legal certainty, we call attention to the need to differentiate between those rules below that are enshrined in generally binding legal regulations and those that represent a non-binding, although authoritative, interpretation by the EC.

- **JESSICA financial management instrument – what it is<sup>6</sup>**

The General Regulation makes it possible for Member States to provide contributions from the EU structural funds (European Regional Development Fund and European Social Fund) not only in the form of unrecoverable aid, but to also use them for recoverable investments into urban development and then use the returns from these investments for further urban development.<sup>7</sup> The purpose of this alternative management of resources from EU funds is mainly to ensure the recycling of (insufficient) public resources, increase motivation to use the resources properly, execute projects, and implement know-how from the private sector into the management of these public resources.

When realising these investments, it is necessary to adhere to these basic rules:

- (i) **Investment via funds**

Investments have to be implemented via the financial engineering instruments defined in the General Regulation, i.e., via urban development funds (“UDF”) and holding funds (“HF”)<sup>8</sup>.

- (ii) **Operational programme rules**

It is possible to invest only those resources allocated for management under one of the operational programmes and in compliance with the rules of such operational programme.

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<sup>6</sup> Article 44 of the General Regulation.

<sup>7</sup> This is in compliance with Article 3(2) of Regulation No 1080/2006, which states that the European Regional Development Fund contributes towards the financing of measures supporting regional and local development by, for example, the creation and development of financing instruments, such as local development funds. Conversely, Regulation No. 1081/2006 does not set out the possibility to finance financial engineering instruments from the European Social Fund (see Article 11 – eligibility of expenses). The pertinent provision of the General Regulation thus apparently represents an indirect amendment of Regulation No 1081/2006.

<sup>8</sup> In compliance with the EU law terminology, this analysis uses the term “financial engineering instrument” for the HF and UDF. Even in informal language, these financial engineering instruments could be called the “JESSICA funds” or “JESSICA investment funds”. However, one has to keep in mind that these need not be “funds” as defined by the Czech Collective Investment Act or other Czech legal regulations. “Financial engineering instruments”, “HF” and “UDF” are terms regulated by EU law. As in the case of “Managing Authorities”, “Audit Authorities”, etc., financial engineering instruments are defined by EU law especially with regard to their operational classification into the implementation structure related to the management of resources from the EU funds and will have some different formal attributes in each Member State (e.g., a different legal form).

### 3. Legal analysis (continued)

#### (iii) Subject of investment

It is possible to investment only in public private partnerships and in other projects included in the integrated plan for sustainable urban development.

The Managing Authority of the operational programme thus can designate a part of the resources intended for management within the given operational programme for investment via the urban development funds. If realising investments via a number of urban development funds, the Managing Authority can make use of assistance from the holding fund.

- **Forms of financial engineering instruments<sup>9</sup>**

The Implementing Regulation sets out two basic forms of financial engineering instruments (HF, UDF):

- (i) **Fund – legal person**

A legal person governed by agreement between the co-financing partners or shareholders.

- (ii) **Fund – separate financial unit**

A separate financial unit within an existing financial institution. Through separate accounting and other appropriate procedures, such institution has to ensure that its original resources are separated from the JESSICA resources (contributions transferred from the operational programme and contributions from other investors for the purpose of investment into urban development projects within the framework of the JESSICA instrument [see below]).

- **Selection of a holding fund<sup>10</sup>**

According to Article 44 of the General Regulation, the Managing Authority is to select a holding fund manager via public procurement. In the event that an agreement with the holding fund is not a public contract under national law, a grant can be awarded to the appropriate financial institution for the purpose of involving it in the use of the JESSICA instrument (a direct financial contribution in the form of a gift<sup>11</sup> without a prior call for proposals), if such procedure is in compliance with national law compatible with EU law.

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<sup>9</sup> Article 43(2) of the Implementing Regulation.

<sup>10</sup> Point 2a of the Note from 2007.

<sup>11</sup> Just as stated above with regard to the term “financial engineering instruments”, the term “gift” is used here as an EU legal term that need not correspond to the term “gift” as it is used in Czech legal regulations. In accordance with the budgetary rules, this “gift” will usually have the form of a grant in the Czech Republic (see below).

### 3. Legal analysis (continued)

The Note from 2008<sup>12</sup> indicates the characteristic traits that typically distinguish between the relationship between the financial engineering instrument and the Managing Authority, as the supplier and customer of services, and the relationship between the public service provider (grantee) and the grantor. In the case of a public contract, the Managing Authority will be in the position of the customer of the management services that are described in the respective agreement and for which the financial engineering instrument/supplier is to receive remuneration. The Managing Authority chooses the supplier based on a tender and essentially pays for all of the costs associated with the provision of such services. Conversely, in the case of a relationship between a public service provider and grantor, it will usually be the public service provider who initiates the contribution from the Managing Authority for the execution of the respective public service corresponding to the purpose of the Managing Authority. Unlike public procurement where the results of the management of the entrusted funds are essentially awarded to the customer-Managing Authority, the profit generated by the public service provider essentially remain with the grantee for the continued funding of the respective public service.

In the Note from 2007, the EC further provides a typical profile of a public service provider - potential holding fund manager that can be awarded a grant (unrecoverable contribution). This should be an EU or national financial institution focused on the implementation of public policy objectives. National legal regulations that would allow such a grant to be awarded should specify and list the public policy objectives whose fulfilment justify the award of the grant and confirm that the institution in question has the necessary expertise to act as a holding fund. The EC further calls attention to the fact that the provision of a grant does not release the authorities in question from their responsible to monitor, control and otherwise manage these allocated resources in compliance with legal regulations.

In the Note from 2007, the EC suggests that the Member States should entrust the management of the holding fund to the EIB or EIF by assigning the contract. In the Note from 2008,<sup>13</sup> the EC further explains that the relationship between the EIB/EIF and the Member States is a privileged one, defined primarily by EU law, and, for this reason, public procurement rules will not apply to it. In the meantime, however, this issue was expressly addressed in the amendment to Article 44 of the General Regulation (EU law now expressly allows the EIB/EIF to be entrusted with the management of the holding fund without following public procurement procedures).<sup>14</sup>

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<sup>12</sup> Point A 1.2 of the Note from 2008.

<sup>13</sup> Point A 1.1 of the Note from 2008.

<sup>14</sup> It is not without interest that the legislators stipulate that the Member States should engage the EIB/EIF by awarding them the contract (without a tender) and not by awarding them a grant, even though both institutions are providers of a public service compatible with the purpose of the Managing Authorities. Even for this reason, we recommend making use of the possibility of awarding grants to financial institutions only if it is clear that the relationship is truly one of supplier/customer of management services.

### 3. Legal analysis (continued)

As the involvement of holding funds is voluntary in the structure for utilising the JESSICA instrument, the EC essentially has nothing against the holding fund being would up after the resources transferred to it from the operational programme are transferred for the purpose of financing the appropriate urban development funds and the respective receivables from the urban development funds then transferred to the Managing Authority<sup>15</sup>.

- **Selection of urban development funds**<sup>16</sup>

The EC stresses the need to observe maximally transparent rules when selecting the urban development fund managers and allocating resources from the operational programmes to these funds. These rules should take into account the objectives of the operational programme in question and should ensure observance of public procurement rules, if these rules are applied. The EC recommends that the Managing Authorities entrust, if possible, a greater number of financial engineering instruments in order to achieve the maximum involvement of resources and know-how from private subjects and the fulfilment of the objectives of the operational programme in question.

The monitoring committee of the operational programme in question should approve both the rules for selecting the urban development fund and the criteria that the selected funds will follow when selecting the recipients of their investments under the respective funding agreements.

The EC expects the urban development funds to invest in a greater number of projects, not in only one, to fulfil the defining trait of the funds under the General Regulation<sup>17</sup>.

- **Forms of investment**

The Implementing Regulations sets out three possible forms of investment:

- (i) Loans (or equivalent instruments)
- (ii) Guarantees (or equivalent instruments)
- (iii) Investments through equity<sup>18</sup>

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<sup>15</sup> Reply to Question No 11 of the Note from 2008.

<sup>16</sup> Point 2b of the Note from 2007, Point A 2 of the Note from 2008.

<sup>17</sup> Reply to Question No. 12 of the Note from 2008.

<sup>18</sup> Article 46(2) of the Implementing Regulation.

### 3. Legal analysis (continued)

The investments must not include the creation or development of further financial engineering instruments, such as venture capital funds or loan or guarantee funds for businesses.<sup>19</sup> The Implementing Regulation also expressly forbids the urban development funds to re-finance acquisitions or participations in already completed projects.<sup>20</sup>

The EC stresses<sup>21</sup> that investment by the urban development fund through equity has to be strictly understood as an investment through a shareholding or business share, i.e., not, for example, as a developer’s investment in a specific project, although it bears the full risks tied to the execution of the project (as opposed to debt investments). For this reason, e.g., the urban development fund management costs may not include the costs of execution of the projects themselves, such as the costs of obtaining building permits, contract documentation, etc.

- **Cumulation of aid resources for projects<sup>22</sup>**

In accordance with the Implementing Regulation, projects that receive investments via the urban development funds can also obtain a contribution or other form of assistance from the operational programme.

In this connection, one should be reminded of the general principle of the EU budgetary rules, according to which the same costs may not under any circumstances be financed from the EU budget twice.<sup>23</sup> In the event that one project is to be financed both by a loan from a JESSICA instrument and by a form of grant from the operational programme or other EU instrument, for example, it will thus be necessary, for the needs of preparing and assessing requests and related statements, to duly separate such supported actions or costs (for example, a loan will be granted for the construction of a university campus and a grant awarded for training employees, although under one broader project).

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<sup>19</sup> Article 46(1) of the Implementing Regulation.

<sup>20</sup> Article 46(3) of the Implementing Regulation.

<sup>21</sup> Reply to Question No 15 of the Note from 2008.

<sup>22</sup> Article 43(6) of the Implementing Regulation.

<sup>23</sup> Article 111 of Council Regulation (EC, EURATOM) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities, as amended.

### 3. Legal analysis (continued)

- **Cumulation of contributions from a greater number of operational programmes, mixed projects<sup>24</sup>**

The European Commission is of the opinion that it is possible to transfer contributions from a greater number of operational programmes to the same financial engineering instrument. This can concern programmes co-financed by either the European Regional Development Fund or the European Social Fund, where it is possible to make use of cross-financing of up to 10% or 15%, respectively.<sup>25</sup> In such case, however, the respective holding fund/urban development fund has to demonstrate sufficiently, especially through separate accounting, the separation of resources coming from the various operational programmes and, if applicable, other EU funds.

EC is also aware that projects into which urban development funds will invest can contain components that do not fulfil the conditions for assistance from structural fund resources. For this reason as well, the financial engineering instrument manager has to sufficiently demonstrate that the resources are separated and identified down to the final level of the project for the purpose of proving the eligibility of the costs in question.<sup>26</sup>

- **Use of returns on investment and interest, withdrawing resources from investments<sup>27</sup>**

As opposed to the classic method of using resources from EU funds where such resources are provided in the form of unrecoverable grants, these contributions are invested through the financial engineering instruments. The resources invested into urban development should thus be recovered or cumulated. According to the General Regulation, the pertinent bodies of the Member States in question use the resources recovered from the investment and the resources remaining after repayment of all guarantees again in favour of the urban development projects. The interest from payments from the operational programmes to the urban development funds/holding funds are used to invest in urban development projects. This means that the financial engineering instrument managers will not refund this interest to the Managing Authority (or the urban development fund/holding fund), but will invest them in accordance with the conditions of the respective funding agreement.

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<sup>24</sup> Point 1a) of the Note from 2007 pertaining to the application of Article 60(d) of the General Regulation and Article 15 of the Implementing Regulation.

<sup>25</sup> Reply to Question No 1 of the Note from 2008. The EC refers to cross-financing conditions set out in Article 34 of the General Regulation and Article 8 of Regulation (ES) No. 1080/2006 on the European Fund for Regional Development.

<sup>26</sup> Point B 3 of the Note from 2008. See also the Reply to Question No 13 of the Note from 2008.

<sup>27</sup> Article 78(7) of the General Regulation

### 3. Legal analysis (continued)

The requirement under the General Regulation that returns on investments be reused for the benefit of urban development projects should, according to the EC,<sup>28</sup> be interpreted to mean that returns on investments should, if possible, be reused in the region covered by the operational programme and, if possible, through the financial engineering instruments with a view to ensuring the further involvement of private resources and recycling of public funds. EU law does not stipulate that the further use of revenues from investments should be ensured by the Managing Authority from whose operational programmes the original resources had been allocated. The person who will be authorised and, at the same time, obliged to reuse the investment revenue should be stipulated by national law.<sup>29</sup>

Private contributions into operations or financial engineering instruments have to be paid out to the private investors. The returns on these private investments are thus not subject to the obligation that they be re-used in favour of urban development projects.<sup>30</sup>

Funding agreements concluded with the financial engineering instruments have to set out the procedure for withdrawing both resources from the financial engineering instruments and from contributions invested into projects. It will also be these funding agreements that will stipulate when and under what conditions the investment revenue has to be withdrawn from the financial engineering instruments and re-used in favour of urban development projects. The EC deems it logical that the revenue should not be withdrawn until the respective financial engineering instruments are wound up, so that these instruments have the maximum resources available to them while in existence.<sup>31</sup> The withdrawal of funds from the financial engineering instruments can occur essentially only after the end of one or more cycles of investment into urban development projects. Due to the requirement of sound financial management and to avoid irregularities in expenditure reporting (see below) and circumvention of the other rules for managing resources from EU funds, the EC recommends transferring the resources from the operational programmes to the financial engineering instruments with forethought and in stages, with a view to the anticipated actual investments.<sup>32</sup>

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<sup>28</sup> Points A 2 and A 3 of the Note from 2008.

<sup>29</sup> Reply to Question No 6.2 in the Note from 2008.

<sup>30</sup> Reply to Question No 6.4 in the Note from 2008.

<sup>31</sup> Reply to Question No 6.5 in the Note from 2008.

<sup>32</sup> Reply to Question No 10 in the Note from 2008.

### 3. Legal analysis (continued)

- **Preferential payment of returns for market investors<sup>33</sup>**

The Implementing Regulation allows for returns on investments to be preferentially paid out to market co-investors. Such returns can be provided up to the amount of the remuneration stipulated by the by-laws of the financial engineering instrument and then have to be divided proportionately between all co-financing partners or shareholders of the financial engineering instrument.

- **Eligibility of costs<sup>34</sup>**

It generally applies that expenditure on operations and the financial resources that fund these operations on top of the EU funds have to be documented in the statement of expenditure that serves as the basis for executing payments. In the case of the financial engineering instruments, expenditures are defined somewhat differently than for the award of grant and are assessed differently in two phases:

- (i) **Temporarily eligible expenditure**

In the first phase, all expenditure incurred on the creation of the financial engineering instrument (HF/UDF) or on contributions into them is deemed eligible. Thus, in the first phase, the statement of expenditure contains all such expenditure.

- (ii) **Final eligible expenditure**

In the second phase, upon the partial or final closure of the operational programme in question, the statement of expenditure is corrected to include only the sum of (i) all payments executed from the urban development funds to the pertinent projects, (ii) all amounts provided by or tied to the urban development funds for the reason of guarantees under the respective projects and (iii) eligible fund management costs.

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<sup>33</sup> Article 43(5) of the Implementing Regulation.

<sup>34</sup> Article 78(6) of the General Regulation

### 3. Legal analysis (continued)

- “Beneficiaries” and “operations”<sup>35</sup>

For the correct application of the general regime for managing resources from EU funds in connection with utilisation of the JESSICA financial instrument, it is necessary to be aware of the shift in understanding of the terms “beneficiary” and “operation”. According to notices from the EC, in the case of utilisation of the JESSICA instrument, “operation” is not the execution of the urban development projects themselves, but the creation of the financial engineering instrument (HF, UDF) or the transfer of resources into it and the subsequent investment of these resources in the urban development project. This investment will further lead to a fulfilment of the aim of the relevant operational programme priority axis. The “beneficiaries” are, according to the EC, the financial engineering instruments (HF, UDF) themselves, as these instruments are responsible for commencing and executing “operations” (i.e., investments into urban development projects). Thus, to put it simply, according to the EC, the *beneficiary means the fund* and the *operation means the investment* within the scope of the JESSICA financial instrument.

This view reflects in a clear way the rules that the General Regulation lays down in particular for reporting expenditure in connection with using financial engineering instruments (see above). We are of the opinion, however, that in and of itself it is not sufficient for the correct interpretation of the other relevant provisions of legal regulations and the other documents issued for managing resourcing from the EU, both at the level of the EU and at the level of the Czech Republic. It continues to apply that operations financed from the funds have to comply with EU law and the actions adopted on the basis thereof.<sup>36</sup> Implementation of the operational programmes continued to be the responsibility of the Member States at the appropriate territorial level.<sup>37</sup> The Managing Authorities are responsible for implementing the operational programmes in accordance with the principle of sound financial management. They are to ensure in particular that operations are selected for funding in accordance with the criteria applicable to the operational programme in question and that they comply with valid Community and Czech rules for the whole of their implementation period, to ensure that beneficiaries and other entities involved in executing the operations keep a separate accounting system or an adequate accounting code for all transactions relating to the operations, etc.<sup>38</sup> It also applies that the beneficiary is responsible for informing the public about the assistance it obtained through the funds through explanatory plaques and informing the entities taking part in the operation,<sup>39</sup> with other principles and responsibilities related to the management of contributions from EU funds applying to the same extent as well.

<sup>35</sup> Points 1a and 1b of the Note from 2007.

<sup>36</sup> Article 9 of the General Regulation.

<sup>37</sup> Article 12 of the General Regulation.

<sup>38</sup> Article 60 of the General Regulation.

<sup>39</sup> Article 8 of the Implementing Regulation.

### 3. Legal analysis (continued)

We believe that the pertinent EU regulations and related regulations and documents issued at the level of the Czech Republic will have to be interpreted with a view to the nature of the JESSICA instrument and not formulaically, i.e., that “beneficiaries” are always the financial engineering instruments and “operations” are the investments carried out by them. If, for the purpose of reporting expenditure under the operational programme, the project implementers’ costs under the JESSICA instrument are not monitored, this should not mean that the provision of the financial assistance (albeit recoverable) will not be conditioned by, for example, the requirement to adhere to EU and Czech legal regulations, demonstrate the use of the financial assistance for the urban development project in questions, and fulfil other relevant terms and conditions on the part of the project implementer.

- **In-kind contributions into financial engineering instruments<sup>40</sup>**

The General Regulation assumes that the financial engineering instruments will collect both resources from the operational programmes and resources from other entities, including in-kind contributions. Such in-kind contributions will be deemed expenditure for the creation of financial engineering instruments/for contributions into them.

The EC warns, however,<sup>41</sup> that the eligibility of expenditure in the form of in-kind contributions into financial engineering instruments are temporary, as upon the closure of the operational programme, it will be necessary to document that these contributions had in fact been invested in urban development projects and that all appropriate legal regulations have been adhered to, including the conditions that co-financing from the structural funds does not exceed overall (final) eligible expenditure after the value of all these in-kind contributions are deducted (see below).

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<sup>40</sup> Article 56 of the General Regulation.

<sup>41</sup> Reply to Question No 14 of the Note from 2008.

### 3. Legal analysis (continued)

- **Co-financing**

Resources from EU funds cover only part of the eligible costs of operating the operational programme in question.<sup>42</sup> With regard to the peculiarities of defining costs in connection with the use of financial engineering instruments, the General Regulation sets out some other principles for calculating the co-financing rate from EU funds. The General Regulation states that the co-financing rate is used for eligible expenditure incurred by the beneficiary.<sup>43</sup> According to the EC,<sup>44</sup> this rule needs to be interpreted in the way that the co-financing rate is used for the total amount that the urban development fund had in fact invested – or that is tied to the guarantee or paid out for the reason of the guarantee – or for the appropriate eligible fund management costs.<sup>45</sup>

Article 7(1) of Regulation No 1080/2006<sup>46</sup> states that a contribution from the European Regional Development Fund cannot be provided for the purchase of land if the amount exceeds 10% of the total eligible costs for the operation concerned. The EC warns that this limit also applies to operations in the form of establishing financial engineering instruments, transferring contributions into them, and carrying out the appropriate investments.<sup>47</sup>

As regards in-kind contributions to financial engineering instruments, co-financing from the structural funds should not exceed the overall eligible expenditure after subtracting the value of these in-kind contributions.<sup>48</sup>

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<sup>42</sup> According to Article 53 of the General Regulation and in connection to Chapter 12 of the National Strategic Referential Framework of the Czech Republic, contributions from the structural funds in the case of “convergence” goals” and “Regional Competitiveness and Employment” should cover 85% of eligible costs, with the remaining 15% being covered by Czech public sources.

<sup>43</sup> Article 78(6) of the General Regulation.

<sup>44</sup> The fact that the EC discusses the original wording of Article 78 of the General Regulation in the Note from 2007 in no way changes this.

<sup>45</sup> Point 2.4 of the Note from 2009. In this connection, attention should be called to the fact that the term “beneficiary”, for the purposes of reporting costs connected to the implementation of the operational programmes under the JESSICA initiative (holding fund/urban development fund), need not correspond to the term “aid beneficiary” from the point of view of the rules for the granting of public aid, as could be construed from the definition in Article 2(4) of the General Regulation. For more on this, see below.

<sup>46</sup> Regulation (EC) No 1080/2006 on the European Regional Development Fund

<sup>47</sup> In its reply to Question No 7 of the Note from 2008, the EC does not expressly state whether the 10 percent limit should be calculated from all investments made by the urban development fund or only from each of the various investments. From the context and purpose of the provision, however, it is apparent that the second option applies.

<sup>48</sup> To the method for stipulating the value of in-kind contributions, see Article 51 of the Implementing Regulation in particular.

### 3. Legal analysis (continued)

- **Business plans**<sup>49</sup>

The Implementing Regulation states that in the process of selecting financial engineering instruments by the respective Managing Authority or holding fund, these financial engineering instruments should submit their business plan or other appropriate document.<sup>50</sup>

After the amendment of the Implementing Regulation, however, the points that the business plans should contain are no longer specified.<sup>51</sup> In order to understand the purpose of this document, we nevertheless list these points in the way specified by the Implementing Regulation in force until 13 October 2009:

- (i) The targeted market for urban projects and the criteria, terms and conditions for financing them.
- (ii) The operational budget of the financial engineering instrument.
- (iii) The ownership of the financial engineering instrument.
- (iv) The co-financing partners or shareholders.
- (v) The by-laws of the financial engineering instrument.
- (vi) The provision of professionalism, competence and independence of the management.
- (vii) The justification for, and intended use of, the contributions from the structural funds.
- (viii) The policy of the financial engineering instruments concerning exit from investments in enterprises or urban projects.
- (ix) The winding-up provision of the financial engineering instruments, including the reutilisation of resources returned to the financial engineering instrument from investments or left over after all guarantees have been honoured, attributable to the contribution from the operational programme.

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<sup>49</sup> Article 43(3) of the Implementing Regulation.

<sup>50</sup> According to the Czech language version of the implementing regulation, the business plans should not be submitted until after the selection of the financial engineering instruments (“As soon Managing Authorities ... select an instrument...”). Based on a comparison with other language versions of the Implementing Regulation (English, French German) and on a logical interpretation, our conclusion is, however, that the business plans should be submitted during the selection process and not after it.

<sup>51</sup> The Implementing Regulation also does not stipulate that the Managing Authority has to assess or check the fulfilment of the business plans or that it is responsible for this assessment and control. In this respect, amendment No. 846/2009 led to a reduction in the severity of the requirements on the financial engineering instrument manager and the Managing Authorities. Nevertheless, we believe that these points of the business plan that had been specified by the Implementing Regulation until 2009 will usually be contained in funding agreements (see below) and that their fulfilment will have to be assessed and controlled by the Managing Authorities or holding funds as part of sound financial management of the resources from the EU funds.

### 3. Legal analysis (continued)

- **Funding agreements**<sup>52</sup>

A funding agreement setting out the arrangements for managing the resources from the operational programme in question through the financial engineering instrument for the Managing Authority should be concluded between the urban development fund and the Managing Authority of the operational programme in question. In the event of the involvement of a holding fund, the Managing Authority should conclude a funding agreement with this fund, and this holding fund should then conclude a funding agreement with the appropriate urban development fund.

The funding agreements concluded with holding funds should generally define the financing arrangements and objectives. These agreements should include these measures:

- (i) The terms and conditions for contributions from the operational programme to the holding fund.
- (ii) A call for expression of interest addressed to urban development funds.
- (iii) The appraisal, selection and accreditation of financial intermediaries or urban development funds by the holding fund.
- (iv) The setting up and monitoring of the investment policy or the targeted urban development plans and actions.
- (v) Reporting by the holding fund to Member States or Managing Authorities.
- (vi) Monitoring the implementation of investments.
- (vii) Audit requirements.
- (viii) The exit policy of the holding fund out of the financial engineering instruments.
- (ix) The winding-up provisions of the holding fund, including the reutilisation of resources returned to the financial engineering instrument from investments made or left over after all guarantees have been honoured.

In appropriate cases, the agreement should take into urban development studies or assessments as well as integrated urban development plans that are part of the operational programmes concerned.

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<sup>52</sup> Article 43(3) and Article 44 of the Implementing Regulation

### 3. Legal analysis (continued)

Funding agreements concluded with the urban development funds should include at least the following:

- (i) The terms and conditions for designating contributions from the operational programme for investment in this fund.
  - (ii) The investment strategy and planning.
  - (iii) Monitoring the implementation.
  - (iv) The exit policy for the contribution from the operational programme out of the urban development fund.
  - (v) The winding-up provisions for the urban development fund, including the reutilisation of the operational programme resources returned to the fund in question from investments or left over after all guarantees have been honoured.
- **Costs of managing the financial engineering instrument<sup>53</sup>**

The Implementing Regulation sets out the amount of the costs related to the management of the financial engineering instruments that will be deemed eligible. Higher costs will only be eligible based on the results of a public tender for the respective services.<sup>54</sup>

Management costs that are considered by the Implementing Regulation to be a priori eligible may not exceed, on a yearly average, 2% of the capital contributed from the operational programme to the holdings fund and 3% of the capital contributed from the operational programme or holding fund into the urban development fund. In our opinion, these limits of a priori eligible management costs may not be added together in the event of involvement of the HF. Even in the case of involvement of the HF, a priori eligible UDF management costs may amount to only 3% of contributed capital.

In this connection, the EC stresses<sup>55</sup> that the Managing Authorities should not approve such high management costs automatically, but to proceed according to the principles of sound financial management (see below even in relation to the application of the rules for State aid). The EC recommends that the Managing Authorities link the amount of the remuneration to the amounts that will actually be invested, thereby motivating the fund managers.

<sup>53</sup> Article 43(4) of the Implementing Regulation.

<sup>54</sup> EU law does not specify the services that constitute financial engineering instrument management, i.e., the services that fall under JESSICA resource management and that the financial engineering instrument may provide above the framework of such management (any legal advisory above the framework of JESSICA resource management and so on). We therefore believe the funding agreements need to define the services provided in the framework of JESSICA resource management and the services provided outside of this framework. The services provided outside of the framework of JESSICA resource management will a priori be subject to public procurement procedures just like other the services contracted by the contracting authority, even if JESSICA resource management is not contracted in this way (in the case of involvement of the EIB/EIF).

<sup>55</sup> Point 2c of the Note from 2007.

### 3. Legal analysis (continued)

The two/three percent limit should be calculated not only from resources from EU fund and other public resources allocated from the operational programme, but also from private resources under the condition that the appropriate priority axis is expressed by stipulating total eligible expenditure.<sup>56</sup> The remuneration for fund management can be paid out in unequal amounts, e.g., more in the beginning for the reason of high expected costs of executing the investment and less in later periods. Over the entire period until the closure of the operational programme, however, the specified limit has to be adhered to (unless higher costs are supported by the results of public procurement proceedings).

When it comes to eligibility of the costs of managing the financial engineering instrument, the EC provides examples of the types of costs that it had considered eligible in the past (staff costs, including travel expenses, the cost of offices equipment, IT systems, such costs being incurred in carrying out activities such as selection and tendering procedures, controls, monitoring and reporting, information and etc., or overhead costs of the financial institution managing the fund as a separate accounting entity). The eligibility rules pertaining to these costs are set out in more detail in the national cost eligibility rules.<sup>57</sup>

- **Major projects**<sup>58</sup>

The execution of major projects within the meaning of Article 39 of the General Regulation<sup>59</sup> is subject to special information requirements and approval by the Commission. The EC calls attention to the fact that urban development fund investments fulfilling the characteristics of major projects are subject to these procedures.

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<sup>56</sup> Which however is not the case in the Czech Republic – see Chapter 12 of the National Strategic Referential Framework of the Czech Republic.

<sup>57</sup> Reply to Question No 9 of the Note from 2008. It refers to Article 56(4) of the General Regulation.

<sup>58</sup> Point 2d of the Note from 2007.

<sup>59</sup> Operations constituting work, activities or services that are intended to help achieve an indivisible task of an exact business or technical nature, with clearly defined goals, whose total costs exceed EUR 25 million in the case of the environment and EUR 50 million in other areas.

### 3. Legal analysis (continued)

- **Measures against distortion of competition on the venture capital and lending markets<sup>60</sup>**

It ensues from the fundamental nature of the investments that the urban development funds should realise using resources from the operational programmes that these resources can be provided under terms and conditions that are more favourable than market conditions. For this reason, the Implementing Regulation demands that the Managing Authorities adopt preliminary measures to minimise distortion of economic competition on the venture capital and lending markets and on the private guarantee market. We believe that such measures will include ascertaining the actual conditions on these markets and only realising investments under more favourable conditions (loans bearing interest at rates that are lower than market rate, provision of loans also for projects that would otherwise not receive financing etc.) if market failure is identified (namely the impossibility of obtaining funding for the project on venture capital markets or private guarantees).

- **Document retention<sup>61</sup>**

The EC reiterates that even when using financial engineering instruments it is necessary to ensure that documents are retained in particular pursuant to Article 90 of the General Regulation and the rules related to the allocation of State aid. The scope of the documents that have to be retained will be determined by the conditions that will be applied to the utilisation of resources from the EU funds (and observance of which may be examined in the future). Generally then it is necessary to retain documents proving the realisation of the investment into the project implementer. The availability of expenditure documentation in the form of invoices for the purchase of goods or services or the execution of construction work by the project implementer will only be required if the provision of the investment is conditional on certain expenditure. From the point of view of the requirements of the General Regulation, the responsibility to ensure documents retention lies with the pertinent Managing Authority. It is assumed that the documents will be held by the respective financial engineering instrument for the purpose of any audits and not by the investment recipient. The retention of documents will be required of the investment recipient if the provision of the investment is conditioned on certain expenditure on goods, services or construction work (and the project implementer has to document that such expenditure had actually been made).

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<sup>60</sup> Article 43(7) of the Implementing Regulation

<sup>61</sup> Point 4 of the Note from 2007.

### 3. Legal analysis (continued)

- **Integrated urban development plans<sup>62</sup>**

According to Article 44 of the General Regulation, it is possible to use the JESSICA instrument assistance to assist only those projects included in the respective integrated sustainable urban development plan. In this connection, the EC reiterates that EU law does not define these sustainable urban development plans. These plans should thus be defined by the Member State and Managing Authorities in light of Article 8 of Act No. 1080/2006, within the meaning of Section 2.1 of the Community strategic guidelines on cohesion<sup>63</sup> and with regard to local conditions. The term integrated urban development plan (IUDP) is used further in the text hereof; nevertheless, what is meant is the definition specified in Section 44 of the General Regulation.

- **Revenue-generating projects<sup>64</sup>**

According to Article 55 of the General Regulation, eligible expenditure on revenue-generating projects should not exceed the value of the investment cost less the revenue from the investment. The regulation thus tries to limit assistance from EU funds to the lowest necessary extent with regard to the revenue that the subsidised project will generate in the future, and thus also protect the internal market from artificial interference.

The EC is of the opinion that these rules limiting the amount of possible assistance from EU funds shall not apply to the use of financial engineering instruments. The reason is either the presence of an element of State aid in the project in question<sup>65</sup> (the influence on the internal market will already be assessed during assessment for State aid) or the nature of use of the financial engineering instrument (urban development funds will principally invest in revenue-generating projects, which, however, should not cause unreasonable distortion of the internal market, as the returns on investment will be reutilised for urban development in accordance with the appropriate legal regulations).

In this connection, we would like to call attention to the fact that, in our opinion, the above approach will, nevertheless, apply to the allocation of aid to projects whose other parts will be the subject of investment from urban development funds (in this connection, see the section “Cumulation of aid for projects” above with regard to the need to keep separate records for parts of projects assisted in various forms from EU funds).

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<sup>62</sup> Point B 2 of the Note from 2008.

<sup>63</sup> Council Decision of 6 October 2006 on Community strategic guidelines on cohesion No 2006/702/EC.

<sup>64</sup> Point B 4 of the Note from 2008

<sup>65</sup> Article 55(6) of the General Regulation.

### 3. Legal analysis (continued)

- **Role of the EIB/EIF<sup>66</sup>**

In a number of places, the General Regulation stresses the coordination and procedural role of the European Investment Bank and the European Investment Fund as EU financial instruments established for the purpose of implementing cohesion policy. For the purposes of using financial engineering instruments, the General Regulation sets out in particular that the management of the holdings funds can be entrusted to the European Investment Bank or the European Investment Fund directly (unlike other subjects) without prior public procurement proceedings.<sup>67</sup> At this point it should be reiterated that the JESSICA financial instrument is a joint initiative of the EC, EIB and the European Development Bank of the Council of Europe and that the EIB has arranged for a number of feasibility studies on the JESSICA instrument from contributions from EC resources, thereby representing an important component in the gradual process of creating the best procedures and interpretations of legal regulations in connection with the implementation of the JESSICA in the EU.

- **State aid<sup>68</sup>**

The Implementing Regulation expressly mentions that contributions provided from operational programmes and other public sources in favour of financial engineering instruments are subject to guidelines on State as are investments made using these instruments.

Even the EC calls attention to this fact.<sup>69</sup> According to the EC, it is possible to identify two levels of implementation of financial engineering instruments where the guidelines for state aid can be applied:

- (i) **State aid for investment recipients**

The conditions under which urban development funds investment in projects have to be examined from the point of view of the conditions for awarding state aid and observe any prescribed procedures. Examining the presence of state aid elements will be necessary in those cases where the resources will be provided under advantageous interest terms.<sup>70</sup>

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<sup>66</sup> Preamble: points 1, 40, 41, 49 et seq., Articles 3, 9, 27, 31, 36, 37, 40, 41, 44, 45, 46, 64, 103 and 104.

<sup>67</sup> Article 44 of the General Regulation. For more detailed conditions for commissioning a holding fund manager, see the overview of the relevant provision of the Note from 2007 below.

<sup>68</sup> Point 26 of the Preamble to the Implementing Regulation.

<sup>69</sup> Point 3 of the Note from 2007 and points A 2 and B 1 of the Note from 2008. The EC refers to the Community Guidelines for State Aid to Promote Risk Capital Investments in Small and Medium-Sized Enterprises (2006/C 196/02). Since the adoption of the Note from 2007, Commission Regulation No. 800/2008 has also been adopted and, in this connection, should also be taken into consideration – see below for more details.

<sup>70</sup> Point B 1 of the Note from 2008.

### 3. Legal analysis (continued)

#### (ii) State aid for fund managers

If the remuneration for financial engineering instruments managers ceased to correspond with market remuneration, this remuneration, regardless of the two/three percent limit stipulated in the Implementing Regulations, would represent State aid and would required the observance of the respective procedures.

The EC calls attention to Article 43(7) of the Implementing Regulation, under which the Managing Authorities shall take precautions to minimise distortion of competition in the venture capital or lending markets. This aspect will be relevant in assessing the compliance of State aid with Community law.

- **Public contracts**

As mentioned above, the Managing Authorities have to ensure the observance of public procurement procedures there where it is required by valid law. In its Note from 2008,<sup>71</sup> the EC calls attention to the fact that these procedures may have to be observed even in connection with the selection of private co-investors for the holding fund/urban development funds.

#### 3.1.2. JESSICA – Czech legal regulations and documents

Neither binding legal regulations nor the methodological documents issued on the level of the Czech Republic factually reflect the possibility to make use of financial engineering instruments, including the JESSICA instrument.<sup>72</sup> This fact in itself does not represent a legal obstacle to using this instrument. The general regime for managing resources from EU funds (setting up the structure of operational programmes and their bodies, financial flows, expenditure certification, resolution of irregularities etc.) is regulated by directly applicable EU regulations and generally binding legal regulations and the appropriate methodological documents of the Czech Republic. The JESSICA instrument has to be applied within this general management regime, thus also using procedures that have also already been tested in practice to a certain degree.

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<sup>71</sup> Reply to Question No 2.3 in the Note from 2008.

<sup>72</sup> An exception is the Financial Flows Procedure, which mentions the possibility of using financing engineering instruments in point 4.3 (page 46 and 47), although it fails to cover all relevant aspects of financial flows in connection with this type of management of resources from EU funds.

### 3. Legal analysis (continued)

The differences as opposed to the general regime that will arise in connection with managing resources from EU funds under the JESSICA instrument ensue from directly applicable EU legal regulations. As mentioned above, Czech legal regulations do not expressly reflect or prohibit the use of the JESSICA financial instrument. The lack of detailed rules for using the JESSICA instrument in the Czech Republic means an increase in the burden on stakeholders (first and foremost on the Managing Authorities) in connection with the management of EU resources. These entities shall apply legal regulations and methodological documents pertaining to the general management regime applicable to resources from EU funds (budgetary rules, methodological documents, etc.) *mutatis mutandis*, i.e., commensurately, with regard to the specifics of this instrument and the specific method of its implementation. For this reason, generally binding Czech legal regulations and the methodological documents connected to them should be amended to include the express possibility to make use of the JESSICA instrument, namely in connection with these provisions where the *mutatis mutandis* application of the general regime for managing resources from EU funds can result in interpretational problems (see especially “Inadequacies of the rules for implementing the JESSICA financial instruments in the Czech Republic”).

This part of the analysis is devoted to the provisions of certain legal regulations and documents that we consider to be relevant from the point of view of implementation of the JESSICA financial instrument in the Czech Republic.

- **Forms of financial engineering instruments**

Act No. 513/1991 Coll., the Commercial Code, as amended	“ <b>Commercial Code</b> ”
Act No. 189/2004 Coll., on Collective Investment, as amended	“ <b>Collective Investment Act</b> ”
Act No. 211/2000 Coll., on the State Housing Development Fund, as amended	
Act No. 388/1991 Coll., on the State Environmental Fund of the Czech Republic, as amended	
Act No. 219/2000 Coll., on the Property of the Czech Republic and the Representation of the Czech Republic in Legal Relations, as amended	

Just like the other aspects of the JESSICA instrument, EU law addresses the issue of the form of financial engineering instruments (HF, UDF) in a very general way only. It is therefore up to the Member States (and specifically the Managing Authorities) to choose such methods of implementation that will satisfy the EU and Member State regulations and, at the same time, ensure that rules are in place to ensure the proper functioning of these instruments.

### 3. Legal analysis (continued)

According to EU law, both the HF and UDF can be legal persons or separate financial (accounting) units within existing financial institutions. EU law does not stipulate whether the resources allocated from the operational programme should pass into the ownership of the pertinent financial engineering instrument. The form of the allocated resources, the terms of such allocation and even the transfer of these resources back again have to be specified in the respective funding agreement and can differ from one operational programme to the next.

One of the objectives of the JESSICA instrument is to include the know-how of private investors and investment managers and advisors in managing resources from EU funds. Financial engineering instruments should identify projects for the Managing Authorities that are not only suitable for the integrated urban development plans but where a return on investment can be expected, i.e., a source of financing for the other urban development projects by public entities (namely for the period 2014+, where low contributions from EU funds are expected). These instruments should, for the appropriate remuneration, realise the investments in question, monitor them, and, in the end, ensure the recovery of the returns or ensure the early withdrawal of the resources from the investment.

EU law does not expressly state that the financial engineering instruments have to be established for the purpose of doing business, nor does it prohibit these instruments from outsourcing certain activities tied to the management of JESSICA resources to third parties. We base our analysis of the possible legal forms of financial engineering instruments on our understanding of the objectives of the JESSICA financial instrument, with one of the main ones being the incorporation of the know-how of private investment advisors in the management of resources from EU funds. At the same time, the requirement of sound financial management and transparency with respect to the management of resources from EU funds continues to apply.

Thus, if the financial engineering instrument (HF) is not a public financial institution, we assume that the financial engineering instruments will undertake the activity in question for business purposes. Legal forms such as public benefit organisations apparently cannot be precluded simply for the reason of statutory requirements, but their involvement is unlikely for the above reasons.<sup>73</sup>

With regard to the above and based on statutory rules in relation to the form of the financial engineering instruments, we believe that, in connection with the implementation of the JESSICA financial instrument in the Czech Republic, it will be possible to make use of the following forms of financial engineering instruments (HF and UDF):

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<sup>73</sup> In the case of the HF-public services provider, the returns on investment will, for the purpose of urban development, be reutilised by this entity, i.e., not by the Managing Authority-customer of the service. The HF-public service provider will not be established for business purposes, but for the purpose of providing a certain public service. Just like a professional investment manager, it will have the necessary know-how and facilities for the proper management of JESSICA/JESSICA resources.

### 3. Legal analysis (continued)

#### (i) Separate financial units

Financial engineering instruments can exist as separate financial (accounting) units within an existing financial institution. We believe that commercial banks and financial-type public entities can be included under the term financial institution. In our opinion, the EIB, EIF, Českomoravská záruční a rozvojová banka (Czech-Moravian Guarantee and Development Bank), Státní fond rozvoje bydlení (State Housing Development Fund) or Státní fond životního prostředí České republiky (State Environmental Fund of the Czech Republic) fall into this category.

It will be up to the appropriate financial institutions and Managing Authorities to assess whether these financial institutions are able to manage resources under the JESSICA instrument for the Managing Authorities (compliance with statutes and other internal documents and procedures) and have the necessary personnel and expertise. In the event of the involvement of these public financial institutions, it cannot be precluded that they will not be service providers for the Managing Authorities but public services providers instead (see above regarding the selection of a holding fund).

In our opinion, EU law does not stipulate the restriction that resources entrusted under the JESSICA instrument to a financial engineering instrument-separate financial unit have to be continuously held by the financial institution in question. It is will thus not be out of the question for a financial engineering instrument-separate financial unit to give the funds entrusted to them to a different financial institution for management, e.g., a commercial bank, to appreciate the funds prior to their investment in urban development projects.

#### (ii) Legal persons

Financial engineering instruments can exist as independent legal entities governed by agreements between co-financing partners or shareholders. In our opinion, the demands of EU legal regulations are fulfilled by capital companies established under the Commercial Code and doing business in the following unregulated trades: No. 60 (provision of advisory and consulting services, elaboration of expert studies and opinions) and No. 70 (provision of services in the area of administrative management and services of a business and organisational nature). The choice of these two forms will depend in particular on the extent of the expected involvement of other investors.

### 3. Legal analysis (continued)

The more such investors there are and the greater the expectation of their fluctuation, the greater the benefits of a joint-stock company. The benefit of an s.r.o. (limited liability company) and a.s. (joint stock company) is that these forms do not require many founders. Thus, there need only be one founder (e.g., a regional council, municipality or region). In the event that a financial engineering instrument is established by a Managing Authority-Ministry, only the form of a joint-stock company can be considered.<sup>74</sup>

Financial engineering instruments-s.r.o./a.s. do not have to be “funds” within the meaning of the Act on Collective Investment. They will be subject to the regime of this legislation only if they fulfil the conditions for the application of this special regulation, i.e., if they collect financial resources for the purpose of their collective investment within the meaning of the Act on Collective Investment. As is stipulated in the terminological note at the beginning hereof, however, this cumulation of resources for the purpose of their investment within the meaning of the Act on Collective Investment is not a characteristic of the JESSICA financial engineering instrument.

The JESSICA financial engineering instruments will first of all be the managers of funds contributed from the operational programme in question for the Managing Authority. Their further activities, ownership structure and ambitions will then be determined by their form and the regulatory framework in which they will operate.

In our opinion, the financial engineering instruments will thus also be able to have the form of a special qualified investor fund under Section 56 of the Act on Collective Investment. The advantage of this form is the focus on collecting qualified investors' contributions that would finally be invested in the respective urban development projects.<sup>75</sup> The disadvantage of this form is the complexity of the regulatory framework and related higher management costs (necessity for a permit from the Czech National Bank, setting of a minimum value of the initial investment, the obligatory involvement of a depositary, and so on).

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<sup>74</sup> See the express restriction in Section 28 of Act No. 219/2000, Coll.

<sup>75</sup> An additional benefit is the various tax allowances.

### 3. Legal analysis (continued)

In our opinion, management of JESSICA resources need not be the only activity of the financial engineering instrument-legal person, nor does a new entity have to be established for this purpose. The effect that any other activities of the financial engineering instrument on the management of the entrusted funds should be one of the aspects that should be taken into consideration by the Managing Authorities when deciding on using such an entity for the provision of such services.

The financial engineering instrument can be established by the Managing Authority directly, the Managing Authority can be a co-owner of this instrument (“equity model”), or it can make use of the services of an existing instrument for the appropriate remuneration (“non-equity model”).<sup>76</sup>

- **Involvement of regional councils, municipalities and regions**

Act No. 248/2000 Coll., on Support for Regional Development, as amended	“ <b>Act on Support for Regional Development</b> ”
Act No. 128/2000 Coll., on Municipalities, as amended	“ <b>Municipalities Act</b> ”
Act No. 129/2000 Coll., on Regions, as amended	“ <b>Regions Act</b> ”
Act No. 250/2000 Coll., on Budgetary Rules of Regional Budgets, as amended	“ <b>Municipal Budgetary Rules</b> ”

#### (i) **Regional councils**

Regional councils were established by the Act on Regional Development Support as legal persons under public law undertaking the management the Czech Republic’s economic and social cohesion policy within the respective cohesion regions.<sup>77</sup> The regional councils are the Managing Authorities of the respective regional operational programmes; therefore, it is in their remit to use the JESSICA instrument while observing of the appropriate legal regulations and rules of other relevant EU and Czech documents. As the financial engineering instruments to be used should have the form of a legal person, we believe that the regional councils are authorised to (co-)found these financial engineering instruments, with the costs of the creation of such instruments being deemed temporarily eligible costs (see above).<sup>78</sup>

<sup>76</sup> With respect to the non-equity model, a certain level of examination of the difference between the two possible forms of financial engineering instruments will occur, because like instruments-separate financial units, even with respect to these non-equity instruments, allocation of the JESSICA resources and their management will occur separately from the instruments’ other activities.

<sup>77</sup> Section 16 of the Act on Support for Regional Development.

<sup>78</sup> We believe that attention should be called to the fact the regional councils as well as legal persons under public law have limited rights and responsibilities. Their right to establish financial management instruments-legal persons in connection with use of the JESSICA instruments ensues from the above-described compliance of this step with the purpose for which they were established. This right should however not be generalised. The right of the regional councils to establish any other legal persons outside the use of the JESSICA instrument will

### 3. Legal analysis (continued)

Finally, regional councils could also be those bodies of the Czech Republic that should reutilise returns on investments made by the financial engineering instruments in the framework of regional operational programmes for the benefit of urban development projects.<sup>79</sup>

#### (ii) Regions and municipalities

In connection with the implementation of the JESSICA instrument, the regions and municipalities should play a key role, as one of the purposes of this instrument and the move away from unrecoverable aid to recoverable investment is to motivate the local authorities to select sustainable development projects and increase the responsibility of all stakeholders to have projects executed successfully. The regions and municipalities can be the first in the line of beneficiaries of the financial assistance provided from the JESSICA instrument in compliance with the Municipal Budgetary Rules<sup>80</sup> and the Act on Support for Regional Development.<sup>81</sup> Both the regions and the municipalities can also establish legal persons that will be the final beneficiaries of the financial assistance from the JESSICA instrument.<sup>82</sup>

Both the regions and the municipalities can also (co-)found the financial engineering instruments-legal persons and thereby share the management of the resources from the operational programmes.<sup>83</sup> Finally, both the regions and municipalities can provide guarantees to the urban development funds for the payables of the beneficiaries of the financial assistance from the JESSICA instrument.<sup>84</sup>

Both the regions and the municipalities can include co-financing from their own budgetary resources under the JESSICA instrument both on the level of the financial engineering instruments or on the level of the projects themselves.

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have to be assessed very carefully with regard to compliance with the purpose for which the regional councils were established. For more on the theory of limited rights and responsibilities see, for example Hendrych, D. et al. *Administrative Law*. General part. 6<sup>th</sup> edition. Prague: C.H.Beck, 2006, pg 106 et seq. Further see Jehlička, O., Švestka, J. Škárková, M. et al. *Civil Code. Commentary*. 9<sup>th</sup> edition. Prague: C.H.Beck, 2004, pg 155.

<sup>79</sup> Article 78 of the General Regulation. As stated below, we recommend expressly specifying such bodies in the respective methodological documents of the Czech Republic. If such bodies are not expressly specified, we believe that the returns on investment under the regional operational programmes should continue to be used by the regional councils or their legal successors.

<sup>80</sup> Section 7(3) and Section 8(3) of the Municipal Budgetary Rules.

<sup>81</sup> Section 7(4) of the Act on Support for Regional Development.

<sup>82</sup> Section 35a(1) of the Municipalities Act; Section 14(3) of the Regions Act.

<sup>83</sup> Unlike the ministries, the regions and municipalities will be able to establish financial engineering instruments in the form of both a.s. and s.r.o. in compliance with Section 23 of the Act on Support for Regional Development, Section 35a of the Municipalities Act and Section 14 of the Regions Act.

<sup>84</sup> Section 38(3)( a) of the Municipalities Act; Section 17(3)( a) of the Regions Act.

### 3. Legal analysis (continued)

- Management of resources from EU funds (deviations from the general regime)

Act No. 218/2000 Coll., on Budgetary Rules, as amended	<b>“State Budgetary Rules”</b>
Act No. 250/2000 Coll., on Budgetary Rules of Regional Budgets, as amended	<b>“Municipal Budgetary Rules”</b>
Act No. 320/2001 Coll., on Financial Control in Public Administration, as amended	<b>“Financial Control Act”</b>
Decree No. 416/2004 Coll., implementing the Act on Financial Control in Public Administration	
Decree No. 52/2008 Coll., which lays down the principles and terms of financial settlement of relations with state budget	
Decree. 560/2006 Coll., on the involvement of the State budget on financing the renewal of estate, as amended	
Methodology for financial flows and control of programmes co-financed by the structural funds, Cohesion Fund, and European Fisheries Fund for the 2007-2013 programming period	<b>“Financial Flow Methodology”</b>
Methodological handbook of eligible costs for programmes co-financed by the structural funds and Cohesion Fund for the 2007-2013 programming period	<b>“Methodology of Eligible Costs”</b>
Methodology for the certification of costs for the 2007-2013 programming – in force from 1 September 2007	<b>“Cost Certification Methodology”</b>
COCOF working document to simplify expenditure reporting (January 2010)	
Guidelines for cross-financing for the 2007-2013 programming period 2007 – 2013	<b>“Cross-Financing Guidelines”</b>
Methodology for monitoring SF and CF programmes in the 2007-2013 programming period	
Framework methodology for managing calls for proposals	<b>“Methodology for Managing Calls for Proposals”</b>
Methodological recommendations for managing calls for proposals	
Methodological guideline Irregularities – October 2009 version	
Methodological recommendation of the NCA: Rule n+3/n+2 in the 2007 – 2013 programming period	
Methodological Guideline of the MfRD to the main principles for the preparation, assessment and approval of the IUDP (based on Resolution No. 833 of the Government of the Czech Republic of 13 August 2007)	

### 3. Legal analysis (continued)

Methodological manual for revenue-generating projects	<b>“Methodology for revenue-generating projects”</b>
Methodological guideline for document retention in the 2007-2013 programming period	<b>“Document retention methodology”</b>
Methodology for communicating execution of EU funds in the 2007-2013 programming period (transparency, coordination and management of communication): Methodology for creating and executing the Communication Action Plan for OP	<b>“Communication Methodology”</b>
Recommended guidelines for reviewing 2007-2013 operational programmes	<b>“Operational Programme Review Methodology”</b>
2007–2013 National Strategic Reference Framework of the Czech Republic	
Documents of the relevant operational programmes	

The JESSICA instrument represents a relatively new regime for the management of resources from EU funds, which has a special standing within the general management regime pertaining to these resources. This instrument is intentionally worded broadly to allow a number of implementation options according to the needs and interests of the stakeholders.<sup>85</sup> In the future, amendments can be expected in the relevant legal regulations on the EU level.<sup>86</sup>

For these reasons, we believe that not even on the level of the EU or the Czech Republic will it be possible to create rules for utilising the JESSICA instrument in the same exhaustive way as in the case of the rules for the general regime for managing resources from EU funds. The basic approach in connection with the utilisation of the JESSICA financial instrument should be the application of existing relevant Community and Czech legal regulations and documents *mutatis mutandis* upon the application of special rules for the JESSICA instrument. In connection with the *mutatis mutandis* application of the rules of the general regime for managing resources from EU funds, it is necessary to ensure in particular the observance of the existing basic general principles of such management.<sup>87</sup>

<sup>85</sup> Namely the Managing Authorities, regions and municipalities, private investors, professional investment managers and project implementers.

<sup>86</sup> See the draft amendment to the General Regulation mentioned above. It is expected that efforts will be made to clarify and ease the rules for the purpose of faster implementation of the JESSICA instruments and other financial engineering instruments in the Member States.

<sup>87</sup> In particular ensuring observance of Community and national legislation, sound financial management, focus to fulfil the relevant objectives, and sharing management responsibility between the Commission and the Member States.

### 3. Legal analysis (continued)

As mentioned above, the entities involved in the management of resources from EU funds will, due to the non-existence of express rules for utilising the JESSICA instrument, apply existing legal regulations and methodological documents *mutatis mutandis* to the nature of this instrument. Below we list some of the expected deviations from the application of the general management regime pertaining to these resources:

#### (i) Beneficiaries and operations

As had already been mentioned above, a factual “multiplication” of the number of entities that can be deemed “beneficiaries” and the activities that will represent “operations” occurs in connection with the implementation of the JESSICA instrument. It will thus be necessary to apply the obligations that legal regulations and other documents attach to the “beneficiaries” *mutatis mutandis* to the financial engineering instruments (HF and UDF) and the project implementer. Similar “operations” will have to be commensurately understood as the transfer of resources from the financial engineering instruments as well as the realisation of investments and execution of the projects in question.

For example, the provisions on the beneficiary’s obligation to prepare a financial plan for his project have to be applied *mutatis mutandis* to draft business plans pertaining to the financing engineering instruments for the purpose of their selection and, in the case of project executors, to the draft project plan for the purpose of acquiring investments based on the respective urban development fund’s call for proposals.<sup>88</sup> Business plans should be part of funding agreements concluded with the financial engineering instruments, and the project plan should be part of agreements pertaining to the realisation of the investment (such as loan agreements).<sup>89</sup> These plans and agreements should be mutually consistent (the conditions of the funding agreement with the HF have to be reflected in the funding agreement with the UDF etc.).

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<sup>88</sup> In our opinion, even those projects that should be invested in need to be chosen in such a way to correspond to the conditions of the operational programme from which the respective JESSICA resources were set aside. See also point 6.2.3 below (business and investment plans of the financial engineering instruments have to be in compliance with the conditions of the respective operational programme and respect IUDP conditions).

<sup>89</sup> Financial Flows Methodology, Chapter 3.1, page 18.

### 3. Legal analysis (continued)

In accordance with Article 60 of the General Regulation, the Managing Authority will continue to be obliged to ensure that the financing operations will be selected based on criteria approved for the operational programme in question and remain in compliance with EU and national legislation for the entire implementation period. These obligations will be fulfilled by the Managing Authority in cascading manner through the financial engineering instruments and on all levels of such cascade. The instruments that are used for calls for aid applications<sup>90</sup> and that should help the Managing Authorities identify the beneficiary that fulfils the given criteria will thus be applied *mutatis mutandis* to the process of selecting the financial engineering instruments and the project implementers. The rules pertaining to the calls for applications that will lead to the realisation of each implementation level of the cascade (the Managing Authority for the purpose of selecting the HF, the HF for the purpose of selecting the UDF, and the UDF for the purpose of selecting the project implementer) will again have to be mutually consistent.

It will further be necessary to ensure the *mutatis mutandis* application of, for example, the requirements regarding publicity and approval of major projects (or investments).<sup>91</sup> If the pertinent provisions of the General Regulation and Implementing Regulation are not amended, the project implementer will, for example, be obliged to inform the public and entities involved in the operations about the investment that it received from the resources of the EU funds.<sup>92</sup> These obligations should be specified in the pertinent funding agreement to avoid disputes about the appropriate interpretation of the provisions on the general regime for managing resources from EU funds.

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<sup>90</sup> Methodology for the Management of Calls for Proposals, Article II, Page 3.

<sup>91</sup> Under the current wording of Article 57 of the General Regulation, it would be necessary to ensure the observance of the condition of durability of operations even in connection with the utilisation of the JESSICA instrument. The draft amendment of the General Regulation COM(2009) 384 final changes Article 57 of the General Regulation in such a way that it applies only to the activities set out Articles 3(2)(a) and (b) of Regulation No 1080/2006 and thus not to the creation and development of the urban development fund (UDF). If the amendment of the General Regulation is adopted in this wording, the investments made by the urban development funds will not be conditioned on adherence to the conditions of durability of operations.

<sup>92</sup> Article 8 of the Implementing Regulation, Communication Methodology

### 3. Legal analysis (continued)

#### (ii) Financial flows

The Financial Flow Methodology deals with the situation where an intermediary body within the meaning of Article 59 of the General Regulation will be included in the implementation structure to further distribute the resources.<sup>93</sup> These principles will have to be applied mutatis mutandis to the financial flows between the Managing Authority and the HF, between the HF and UDF, and between the UDF and the project implementer, which can be deemed to be the main parties to the financial flows process. The conditions for awarding grants to the Managing Authority should thus be further reflected in the funding agreement concluded between the Managing Authority and the first beneficiary (the HF, if there is one), including the obligation of this beneficiary to bind beneficiaries on lower levels to the same obligations stipulated in the funding agreement.

Like in the general regime for the management of resources from EU funds, it will be necessary in connection with the utilisation of the JESSICA instruments to observe first and foremost the State Budgetary Rules (in connection with the utilisation of the JESSICA instruments by the thematic operational programmes) or the Municipal Budgetary Rules (in connection with the utilisation of the JESSICA instruments by regional operational programmes).

In the general regime of management of resources from EU funds, the award of grants to Managing Authorities occurs in the form of decisions/agreements to award grants.<sup>94</sup> In connection with the utilisation of the JESSICA instrument, funding agreements should be concluded between the Managing Authority and financial engineering instruments. We believe that based on this mutatis mutandis application of the Financial Flows Methodology and the respective generally binding legal regulations, namely the budgetary rules, these agreements in the Czech Republic will in fact be composed of (i) agreements on the provision of services for the purpose of managing JESSICA resources as public contracts and (ii) decisions/agreements to award grants in relation to the resources that should be invested by the financial engineering instrument and that the Managing Authority has to provide it for this purpose.<sup>95</sup>

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<sup>93</sup> Financial Flow Methodology, Page 36, Chapter 3.12, point 18.

<sup>94</sup> Financial Flows Methodology, Chapters 3.12 and 3.13, pages 35 et seq.

<sup>95</sup> By reason of (i) the agreement on the provision of services, the Managing Authority will pay to the financial engineering instrument a two- or three-percent remuneration for the provision of management services (or the remuneration that was the result of the selection procedure for the public contract suppliers), and by reason of (ii) the decision/agreement to award a grant (included in the funding agreement as one of the conditions for the provision of management services), the Managing Authority will transfer to the financial engineering instrument resources from the operational programme that should be invested by the instrument (i.e., in connection with the absence of a holding fund, e.g., 97% of the resources set aside from the operation programmes). In case of doubt from the point of view of observance of formal requirements, namely the State Budgetary Rules, it is not possible to preclude the possibility that the funding agreement will contain only provisions according to point (i) above (conditions for the provision of JESSICA services), with the force of this agreement being conditional on or otherwise tied to the award of the grant (see point (ii) above). We believe that in the case of the application of the

### 3. Legal analysis (continued)

Funding agreements concluded between the HF and UDF will then represent the agreement on the provision of the pertinent management services, with one of the conditions for the provision of these services being the transfer of the respective resources for the realisation of investments.

#### (iii) Co-financing

Based on Article 53 of the General Regulation and in accordance with the wording of the National Strategic Referential Framework of the Czech Republic, contributions from the European Regional Development Funds are limited to 85% of the total volume of public contributions. This co-financing rate pertains to operations of the respective operational programmes, even though its observance is monitored at the level of the priority axes.

In accordance with the Note from 2007, operations in the case of utilisation of the JESSICA instrument consist of both contributions from the operational programme into the HF and UDF and the subsequent UDF investments. We thus believe that, for the purposes of monitoring the observance of the above co-financing rate, all Czech public expenditure at the various levels of implementation of the JESSICA instruments (investments by the regions into UDF etc.) will be calculated into the volume of Czech public expenditure. It will be necessary to interpret the respective methodologies, namely the Financial Flows Methodology, in this way.

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Municipal Budgetary Rules (regional operations programmes) there is no reason for this option. In the case of the involvement of the EIB/EIF, as the holding fund managers, the respective funding agreement will incorporate conditions for the provision of management services even though these were not the results of public procurement proceedings – see “Selection of the holding fund” above. In the case of the provision of an unrecoverable contribution to the public service provider, the funding agreement will comprise only the decision/agreement to award a grant like in the case of the general regime for managing resources from the EU funds.

### 3. Legal analysis (continued)

#### (iv) Eligible expenditure and certification

The Managing Authority is responsible for the quality and completeness of the certification data and is responsible for checking their correctness before the certification and arrange for any corrections. The conditions for carrying out the certification include not only verification of the expenditure statements but also verification of observance of EU and Czech legislation and the proper functioning of the management and controlling system on all implementation levels.<sup>96</sup> In connection with the utilisation of the JESSICA instrument, the Managing Authority will be subject to higher certification demands as a result of the greater number of beneficiaries and separation of the eligible cost regime (temporary eligible costs and final eligible costs – see above). It is up to the Managing Authority to ensure that the respective costs are properly documented (in connection with the creation of the funds or transfer of resources from the operational programme to it and in connection with the realisation of investments)<sup>97</sup> and that the relevant transactions are readily differentiable in the books kept by the beneficiaries (HF, UDF, and the project implementer) from other accounting transactions (this will be one of the conditions of the funding agreements and the investment agreement).

#### (v) Document retention

Document Retention Methodology lays down the conditions for storing documents at all levels of implementation of projects financed by EU funds. The methodology allows Managing Authorities to impose the obligation on beneficiaries to store documents or to commit an intermediary body to do this.<sup>98</sup> The methodology recommends that beneficiaries observe Czech legal regulations pertaining to document retention (namely Act No. 499/2004 Coll., on Archiving and Document Services, as amended) or to apply these regulations to the beneficiaries *mutatis mutandis*.<sup>99</sup> It will be necessary to apply these principles *mutatis mutandis* in connection with the conclusion of the funding agreement and investment agreement in the framework of implementation of the JESSICA instrument even on foreign financial engineering instruments or project implementers.

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<sup>96</sup> Cost Certification Methodology, Chapter 2.1, page 5.

<sup>97</sup> Eligible Costs Methodology, Chapter 4.1.1., page 91.

<sup>98</sup> Document Retention Methodology, Chapter 3.7.1., page 27.

<sup>99</sup> Document Retention Methodology, Chapter 5.1., page 35.

### 3. Legal analysis (continued)

#### (vi) Resource management outside the Czech Republic

JESSICA financial engineering instruments need not be separate financial units of Czech (branches of) financial institutions or legal persons with their seat in the Czech Republic. In fact, limiting the financial engineering instruments to Czech entities would clearly be in violation of the non-discrimination principle (be it generally laid down in primary Community law or in public procurement rules).

In this connection, the question arose in practice as to how to apply, in connection with the JESSICA instrument, Section 33(7) of the State Budgetary Rules, which states that the State treasury resources may not be placed outside accounts subordinated to the State treasury.

We believe that the resources paid out to the regional councils for management as part of their operational programmes are no longer part of State treasury funds within the meaning of Section 3(h) of the State Budgetary Rules and, thus, can be deposited, for example, with financial institutions outside of the Czech Republic.

The resources entrusted to the Managing Authorities—ministries for management would be subject to the above restriction based on a purely semantic interpretation of the provisions in question. In our opinion, however, such interpretation would again be incorrect. The requirement that JESSICA resources be managed for the Managing Authorities—ministries exclusively on the accounts of Czech (branches of) banks appears to be in violation of the principle of non-discrimination on the internal market<sup>100</sup> and the principle of the indirect force of EU law.<sup>101</sup> This requirement would force JESSICA resource managers from other Member States to manage the entrusted resources on accounts maintained exclusively at Czech (branches of) banks, and the reasons for the introduction of this restriction appears hardly proportionate to restrictions caused on the EU’s internal market.

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<sup>100</sup> As defined in Article 56 et seq. and Article 63 et seq. of the Treaty on the Functioning of the European Union, Directive 2006/123/EC on services in the internal market and implemented for example by Act No. 222/2009 Coll., on the Free Movement of Services.

<sup>101</sup> As regards to the doctrine of the indirect force of EU law (formerly Community law), see the judgement of the Court of Justice of the European Union (formerly the Court of Justice of the European Community) in case Van Colsonová, C-14/83, and related rulings of the Court of Justice, namely the pro-integration decision in case Seda Küçükdeveci, C-555/07. Also see, for example, the explanation of the doctrine on [http://www.landwellglobal.com/images/cz/cze/cz\\_download/hi\\_cz\\_cze\\_moniteur20054.pdf](http://www.landwellglobal.com/images/cz/cze/cz_download/hi_cz_cze_moniteur20054.pdf)

### 3. Legal analysis (continued)

The conclusion that the above restriction would apply to the EIB (or the EIF, which is owned by the EIB), as the holding fund managers, seems entirely absurd. As mentioned above, the EIB is the EU body authorised to implement cohesion policies – the policies executed jointly by the EU and the Member States.<sup>102</sup> The EIB is, however, not only subject to policy control by the Czech Republic, but also to this country’s financial influence, as the Czech Republic is one of its shareholders. For this reason, it appears to us entirely at variance with the logic behind the relationship between the Czech Republic and the EIB (and to the obligation of the Czech Republic to be loyal to the EU) that the EIB, for the purpose of managing JESSICA resources (resources from EU funds and Czech public resources), would have to establish a branch in the Czech Republic or set up an account at one of the Czech (branches of) banks and manage the resources from it for the Czech Managing Authorities.

#### (vii) Revenue-generating projects<sup>103</sup>

As mentioned above, the special mechanism of Article 55 of the General Regulation for calculating the amount of grants for revenue-generating projects does not apply to investments under the JESSICA instrument. For the sake of certainty, we reiterate that the Managing Authority will be obliged to continue applying this mechanism if unrecoverable grants are awarded to the respective project or its part (if the respective project is not subject to State aid rules).

#### (viii) Revision of operational programmes

It should also be reiterated here that the JESSICA instrument is only a special regime for the management of resources allocated for management under the operational programme concerned. Like the awarding of grants, even the investments realised using these resources have to fulfil the terms and conditions laid down by the respective operational programmes. In the event that programme documents contain conditions that will not be compatible with the JESSICA instrument or will be slowed down by it, it will be appropriate to make use of the possibility to conduct a revision of the operational programme in compliance with Article 33 of the General Regulation and the procedures for revision of operational programmes.<sup>104</sup>

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<sup>102</sup> See Article 4 of the Treaty on the Functioning of the European Union.

<sup>103</sup> Methodology for Revenue Generating Projects.

<sup>104</sup> The proposed amendment of Article 48 of the General Regulation should facilitate this process.

### 3. Legal analysis (continued)

#### 3.1.3. State aid (EU, Czech Republic)

Articles 107 – 109 of the Treaty on the Functioning of the European Union	
Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, as amended	
Commission Regulation (EC) No 794/2004 of 21 April 2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty, as amended	
Notice from the Commission on a simplified procedure for treatment of certain types of State aid (2009/C 136/03)	
Code of Best Practice for the conduct of State aid control procedures (2009/C 136/04)	
Notice from the Commission — Towards an effective implementation of Commission decisions ordering Member States to recover unlawful and incompatible State aid (2007/C 272/05)	
Commission notice on the determination of the applicable rules for the assessment of unlawful State aid (2002/C 119/12)	
Commission notice on the enforcement of State aid law by national courts (2009/C 85/01)	
Commission Regulation (EC) No 800/2008 of 6 August 2008, declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation)	<b>“General Block Exemption Regulation”</b>
Community guidelines on state aid to promote risk capital investments in small and medium-sized enterprises (2006/C 194/02)	<b>“Risk Capital Guidelines”</b>
Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to de minimis aid	
Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (2008/C 155/02)	<b>“Notice on Guarantees”</b>
Communication from the Commission on the revision of the method for setting the reference and discount rates (2008/C 14/02)	

### 3. Legal analysis (continued)

Communication from the Commission — Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis (2009/C 83/01), as amended	
Common Principles For An Economic Assessment Of The Compatibility Of State Aid Under Articles 87.3 (Commission working document) <sup>105</sup>	
Act No. 215/2004 Coll., on Amending Certain Relationships in the Area of State Aid, as amended	
Recommendation of the Office for the Protection of Competition for the provision of various aid according to the “Czech Temporary Framework” – Assistance programme up to EUR 500 000 (N 236/2009 – Czech Republic – Limited amounts of compatible aid under the Temporary Framework)	
Commission Decision of 6 May 2009 No C(2009)3709 (State aid N 237/2009 – Czech Republic - Temporary aid scheme for granting aid in the form of loans with subsidised interest rate)	
Act No. 319/2006 Coll., on Certain Measures for Transparency of Financial Relationships in the Area of State Aid, as amended	

In compliance with Article 107 et seq. of the Treaty on the Functioning of the European Union, State aid<sup>106</sup> means a measure which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market. It generally applies that the granting of State aid is subject to the prior approval of the European Commission, which assesses whether the positive ramifications of the aid (development of small and mid-sized enterprises, environmental protection, higher employment, support for research and development, regional development, etc.) outweighs the negative ones (namely the distortion of competition). Certain types of State aid defined by EU legal regulations where the positive ramifications outweigh the potentially negative ones can be provided with the EC’s prior permission; for some other common types, the Commission publishes the aspect that it will examine when assessing whether the aid complies with EU law.

<sup>105</sup> Available on [http://ec.europa.eu/competition/state\\_aid/reform/economic\\_assessment\\_en.pdf](http://ec.europa.eu/competition/state_aid/reform/economic_assessment_en.pdf)

<sup>106</sup> For the purpose of comprehensibility of this analysis: in the Czech version of the text we use the inaccurate but utilised term “veřejná podpora” (public aid) instead of “státní podpora” (State aid). The term “státní podpora” stated in the titles of regulations is of course left unchanged.

### 3. Legal analysis (continued)

Just like in the general regime for the managing resources from the EU funds, the pertinent entities are obliged, even in connection with utilisation of the JESSICA instrument, to ensure observance of State aid rules. Legal regulations on State aid comprise for the most part EU legal regulations and related methodological documents of the EU,<sup>107</sup> and then the supplementary regulations and methodological documents of the Czech Republic. As in the previous parts hereof, here we also focus exclusively on State aid rules, whose application will be potentially relevant in connection with utilisation of the JESSICA instrument. Thus we do not address, e.g., regional investment assistance (it will generally be the main source of any exemption from the general notification requirements in connection with the implementation of the JESSICA instrument) and employment assistance, investment assistance for the environment, and other types of assistance that may be provided in the general regime of the operational programmes even in connection with utilisation of the JESSICA instrument, which are however not specific to the utilisation of this instrument.

It should be reiterated that according to Article 43(6) of the Implementing Regulation, projects that can be invested in through financial engineering instruments can also obtain a contribution or other form of assistance from the operational programme. In such case, the State aid rules will be applied in the same way as in the general regime for managing resources from EU funds.

In connection with utilisation of the JESSICA instrument, it will be necessary to apply in particular the following regulations and documents related to State aid:

- **Procedural rules<sup>108</sup>**

As mentioned above, the granting of State aid is subject to the EC's prior consent.<sup>109</sup>

The Czech Republic is responsible for ensuring observance of these regulations; however, this will be the work of the pertinent Managing Authority in cooperation with the financial engineering instruments under the terms and conditions laid down in the funding agreements. In the event of a breach of these regulations, both the beneficiary and the Member State (Managing Authority) have to return the provided assistance along with the interest specified by the EC.

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<sup>107</sup> Together available on [http://ec.europa.eu/competition/state\\_aid/legislation/compilation/index\\_en.html](http://ec.europa.eu/competition/state_aid/legislation/compilation/index_en.html). See also Vademecum - Community law on State aid, available on [http://ec.europa.eu/competition/state\\_aid/studies\\_reports/vademecum\\_on\\_rules\\_09\\_2008\\_en.pdf](http://ec.europa.eu/competition/state_aid/studies_reports/vademecum_on_rules_09_2008_en.pdf)

<sup>108</sup> Namely Regulation No 659/1999, Regulation No 794/2004, Notice from the Commission on the simplified procedure for treatment of certain types of State aid, Code of Best Practice for the conduct of State aid control procedures, and Act No. 215/2004 Coll.

<sup>109</sup> Article 107 – 109 of the Treaty on the Functioning of the EU.

### 3. Legal analysis (continued)

The Managing Authority (and for it the financial engineering instrument managers) has to assess on an ongoing basis whether the implementation of the intended measure can lead to the granting of State aid. In such case, it must be ascertained whether the grant of the respective State aid is excluded from the reporting obligation (see below); otherwise it has to request the EU, using the procedure laid down in the Public Procurement Act and the appropriate EU procedural regulations, to approve the assistance or assistance regime. Unlike the general regime for managing resources from EU funds, when utilising the JESSICA instrument, it will calculate grant equivalents using the respective current reference and discount rates set by the Commission.<sup>110</sup>

In the case of the intended grant of State aid, the Managing Authorities will proceed in cooperation with the Office for Protection of Competition, being the Czech coordination authority, when reporting. They will record data in the central register of minor aid and provide the pertinent information and documentation. When concluding funding agreements with the financial engineering instruments, the competencies of each party should be defined in connection with the fulfilment of the obligations in the area of State aid (e.g., it should be expressly stated that the grantor of the State aid within the meaning of Act No. 215/2004 Coll. will be the Managing Authority).

Persons controlled by a public administration authority within the meaning of Act No. 319/2006 Coll. (e.g., a municipality establishes an urban development fund) that are involved in utilisation of the JESSICA instrument will, for the purpose of observance of State aid regulations, continue to be obliged to fulfil record keeping and information obligations in the scope and under the conditions laid down by this legislation (namely keeping a record of awarded public funds and the way they were used and the obligation to keep separate accounting for each of the various activities they are involved in).

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<sup>110</sup> In connection with the provision of unrecoverable grants, the amount of the State aid essentially equals the amount of the grant. As regards assistance provided in a different form (the case of the JESSICA instrument), it is necessary to quantify the benefit that is provided to a certain subject to the detriment of public resources. For example, in the case of loans, the interest rate has to be compared to the reference rate set by the Commission for the Member State in question and the type of debtor (according to the level of creditworthiness and security). As regards the use of reference and discount rates in connection with State aid, see the Communication from the Commission on the revision of the method for setting the reference and discount rate (2008/C 14/02) and the study conducted by Deloitte & Touche GmbH available on: [http://ec.europa.eu/competition/state\\_aid/studies\\_reports/full\\_report.pdf](http://ec.europa.eu/competition/state_aid/studies_reports/full_report.pdf)

### 3. Legal analysis (continued)

- **Risk capital investments**

The reason why certain projects should be supported by investments from EU fund resources is the inability of these projects to obtain capital under normal market conditions. The Managing Authorities will thus respond to such identified capital market failures through such investments. When investing in the respective urban development projects, a recoverable grant of capital to the executors of the given projects will formally occur. These investments should thus make capital more readily available for the project implementers, also by creating the conditions for taking up investments from private investors.

The Managing Authority (in cooperation with the financial engineering instrument managers) will be obliged to examine whether assistance is provided in connection with the utilisation of the JESSICA instrument or whether the provision of such assistance is exempted from the notification requirement. One of the reasons why the intended measure will be exempted from the notification requirement, although it will represent a grant of State aid, could be that it will fulfil the conditions for aid in the form of venture (risk) capital under Section 28 et seq. of the General Block Exemption Regulation. If the measure fails to full these conditions, the intended measure should be compared to the conditions laid down in the Risk Capital Guidelines, as the EC will abide by them when assessing the compatibility of the intended measure with EU law.

The General Block Exemption Regulation defines the conditions under which State aid in the form of the provision of capital is compatible with EU law and not subject to prior approval by the Commission. These conditions are as follows:<sup>111</sup>

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<sup>111</sup> Article 28 et seq. of the General Block Exemption Regulation.

### 3. Legal analysis (continued)

- (i) The measure has to be implemented (only) in favour of SMEs.
- (ii) The measure must be aimed at improving access to capital, in particular by obtaining investment from private investors (measure motivating involvement of private investors).
- (iii) The measure has to be in form of a participation in a profit driven private equity investment fund managed on a commercial basis. At least 30%/50% (according to the area) of the funding for the fund thus has to be provided by private investors; a business plan and exit strategy etc. have to exist for each investment; the fund manager's remuneration has to be linked to performance of the fund; private investors are represented in decision-making; best practices etc. shall apply when managing the fund.
- (iv) The measure has to improve access to (only) risk capital (seed capital, start-up capital, expansion capital – according to area of activity) usually in the form of equity or quasi-equity (the fund has to provide at least 70% of its total budget in the form of these capital investment instruments where, unlike debt investment instruments, the returns for the investor are based in particular on profit or loss of the target enterprise and are not secured in the case of non-payment).
- (v) The aid will be limited to the lowest possible level. The tranches of the investment to be made by the investment fund shall not exceed EUR 1.5 million per target undertaking over any period of twelve months.

In compliance with the Risk Capital Guidelines, the existence of State aid will need to be examined in particular on the following JESSICA instrument implementation levels:

**(i) Selection of private investors and setting the terms of cooperation**

If the conditions for involving private investors in the financial engineering instruments or specific projects will be more advantageous for them than for public investors (namely the Managing Authorities in relation to sharing risk and remuneration) or they are more favourable than if they made these investments without involving public investors, it is possible that they will be granted State aid.

**(ii) Selection of financial engineering instruments and setting the terms of cooperation**

If the terms and conditions under which the financial engineering instrument managers will be managing the resources from the operational programmes for the Managing Authorities do not correspond to market terms and conditions (e.g., in relation to remuneration and their dependence on the fund's profitability), it is possible that they will be granted State aid.

### 3. Legal analysis (continued)

#### (iii) The selection of recipients of the investments of the financial engineering instruments

If the conditions under which the project implementers obtain capital from the financial engineering instruments do not correspond to market conditions, it is possible they will be granted State aid. State aid will apparently be granted to them also if it is provided to the private investors involved in the investment in them or to the managers of the respective financial engineering instruments.

- **De minimis aid**

Another reason why the contemplated measure will be exempted from the notification requirement even though it will represent State aid may be that it fulfils the de minimis aid requirement, i.e., that the granted State aid will be so small that it generally will have no fundamental negative impact on competition or on the EU internal market. De minimis aid may not exceed the aid equivalent of EU 200 000 granted to any one company in the current fiscal year and previous two fiscal years.

This regime can be used on transparent forms of aid where it is possible to determine the aid equivalent without the need to carry out a risk assessment. It can thus be expected that the possibility to utilise this regime in connection with the JESSICA instrument will be limited (it will be difficult to clearly calculate the amount of the aid provided to, e.g., private investors, in the case of their enjoying a certain advantage to public investors etc.). Nevertheless, it is possible to make use of Article 2(4) of the Regulation which stipulates certain procedures for the application of de minimis aid, i.e., for loans and guarantees.

It should be reiterated that support provided under the de minimis regime and under a different exemption regime (e.g., regional investment aid) can be cumulated, but under the condition that the aid measure pertains to various eligible costs and such cumulation does not lead to exceeding the highest aid intensity or aid amount applicable to this aid under the respective block exemption.<sup>112</sup>

- **Guarantees**

The provision of State aid in the form of a guarantee is not exempted from the notification requirement even if qualification conditions are met. Nevertheless, the EC in its Notice on Guarantees explains the aspects of the measures that it will review to ascertain whether the provision of a guarantee is granted aid and if so in what amount and whether it complies with EU law.

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<sup>112</sup> Article 7 of the General Block Exemption Regulation and Article 2 (5) of Commission Regulation No 1998/2006.

### 3. Legal analysis (continued)

When performing the assessment, the EC will apply the market investor principle, i.e., it will examine the possibility of the company beneficiary receiving aid comparable to the financial resources on the capital market. The EC will not regard State aid as a guarantee if (i) the debtor has no financial problems, (ii) the scope of the provided guarantee can be properly measured (the guarantee is tied to specific financial transactions, is for the determined maximum amount and is limited in time), (iii) the guarantee does not cover more than 80% of an unpaid loan or other financial liability and (iv) a regular market price is paid for the guarantee. In the case of individual guarantees for SMEs, the EK, in its Notice on Guarantees, stipulates the amount of the guarantee bonus that, with regard to the debtor’s rating, it deems to be at market price. In the case of assessing the guarantee system, the EC will examine (v) whether the bonus paid by companies to which the guarantee was provided is likely self-financing, i.e., whether it also covers administrative costs related to the operation of the system and the annual remuneration for the corresponding capital required. The financial engineering instruments should take into account the aspects set out in the Notice on Guarantees when defining its investment strategies and conditions for implementing investments.

- **Interim measures**<sup>113</sup>

As a result of the economic crisis, the EC decided to proceed in a more benevolent manner when assessing compliance with contemplated State aid. In compliance with the respective communications from the EC and based on a decision of the EC issued in relation to the Czech Republic, the maximum aggregate amount of de minimis aid and aid provided in the framework of temporary measures is stipulated here (the aggregate amount of de minimis aid and aid provided in the framework of temporary measures may not exceed EUR 500 000 per company in the period from 1 January 2008 to 31 December 2010<sup>114</sup>).

#### 3.1.4. Public procurement (EU, CR)

Act No. 137/2006 Coll., on Public Procurement, as amended	<b>“Public Procurement Act”</b>
Act No. 139/2006 Coll., on Concession Contracts, as amended	<b>“Concession Act”</b>
Mandatory public procurement procedures for awarding contracts co-financed from EU resources not subject to the application of Act No. 137/2006 Coll., on public procurement, in the 2007-2013 programming period (approved by Decision of the Government of the Czech Republic No. 48/2009)	<b>“Mandatory public procurement procedures”</b>

<sup>113</sup> Communication from the Commission — Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis and Commission decisions N 236/2009 and N 237/2009.

<sup>114</sup> See point 4 of the Recommendation of the Office for the Protection of Competition for the provision of various aid according to the “Czech Temporary Framework” – Assistance programme up to EUR 500 000 (N 236/2009 – Czech Republic – Limited amounts of compatible aid under the Temporary Framework).

### 3. Legal analysis (continued)

Methodology for awarding public contracts under Act No.137/2006 Coll., on Public Procurement, and Methodology for awarding public contracts financed from EU resources	
Guidelines for determining financial corrections to be made to expenditure co-financed by the structural funds and the Cohesion Fund for non-compliance with the rules on public procurement (COCOF 07/0037/03-EN)	

EU regulations on public procurement were implemented into Czech law by the Public Procurement Act and the Concession Act in particular. The purpose of these provisions is to ensure that public resources will be used in the most effective manner, i.e., that the contracting authority pays the least for goods, services and construction work and that domestic suppliers will not be artificially preferred to suppliers from other EU Members States. When utilising the JESSICA instrument, the provisions of the Public Procurement Act and Concession Act will be relevant from the following aspects:

- **Purchase of services from the holding fund managers**

The Managing Authorities can, for the purpose of more efficient cooperation with the urban development funds, make use of the services of a holding fund. If the contract is not awarded to the EIB or EIF<sup>115</sup> and the case is not one of awarding a grant to a public service provider (see above), it should be verified whether the Public Procurement Act will apply to the award of the contract and, if so, statutory procedures should be observed. It can be expected that the Managing Authorities will always be in the position of a public contracting authority under Section 2 of the Public Procurement Act and will be obliged to adhere to the procedures set out in this Act.<sup>116</sup>

- **Purchase of services from the urban development fund managers**

It should also be verified whether the Public Procurement Act will apply to the award of contracts by the Managing Authority in the form of services from urban development fund managers and, if so, respective statutory procedures should be observed.

If the Managing Authority utilises the services of a holding fund and the manager of such holding fund is the EIB or EIF, these institutions will apparently not be obliged to observe the Public Procurement Act when awarding the contract for the services to urban development managers, this being in compliance with Section 18(1)(q) of the Public Procurement Act. Thus, the EIB or EIF will proceed according to their own rules.

<sup>115</sup> Article 44 of the General Regulation.

<sup>116</sup> If a holding fund is created as a legal person established and managed exclusively by the Managing Authority, an exemption to the Public Procurement will apply in accordance with Section 18(1)(j) thereof. In the event that the founder and manager is not exclusively the Managing Authority, the application of this exemption will have to be looked at in detail (in the event that the co-founder is a different public contracting authority, such as a municipality or region).

### 3. Legal analysis (continued)

In the event that the holding fund manager is a different entity, it should be verified whether the conditions will be met for the application of the Public Procurement Act. The application of this Act will depend in particular on the legal relationships between the Managing Authority and holding fund managers and on the legal form of the respective holding fund manager. In the event that the resources remain in the ownership of the Managing Authority or, for some other reason, the contracting authority of the respective services is the Managing Authority itself, the Managing Authority will continue to be in the position of a public contracting authority and will proceed in accordance with the Public Procurement Act. In the event that the resources pass into the ownership of the fund manager-financial institution and this entity will require the services of the urban development fund managers, the application of the Public Procurement Act will depend on whether this manager fulfils the characteristics of a type of public contracting authority under this Act.<sup>117</sup>

If the holding fund is established as an independent legal person, the issue of application of the Public Procurement Act will depend in particular on the extent that this fund is financed and controlled by the Managing Authority or other public contracting authority.<sup>118</sup>

We believe it should be mentioned at this point that the purchase of services from financial engineering instruments will pertain to services provided in connection with the JESSICA resources released from the operational programmes of the 2007-2013 programming period. If the terms and conditions of the tendering documentation and resulting contract also do not include services related to the resources from the next programming periods (it is unlikely that they would due to the fact that the legal framework for the functioning of the financial engineering instruments in the next period is not known), the financial engineering instruments involved in the 2007-2013 programming period will be able to provide their services to the public contracting authority even in the next period based on new contracts ensuring from new tenders.

- **Utilisation of JESSICA financial assistance**

In connection with the investments made by the urban development funds, these funds will not have the obligation to proceed in accordance with the Public Procurement Act, as these funds will not be buying goods, services or construction work, but investing in projects with the aim of ensuring the recoverability and profitability of these investments. These entities will, however, be obliged to proceed in accordance with any mandatory procedure under the rules of the respective operational programmes and funding agreements.

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<sup>117</sup> If such an institution is, e.g., Českomoravská záruční a rozvojová banka, a.s., it will apparently be obliged to proceed in accordance with Section 2(2)(d) of the Public Procurement Act. If such institution is a commercial bank, it will apparently not have to proceed in accordance with the Public Procurement Act.

<sup>118</sup> In the event that the fund is financed or controlled predominantly by, e.g., the Managing Authority, we believe that it will again be in the position of a public contracting authority, provided it fulfils the requirements of Section 2(2)(d) of the Public Procurement Act.

### 3. Legal analysis (continued)

In the investment financing phase, it is not possible, however, to eliminate the application of the Public Procurement Act there where the contracting authorities will be the beneficiary under the Public Procurement Act (namely the municipalities and regions), on the part of those beneficiaries-contracting authorities. In other words, if the UDF does not have to select the recipient of the financial assistance-project implementer using the procedure stipulated by the Public Procurement Act, such recipient shall be obliged to do so under this Act in order to receive the financial assistance if the Public Procurement Act imposes this obligation on it (the recipient of the financial assistance will be in the position of the contracting authority).<sup>119</sup>

Recipients of the financial assistance-contracting authority will not, in our opinion, be obligated to select the financial services of the UDF under the Public Procurement Act, but only under the following narrowly defined conditions:

- (i) Exemption under Section 18(1)(j) of the Public Procurement Act  
This exemption will apply in the situation where the UDF, which is to supply the financial services to the contracting authority, will be established and managed exclusively by the respective contracting authority for the purpose of development of the respective contracting authority (e.g., the loan to city X will be provided by the UDF established and managed by city X for the purpose of the development of city X).

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<sup>119</sup> We are aware that this interpretation of the Public Procurement Act is disputable, namely with regard to the effectiveness of the implementation of the JESSICA instrument. The general purpose of the JESSICA instrument is, for the purpose of urban development, to provide financial assistance there where it is normally not accessible under normal market conditions and, in the end, the provision of financial assistance from one public entity (Managing Authority) to another public entity (municipalities, regions) or private entities occurs for the purpose of urban development, albeit through the HF and UDF. EU law, however, does not lay down a general obligation on urban development funds to provide financing under more favourable terms and conditions than market terms and conditions. Furthermore, it is not excluded that urban development funds will provide finances under various terms and conditions according to the financing source (JESSICA resources as opposed to private funding). Although the services provided by the urban development funds could be the subject of a double selection under the Public Procurement Act, repeated selection will not occur and, from the point of view of competition and administration of public resources, is not illogical: in the first phase, management services acquired by the Managing Authority-holding be selected; in the second phase, financial services (No 66000000-0 according to the nomenclature of the CPV) acquired by, e.g., municipalities and regions, will be selected. These contracting authorities will thus have to ascertain in a qualified manner (by proceeding under the Public Procurement Act) whether they will, for example, obtain a loan under more favourable conditions from the UDF or from a commercial bank. They can obtain financial resources from the UDF (i.e., acquire financial services) only if the UDF provides the resources/financial services under more favourable conditions. With regard to the fact that even the Managing Authorities should minimise distortion of competition on the risk capital, loan and guarantee markets when investing via the JESSICA instrument [Article 43(7) of the Implementing Regulation], even these authorities should keep in mind similar measures when laying down the terms and conditions of the pertinent funding agreement, i.e., even in the case that the recipient of the financial assistance is not the contracting authorities under the Public Procurement Act, and should set up mechanisms that will minimise the threat of distortion of competition.

### 3. Legal analysis (continued)

(ii) Exemption under Section 18(1)(e) of the Public Procurement Act<sup>120</sup>

This exemption will be applied in the situation where the UDF subscribes shares issued by the company-project implementer, albeit this company was established and managed exclusively by the contracting authority (thus the acquisition of financial services directly by the contracting authority does not occur under this option).

- **Mandatory procedures**

In the event that the HF, UDF or project implementer does not proceed in accordance with the Public Procurement Act, the Mandatory Public Procurement Procedures should apply to it. For the purposes of legal certainty, this fact should be expressly stated as one of the terms of the funding agreement and investment agreement. Observance of these procedures will lead to there being less of a possibility of the presence of State aid (see above) and less of a risk that financial corrections will be made by the EU, i.e., cancellation of the respective EU contribution.<sup>121</sup>

- **Concession**

The subject of the investment made by the financial engineering instruments can be public private partnerships or other projects included in the integrated urban development plan.<sup>122</sup> The urban development plans can thus, for example, invest the entrusted funds into urban development projects that will be executed on the basis of an agreement where the private entity commits to providing a service or completing works and the public contracting authority makes it possible for the private entity to enjoy profits ensuing from the provision of services or using the completed works. Prior to the implementation of such projects, it should be verified whether such forms of cooperation will fulfil the conditions for the application of the Concession Act and, if so, follow the procedure laid down by such Act. Even the Managing Authority will have the obligation to verify the proper application of procedures under the Concession Act, and this body will do so through the appropriate financial engineering instrument (the obligation to ensure observance of EU and Czech regulations for the duration of the entire operation – see above).

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<sup>120</sup> This exemption is based on Section 16(d) of Directive 2004/18/EC, as commented on in point 27 of the Preamble thereto. The Directive refers to the WTO Agreement on Government Procurement. Although this Agreement does not shed much light on the interpretation of the exemption in Article 16(d) of the Agreement (Annex 4 European Community excludes “contracts for financial services in connection with the issue, sale, purchase or transfer of securities or other financial instruments, and central bank services” from the force of the Agreement), we believe that the wording of the Directive and the respective point of the preamble is sufficient for interpreting Section 18(1)(e) of the Public Procurement Act, as mentioned above, and, conversely, does not allow for the expansion of any acquisition of financial resources on the part of contracting authorities.

<sup>121</sup> Article 99 of the General Regulation. See also the Guidelines for determining financial corrections to be made to expenditure co-financed by the structural funds and the Cohesion Fund for non-compliance with the rules on public procurement.

<sup>122</sup> Article 44 of the General Regulation.

### 3. Legal analysis (continued)

- **Grants**

In accordance with Article 44 of the General Regulation and the Note from 2008, it cannot be eliminated that some potential HF managers will not be in the position of service providers (which should be commissioned in accordance with the Public Procurement Act or in a similar way) in relation to the Managing Authorities, but public service providers, and they will require an unrecoverable grant for these purposes. With regard to the different content of the pertinent legal relationships (supplier-customer vs. public service provider-grantor), one should examine in detail the rules for the activities of a public institution. In case of doubts, we recommend looking at the relationship between the financial engineering instrument and the Managing Authority as a customer-supplier relationship with regard to the pertinent services (resource management) and using the appropriate procedures for the selection of such supplier, namely with regard to the negative impact of this relationship on expenditure certification.

#### 3.2. **Inadequacies of rules for the implementation of the JESSICA financial instrument in the Czech Republic**

The second part our analysis identifies any inadequacies of Czech legal regulations and documents identified in the first part of the analysis from the point of view of implementation of the JESSICA instrument in the Czech Republic and provides general recommends as to the way these inadequacies should be dealt with.

As described above, the characteristics of the JESSICA instrument do not allow for the creation of methodological documents in the same exhaustive manner as is in the case of the rules for the general regime for managing resources from EU funds. The pertinent entities will be forced to use the JESSICA instrument based on the general rules for managing these resources and these general rules shall apply everywhere possible and in the manner corresponding to the characteristics of the JESSICA instrument.

Nevertheless, we believe that the implementation of this instrument in the Czech Republic would be helped by the existence of the appropriate methodological document. In our opinion, this document should focus on the following areas in particular:

### 3. Legal analysis (continued)

- **Explanation of the JESSICA instrument**

With regard to the fact that the pertinent entities will have to apply the general rules for managing resources from EU funds mutatis mutandis to the characteristics of the JESSICA instrument, we find it necessary that these entities, in particular the Managing Authorities, understand the statutory conditions of this instrument, the possibilities available to them for managing operational programme resources, and the obligations arising for them from this. Furthermore, the need to observe the basic principles for managing resources from EU funds should be stressed, namely the principle of observance of legal regulations, sound financial management, transparency, and non-discrimination. It should also be stressed that despite the fact that the management of operational programme resources is carried out by the financial engineering instrument, the responsibility for this activity and its results continue to rest with the Managing Authority.

- **Implementation guide**

A part of the explanation of the JESSICA instrument should also be, e.g., the forms of financial engineering instruments, recommended procedures in connection with their selection, and the conclusion of funding agreements (also including samples of the basic provisions of these agreements). The guide could also call attention to the basic aspects that should be taken into account when selecting financial engineering instruments and drafting funding agreements:<sup>123</sup>

- (i) The terms and conditions for the functioning of financial engineering instruments (legal form, controlling and administrative procedures, personnel, expertise and financial provisions, and experience with the execution and control of urban development projects).
- (ii) Inclusion of the Managing Authority/HF in HF/UDF decision-making procedures (ex-ante specification and ex-post controlling and monitoring procedures, possibility of institutionalisation into the form of, for example, investment councils or other “bodies”, defining the position of these “bodies” in the HF/UDF decision-making procedures and in related procedures, such as public procurement etc., specification of whether the HF/UDF acts on behalf of third parties or represents the Managing Authority/HF).
- (iii) Definition of services (definition of the management of JESSICA resources and differentiating between these services and other services that may be provided, such as legal advice about the framework of JESSICA resource management, assistance in connection with drafting the application for approval of State aid etc.).
- (iv) Involvement of the other investors (method and conditions of involvement, namely whether different conditions will apply to the payout of returns, the issue of using the resources of the financial engineering instrument itself, etc.).

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<sup>123</sup> See also above for more details on areas that need to be addressed in funding agreements under EU law.

### 3. Legal analysis (continued)

- (v) Portfolio of potential projects (relevant in connection with the selection of the UDF) and the procedure in connection with the identification of other projects (calls for proposals).
- (vi) Investment strategy (compliance with the terms and conditions of the operational programme and relevant integrated urban development plans; possible restriction on some of the possible forms of investment; focus only on investments in municipalities with a certain population etc.; expected rate of return on the investment and other expected benefits of the investment, such as socio-economic benefits, environmental benefits, etc.; timeframes for executing investments; comparison of the investment terms with market terms and undertaking measures to minimise distortion of competition; concluding agreements on behalf of the financial engineering instrument or on behalf of the Managing Authority; etc.).
- (vii) Obligations related to the management of JESSICA resources (publicity, monitoring and reporting to HF/Managing Authority and other investors, as the case may be).
- (viii) Mandatory procedures (compliance with the EU and Czech or some other Member State legal regulations, compliance with best practice in the field, public procurement procedure, procedures for identifying State aid and reporting thereof, monitoring outputs, obligation to reflect changes in relevant legislation and its interpretations).
- (ix) Preliminary withdrawal from investments, enforcement of receivables, terms and conditions for reinvestment and payout of returns. In this connection it should be mentioned that in case of insolvency of the project generally binding legal regulations should be followed and the UDF would be one of the creditors.<sup>124</sup>
- (x) Remuneration (amount and method of calculation of remuneration for management, other management costs, method of payment of remuneration).
- (xi) Explanation of the legal regime of financial flows (see “JESSICA – Czech legal regulations and documents, Financial flows” above).

#### 3.2.1. Inadequacies of implementation rules – potential problematic aspects

As mentioned above, the requirement of the *mutatis mutandis* application of legal regulations and methodological documents issued at both the EU and Czech level in relation to the general regime for managing resources from EU funds will be imposed on entities involved in the utilisation of the JESSICA instrument (first and foremost on the Managing Authorities). Despite the fact that this requirement is based on the characteristics of the JESSICA instrument (alternative end-phase process of management of resources from EU funds), the Managing Authorities should not underestimate it and, in case of any doubts, they should consult the contentious interpretation of legal regulations with their legal advisors and the pertinent authorities.

<sup>124</sup> This concerns Act No. 182/2006 Coll., on Insolvency and its resolution (Insolvency Act), as amended.

### 3. Legal analysis (continued)

Based on our analyses above, we recommend that the methodological document to the JESSICA instrument call attention in particular to these potential problematic aspects of the *mutatis mutandis* application of the general regime for managing resources from EU funds:

#### (i) Public procurement

We recommend calling attention to the fact that the Mandatory Public Procurement Procedures for contracts co-financed from EU resources should also be observed by the financial engineering instruments and investment beneficiaries-project implementers. The exception to this requirement should be those cases where the financial engineering instrument is not subject to Public Procurement Act for the reason laid down in its Section 18 (1)(q)<sup>125</sup>. We also recommend calling attention to the need to apply the Public Procurement Act to contracting authorities-UDF financial assistance recipients (the need to conduct tenders for financial services providers).

#### (ii) State aid

We recommend expressly stating that the Managing Authority will be the provider of State aid within the meaning of Act No. 215/2004 Coll. although in compliance with the conditions of the funding agreement it will in fact be the financial engineering instrument who will be making the investment with an aid element or allowing for the involvement of private investors with an aid element.

#### (iii) Co-financing

In connection with utilisation of the JESSICA instrument, expenditure is incurred at various levels of the implementation structure (transfer of resources from the operational programmes to the financial engineering instruments, implementation of investments through these instruments according to the terms and conditions of the operational programme). We recommend explaining that, for the purpose of complying with the respective rate of co-financing of operations from the EU funds, the Managing Authorities will report public expenditure incurred at all these levels of implementation of the JESSICA instrument. Even investments made by the regions or municipalities into the respective financial engineering instruments or projects into which these instruments invest will count as public expenditure.

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<sup>125</sup> For example, the EIB should proceed according to its own public procurement procedures.

### 3. Legal analysis (continued)

#### (iv) Verification and utilisation of applications

We recommend verifying whether the software environment of the applications used in connection with the certification of costs and other operational programme management processes reflect certain modifications related to the utilisation of the JESSICA instrument (for example, the two-phase use of eligible costs) and describing any recommended procedures for the correct use of these applications in connection with utilisation of the JESSICA instrument.

#### (v) Expenditure reporting and certification

With regard to the number of potential forms of financial engineering instruments, the conditions of their cooperation with the Managing Authorities and the conditions for realising investments, we recommend giving examples of documents that the Certifying Authority will accept as proof of the costs expended on the creation of financial engineering instruments/transfer of resources to them and finally the costs of making the investment (e.g., copies of funding agreements, copies of agreements on award of a non-recoverable contribution-grant and documenting that the conditions for this form of involvement of the HF have been met, a copy of a bank transfer document pertaining to the resources, instructions on how to calculate the costs connected to pledging resources for the reason of a provided guarantee that has not been honoured, etc.).

#### (vi) Resource management outside the Czech Republic

With regard to the issue of the possibility to management JESSICA resources outside the Czech Republic which arose from practice (see above), we recommend consulting this issue with all stakeholders (pertinent central public administration authorities) and expressly stating the provisions of Section 33(7) of the State Budgetary Rules, which the Managing Authorities should observe when utilising the JESSICA instrument, in the methodological document.)

In the event of the incorrect interpretation of the above provisions (as in the case of the incorrect interpretation of other provisions of general binding legal regulations), there is also the risk that it will be necessary in the future to deal with the respective irregularities in expenditure reporting. The recommend interpretation of the respective provisions should thus also contain the reasons why the JESSICA resources can or cannot be managed from the accounts maintained at (branches of) banks in other EU Members States other than Czech banks. The recommended interpretation and the reasons leading to it should help the Managing Authorities defend their approach in the case of later enquiries.

### 3. Legal analysis (continued)

In case that it is concluded that the respective restriction imposed by the State Budgetary Rules in connection with utilisation of the JESSICA financial instrument applies, the methodological documents should state that this fact has no influence on the possibility of entities from other EU Member State to manage JESSICA resources for the Czech Managing Authorities. The financial engineering instruments would then, however, have the obligation to manage the funds from accounts maintained at Czech (branches) of banks. Even the conclusion about the application of this restriction should be properly justified; it should clearly explain the reasons for the existence of the respective restriction and the reasons why this restriction is evidently proportional in relation to the restriction caused on the EU internal market. Stating this interpretation of this provision of the State Budgetary Rules in the methodological document (or even better in the pertinent clarifying amendment of the State Budgetary Rules – see above) would then also allow potential financial engineering instrument managers to assess in advance the extent to which the State Budgetary Rules would restrict them and whether they will be willing to adopt the respective measures (management of resources from accounts maintained at Czech banks).

#### (vii) Status of returns on investments

Finally, we recommend expressly resolving the issue of who will be authorised to use the returns on investments tied to the financial engineering instruments and what special terms and conditions would have to be observed (e.g., as opposed to unrecoverable grants, the obligation to use them for recoverable investment, for projects in the region in question, etc.). If the returns on investment are used by regional councils, we recommend reiterating that, in the event of the possible future winding up of the regional councils, it will be the pertinent general binding legal regulation that will determine which entities will be entitled to use the returns on investments after the regional councils and which will enter generally into the legal status of the regional councils.

It should generally be stipulated that the resources will be returned to the Managing Authority (or the successor organisation) that provided them. If the JESSICA financial instrument is executed by one of the regional operation programmes, it should be stated that the resources are to be reinvested in the respective NUTS II region.

### 3. Legal analysis (continued)

Finally, in order to avoid interpretational ambiguities in connection with utilisation of the JESSICA instrument, it is recommended that those regulations that will appear problematic already during the drafting of the methodological document be legislatively amended [see the above discussed interpretation of the State Budgetary Rules in connection with the management of resources outside the Czech Republic; the Act on Support for Regional Development in relation to the establishment of financial engineering instruments by regional councils and the further use of resources from investments (see footnotes 80 and 81 on page 42 hereof); Municipal Budgetary Rules, State Budgetary Rules and the Financial Flows Methodology in relation to the legal nature of the funding agreements; the Public Procurement Act in relation to the procurement of financial assistance from the regional development funds on the part of the municipalities and regions; and so on]. As state above, there where various interpretations of the relevant regulations can be foreseen, we recommend including in the respective methodological document for the JESSICA instrument reasoned interpretations of the legislation wording that can be reasonably deemed correct (see the interpretations above and their substantiation).

## 4. Definitions of types of projects and involvement of private partners

### 4.1. Proposal for suitable types of projects

This section aims to identify suitable types of projects that would fulfil the terms and conditions for financing via the JESSICA financial instrument. For this purpose, information workshops were conducted in selected regions. This concerned the following operational programmes:

- ROP Northwest
- ROP Southwest
- ROP Central Bohemia
- ROP Northeast
- Integrated operational programme
- Operational Programme Prague – Competitiveness.

The workshops were supplemented by **surveys** of selected groups of beneficiaries, with the following areas of inquiry:

- Description of initial state of the project
- Description and objectives of the project
- Entities involved in the project and ownership relations to the territory/real estate in question etc.;
- Estimated total project costs
- Estimate expected returns
- Envisaged time schedule for implementation, including the current state of preparations
- Project implementation risks
- Current restrictions for obtaining funding
- Possibility for including the project in the IUDP

The percentage of questionnaires returned was not sufficient to determine the types of projects at which the thematically focused potential urban development funds should be aimed, which was probably caused by the fact that this is a new method of financing about whose functioning, rules and terms and conditions the representatives of the municipalities have very little information. For this reason, the suitable types of projects for funding via the JESSICA financial instruments were determined via a case study on a main street regeneration project, including a financial model. In the next section, we specify suitable types of projects based on already completed studies from abroad. The aim was to show municipal representatives how projects financed via the JESSICA financial instrument could look like, thereby giving them further ideas for future projects.

## 4. Definitions of types of projects and involvement of private partners (continued)

### 4.1.1. Case studies – “Main street regeneration” project

#### Current state

The main street of a city does not fulfil the demands of a central public space. Until the recent completion of the construction of a bypass, the main street served primarily as a transit corridor (two lanes in each direction). At this time, traffic intensity has fallen substantially and one lane in each direction is sufficient to ensure a steady flow of traffic (the street is now used in particular by residents and vehicles bringing supplies to the centre). The street is bordered on either side by buildings in a bad state of repair, whose ground floors are used only minimally for business activities (shops), with most of the space not being utilised.

#### Proposed investment

If the main street is to assume the function of central, full-fledged city space, it is necessary to address the following:

- Entire revitalisation of the public space
  - Expansion of the space for pedestrians at the expense of one of the extra lanes
  - Creation of rest zones (benches)
  - Repair and reconstruction of the surface, even of the pavements
  - Planting of greenery
  - Instalment of speed bumps
- Regeneration of adjacent buildings
  - Complete reconstruction including both the ground floors and the facades, partially also the remaining space, which will allow, for example, the creation of offices or rental housing

#### Stakeholders

Although the public space (pavements, street) is owned by the city, the adjacent buildings are owned by a private entity.

#### Current limitations on project execution

The willingness of each of the stakeholders to implement the various parts of the project is limited due to the following:

- The city does not have sufficient funds in its budget to revitalise the main street; primarily it can provide land.
- The city is not willing to increase the budget deficit through a loan; the funds for the regeneration of the public space as a whole, including the pavements, ground floors and the street, through grants are not available (e.g., the resources in the given ROP priority axis are not sufficient to finance the entire investment).

The private owner is interested in the reconstruction and commercial use of his buildings, but is worried that the current bad state of the public space (street) will make it impossible to attract renters and is therefore delaying his decision to execute the regeneration project.

#### 4. Definitions of types of projects and involvement of private partners (continued)

It ensues from the above that the mentioned limitations can be eliminated through the execution of a joint project. The benefit of a joint project is the possibility, for example, for the city to have a say in the overall regeneration concept for the area.

##### Roles of each stakeholder (responsibility, investment, revenue, expenditure)

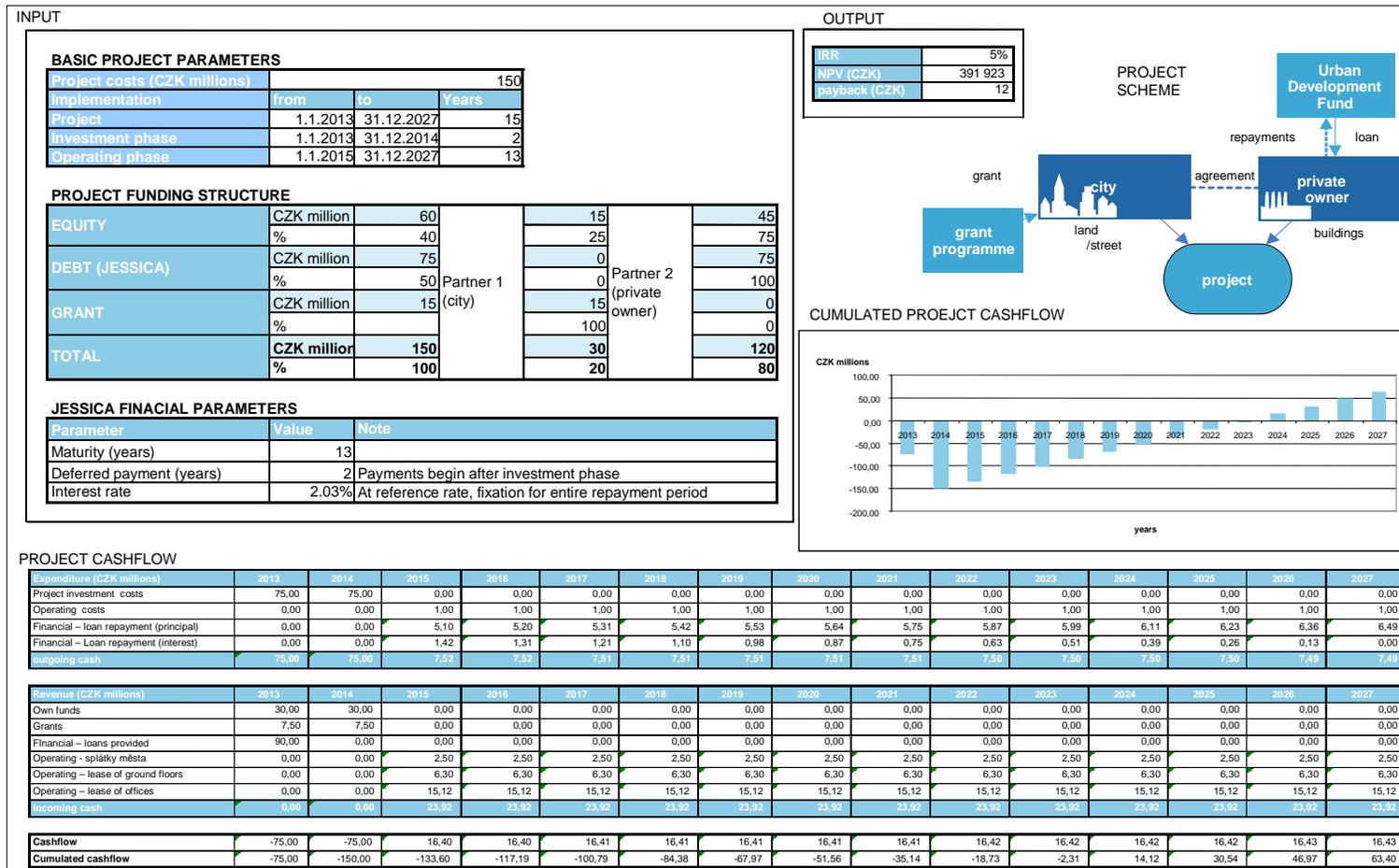
	City	Private owner
Activities and responsibilities	<ul style="list-style-type: none"> <li>- Aid beneficiary</li> <li>- Assignment and commentary of architectural studies and design (contract) documentation</li> <li>- Membership in project steering committees, joint decision-making (e.g., selection of lessees for ground floors of buildings)</li> </ul>	<ul style="list-style-type: none"> <li>- Beneficiary of JESSICA loan</li> <li>- Assignment and commentary of architectural studies and design (contract) documentation</li> <li>- Membership in project steering committees, joint decision-making</li> </ul>
Revenue	<ul style="list-style-type: none"> <li>- Income from lease of advertising space in the space in question</li> </ul>	<ul style="list-style-type: none"> <li>- Lease of office space</li> <li>- Lease of ground floors of buildings (shops)</li> <li>- Payments from city</li> </ul>
Costs	<ul style="list-style-type: none"> <li>- Regeneration of public space (modifications and finishing work)</li> </ul>	<ul style="list-style-type: none"> <li>- Building reconstruction</li> <li>- Regeneration of public space (rough work)</li> </ul>

“Feasibility study on the implementation of the JESSICA financial instrument in the Czech environment for the 2007-2013 programming period”

Final report

2 September 2010

4. Definitions of types of projects and involvement of private partners (continued)



## 4. Definitions of types of projects and involvement of private partners (continued)

### Project

The financial data related to the project are provided on the previous page.

The project is set up in such a way that an agreement containing the basic parameters of the project - financial participation of each stakeholder, list of investment costs and envisaged method for their funding and sharing between the stakeholders, method of decision-making under the project, responsibilities of each party, etc. - is concluded between the city and the private investor.

The project is financed by:

- Equity of both partners – 40% of project costs
- Grants – 10% of project costs
- JESSICA loan – 50% of project costs.

The city is the grant beneficiary under the project, with the grant covering the costs of regeneration of the public space.

The private owner is beneficiary of the loan from the urban development fund. The owner submits the contract documentation, including the agreements concluded with the city, as part of the loan application. The advantages of the loan being utilised by the private partner is as follows:

- The loan does not increase the city's debt.
- The private partner does not have to tender the loan under the Public Procurement Act (unlike the city).

The JESSICA loan is provided under a better rate at the level of the reference rate set by the EC for the Czech Republic (2.03%). Such interest rate is considered to be constant for the entire loan repayment period (13 years). Repayments do not begin until the third year of the project, which corresponds to the start of the operating phase.

The repayments (instalments) are paid by the private investor from project revenue:

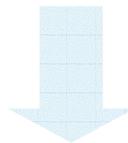
- Lease of ground floor space along the pavements (shops and other services)
- Lease of office space
- Payments made by the city

## 4. Definitions of types of projects and involvement of private partners (continued)

The project (as a whole) set up in this way has an internal revenue percentage of 5% and a current net value of about CZK 390 000. The initial investment is recoverable in the 12<sup>th</sup> year of the project (the 10<sup>th</sup> year of the operational phase).

### Recommendations for the JESSICA project – flexibility of setup

- Form of cooperation of the city/private partner (agreement, concession agreement, creation of a joint SPV, etc.)
- Combination of project sources (subsidies, JESSICA loans, commercial loans, etc.)



Preparing a JESSICA project means finding the ideal project configuration that allows for the joint realisation of projects that the stakeholders would not be able to execute by themselves (due to a lack of finances and initiative, priority of other activities, etc.) but that would bring benefit to all stakeholders.

It is necessary to view the benefit not only in terms of financial returns, but also in terms the socio-economic benefit (e.g., improving the public's perception of the private owner).

#### 4.1.2. Other JESSICA-type projects

The European investment bank had evaluation studies on the implementation of the JESSICA financial instrument drawn up in a number of EU Member States. These studies are available on [http://www.eib.org/products/technical\\_assistance/jessica/studies/index.htm](http://www.eib.org/products/technical_assistance/jessica/studies/index.htm).

Some of the evaluation studies include model projects that could be financed through this instrument. Of the model projects, we chose a number of examples for the purposes of our study, and we list them below also with the aim of **showing the possible setup of JESSICA-type projects, including a new way of thinking** when planning investment activities for the regeneration of the urban environment, that makes use of cooperation between municipalities and private partners.

- **Projects to improve mobility in the urban environment**  
(taken from the evaluation study prepared for the EIB  
[http://www.eib.org/attachments/documents/implementation-of-jessica-in-andalucia\\_en.pdf](http://www.eib.org/attachments/documents/implementation-of-jessica-in-andalucia_en.pdf))  
This project is good example of the comprehensive approach to resolving a situation and shows the possibility of cooperation between the municipality and the private partner.

## 4. Definitions of types of projects and involvement of private partners (continued)

### Current state

The Spanish city of Sanlúcar de Barrameda (approximately 60 000 inhabitants) has drafted a complex strategy for the revitalisation of the centre of the city. One of the problems, also caused by the sudden growth in the city's size in the 20<sup>th</sup> century, is inadequate transport service access to the centre (also low proportion of public transport, no tie-in to individual transport, lack of parking).

### Proposed investment

The project comprises three main actions:

- Implementing an electric minibus network to serve the city centre. The investment costs should include expansion of the city's fleet, reconstruction of the depot (installation of recharging station for the electro-mobiles) and construction of bus stops.
- Creation of a park-and-ride network on the city periphery and its connection to public transport (microbus network). The construction of four car parks is planned along the perimeter of the city centre.
- Establishment of new public leisure areas at the edge of the city centre. Construction of underground car-parks will relieve surface traffic and allow the establishment of parks for leisure time activities, relaxation, etc. or public squares.

### Stakeholders

The project stakeholders are the city and a private partner. The city's task is to manage the project and create the respective urban development fund to co-finance the investment. The city will also provide the land on which the car parks will be built. The private partner will be responsible for the construction of all three parts of the project and for the operation of the car parks.

### Financial structure of the project

The city will bear the costs of operation and maintenance of the bus lines. The private partner will bear the costs associated with the construction and operation of the car parks.

Half of the parking spaces will be sold after being constructed. Other project revenue will comprise fees collected for use of the car parks.

#### 4. Definitions of types of projects and involvement of private partners (continued)

- **Project for reclaiming the historic centre Molkenmarkt und Klosterviertel (Berlin)**  
(Taken from the evaluation study prepared for the <http://www.eib.org/attachments/de-berlin-study-summary-en.pdf>)

The project is an interesting example of a solution for an urban area whose current layout is not suitable for a modern urban environment. It shows that the JESSICA financial instrument can also be used to remodel an urban concept and not only to regenerate brownfields within a city.

##### **Current state**

The Molkenmarkt und Klosterviertel area was substantially destroyed during the Second World War and the majority of the city's districts were obliterated through bombing raids. The area was then used to construct transport infrastructure. The project territory for the most part comprises transport communications or parking space. Such built up area does not respect the urban layout of the city and acts as barrier to the leisure use of the area.

##### **Proposed investments**

The first step of the investment is remodelling the transport network. This will allow construction in the vacant areas as the next step (construction of missing housing blocks in the ground-plan).

##### **Stakeholders**

City, private partners (land owners).

##### **Financial structure of the project**

The project revenue will comprise the sale or lease of the real estate.

- **Project for the transformation of a former hospital**  
(Taken from the evaluation study prepared for the EIB  
<http://www.eib.org/attachments/documents/jessica-in-western-finland-en.pdf>)

This project also shows the use of existing gaps in the market where the construction/renovation of residential buildings in Finland is not assisted from the ERDF.

##### **Current state**

The hospital building is no longer used for its original purpose.

#### 4. Definitions of types of projects and involvement of private partners (continued)

##### **Proposed investment**

According to the plan, the former hospital grounds will be transformed into a centre for well-being and accommodation services mainly for seniors. Such change of use requires the reconstruction and renovation of existing building as well as construction of new buildings within the grounds. The result should be a residential housing complex (about 40%) and service space (about 60%).

##### **Stakeholders**

The hospital grounds were purchased by a real estate agency (40%), the city (20%), and the State (40%).

##### **Financial structure of project**

Project revenue will comprise lease revenue from residential units/rooms and revenue from provision of above-standard care as part of the well-being services.

- **Project for the regeneration of the old gas works into a cultural centre**

(Taken from the evaluation study drawn up for the EIB [http://www.eib.org/attachments/jessica-poland-west\\_en.pdf](http://www.eib.org/attachments/jessica-poland-west_en.pdf))

##### **Current state**

Originally the site was a gas works built in 1856 to supply the city with gas from coal sources. After implementation of the nation-wide gas pipeline, gas production came to an end.

##### **Proposed investment**

The objective is to build a cultural centre on the site for exhibitions, theatres productions, concerts, conferences, galleries and others. The ground floor of the new building will contain cafes, restaurants, bookshops and a library. The other parts will then contain office and other commercial space to make the project financially sustainable.

##### **Stakeholders**

At this time the grounds are owned by the city (68.94%), a private gas company, and a gas pipeline network operator.

##### **Financial structure of the project**

The establishment of an SPV is expected with the involvement of all three entities.

## 4. Definitions of types of projects and involvement of private partners (continued)

### Summary of projects

The projects analysed as part of the preparatory studies for the EIB clearly show the following:

- High flexibility of project structures
- Interest on the part of the entities to execute the projects
- Significant cooperation between the public and private sectors
- Comprehensive approach to resolving the issues of regeneration of urban areas
- At least partial recoverability of the projects

### 4.2. Assessment of the involvement of private partners in the implementation of the JESSICA financial instrument

From the point of view of involvement of private partners in the implementation of the JESSICA financial instrument in the Czech Republic, three levels can be expected:

- **Holding fund/urban development fund manager**  
The main benefit of this option is the transfer of know-how from the private partners (namely banking institutions) involved as the fund managers to the public sector, in particular in the area of financial engineering. It is namely the banking institutions that have extensive experience with the assessing investments from the point of view of their risk, returns etc. and with the assessment of clients, for example from the point of their creditworthiness etc. At the same time, they can provide qualified assistance to the project implementer in the area of investment management.
- **Investor of the holding fund/urban development fund**  
If the private partners are involved as the fund investors, the implementation of one of the main benefits of the JESSICA financial instrument will occur: the leverage effect and receipt of additional funds for investment in the area of urban development. Nevertheless, in such case it would be necessary to resolve in particular the issue of the terms and conditions connected to the provision of aid from two different sources and the terms and conditions of the private partner who will provide the funds.
- **Project implementation partner**  
If the private partner becomes involved in the execution of the project in cooperation with the city, the types of investments that will be made will be those that would otherwise not be executed (e.g., see the case studies in Chapter 4.1.1 hereof). In most cases, the private partner has experience with investment and project management that can be applied in connection with the implementation of the joint investment and, at the same time, will be able to transfer this experience to the public sector.

#### 4. Definitions of types of projects and involvement of private partners (continued)

At the same time, those projects for which full grants would not be awarded – as the project activities do not fall into the assisted activities concept in the framework of the given priority axis or area of intervention – could be realised.

It is apparent that each of the above forms of involvement of private partners has its advantages. With regard to the fact that a different type of institution will be involved in connection with the use of each of the above forms (a bank in the case of fund manager or investor or a developer in the case of a project implementation partner), the use of one or more forms of cooperation with a private partner in connection with the implementation of the JESSICA financial instruments at one time is not precluded.

In the event of interest on the part of private partners and assuming mutually advantageous contractual conditions, all three options can be recommended.

##### 4.3. Assessment of the involvement of Czech financial institutions in the implementation of the JESSICA financial instrument

As part of the analysis, we examined the possibility and interest of banking institutions in the Czech Republic to take part in the implementation of the JESSICA financial instrument in the Czech Republic, namely at the holding fund or urban development fund level. The following table provides a list of the entities addressed.

<b>Czech banking/financial institutions with mainly private capital</b>	<ul style="list-style-type: none"> <li>• Komerční banka</li> <li>• Česká spořitelna</li> <li>• UniCredit</li> </ul>
<b>Czech banking/financial institutions with mainly government capital</b>	<ul style="list-style-type: none"> <li>• Českomoravská záruční a rozvojová banka (Czech-Moravian Guarantee and Development Bank)</li> </ul>
<b>International banking institutions</b>	<ul style="list-style-type: none"> <li>• European Investment Bank</li> </ul>
<b>Government agencies and other public institutions</b>	<ul style="list-style-type: none"> <li>• State Housing Development Fund</li> <li>• State Environmental Fund</li> </ul>

**Table 2 Addressed entities**

As part of our investigation, we arrived at the conclusion that external entities are interested in taking part in the implementation of the JESSICA financial instrument as fund managers (HF/UDF) and in any capital entrance into the funds (HF/UDF).

#### 4. Definitions of types of projects and involvement of private partners (continued)

Nevertheless, we consider the creation of such a communication platform that allows for the involvement of external entities in formulating the terms and conditions of any public procurement to be appropriate - in accordance with the principles of transparency, non-discrimination, and equal treatment – in order for these terms and conditions to contain all aspects that are important for the banking institutions from the point of view of their decision-making process. This will be important in particular there where the external entities will act as the fund investors because, for example, internal procedures (including risk management) of the external subject need not always be compatible with the procedures of the holding fund/urban development fund manager.

#### SWOT analysis of the involvement of Czech banking institutions

S	W
<ul style="list-style-type: none"> <li>- Experience with the provision of financial products, including assessment of the creditworthiness of clients</li> <li>- Experience with the provision of products to Czech public administration and with structural funds</li> <li>- Experience with project and investment management</li> <li>- No need to undertake any measures to ensure compliance with the State Budgetary Rules</li> </ul>	<ul style="list-style-type: none"> <li>- No experience with implementing the JESSICA financial instrument</li> <li>- Absence of such experience can increase the administrative burden on the Managing Authority</li> <li>- Time demands tied to the need to proceed according to the Public Procurement Act</li> <li>- Possible higher costs for the management of resources than for example in the case of a manager that would be a public institution</li> <li>- Bureaucratic bank structure that need not correspond to the requirements of the JESSICA financial instrument</li> </ul>
O	T
<ul style="list-style-type: none"> <li>- In the event that the financial instrument model proves successful, willingness to become investors in the fund and, in this way, multiply the resources that can be used for possible investment in urban zone development</li> </ul>	<ul style="list-style-type: none"> <li>- Need to place emphasis on negotiating business terms and conditions that are equal for both contractual parties</li> <li>- Observance and possible enforcement of business terms and conditions</li> <li>- Terms and conditions for granting aid through the JESSICA financial instrument will not be compatible with the bank's internal rules and procedures</li> </ul>

## 5. Identified risks and barriers

Based on the analysis performed and the activities undertaken as part of the market research, we have identified risks and barriers to the implementation of the JESSICA financial instrument in the Czech Republic and divided them up into the following groups:

- Lack of financial resources
- Lack of suitable projects – low absorption capacity
- Limited timeframe for implementing the JESSICA financial instrument
- Erroneous setup of the implementation structure
- Lack of interest of the Managing Authorities
- Insufficient administrative capacity
- Lack of interest of external entities
- Lack of experience of municipalities with managing projects similar to ones as within the JESSICA financial instrument
- Legislative and procedural barriers

For certain risks/barriers, the NCA is also listed as the risk owner. We understand that the liability for implementation of the financial instrument is borne by the Managing Authority that decides on the implementation (or other involved institutions – holding funds, etc.). We see the role of the NCA in connection with resolving certain risks first and foremost in its advisory and coordination role (e.g., transfer of experience from abroad, support of the MA in connection with negotiating with the EC, ensuring the transfer of information at the national level etc.).

## 5. Identified risks and barriers (continued)

Description	Magnitude	Probability of occurrence	Mitigation/remedial measures	Risk owner <sup>126</sup>
<b>Lack of financial resources</b>				
<p><b>Lack of available (non-contracted) financial resources for the JESSICA financial instrument</b></p> <p>As part of the operational programmes that can consider the implementation of the JESSICA financial instruments (namely ROP and IOP), allocated resources in many areas of assistance are almost all completely committed (i.e., covered by contracts or decision on award of grant or are not available in sufficient volume).</p>	High	High in the case of ROP and individually under OP	<p>Rather than viewing it as risk, this point should be perceived as a barrier to the use of this financial instrument in the current programming period.</p> <p>For its elimination, reallocation of additional financial resources from the operational programmes that do not have sufficient absorption capacity and thus are under the threat that the allocated resources will not be utilised in time can be considered at the central level. The above reallocated resources should reflect actual absorption capacity. At the level of the Managing Authorities, there is the limited possibility of prospective reallocation across the priority axes (even though it can be assumed that the problem of a lack of financial resources in ROPs is shared by all axes<sup>127</sup>) or use of reserves created for covering exchange rate risks<sup>128</sup>. In the case of reallocation between operational programmes, we feel the NCA should assist the Managing Authorities when negotiation with the EC, to accelerate this process.</p>	MA/NCA

<sup>126</sup> The one who can eliminate/resolve the risk

<sup>127</sup> As opposed to Moravia-Silesia, for example, whose regional operational programme showed low utilisation and, thus, an excess of resources in the priority areas with respect to brownfields and where other use of the funds did not in fact present itself in this region

<sup>128</sup> With regard to the development of the CZK/EUR exchange rate, exchange rate gains can be expected

## 5. Identified risks and barriers (continued)

Description	Magnitude	Probability of occurrence	Mitigation/remedial measure	Risk owner
<b>Lack of financial resources</b>				
<p><b>Unwillingness to transfer available resources to JESSICA-type projects</b></p> <p>In a number of regions that still do not have or are not preparing studies from their own initiative, the stance on JESSICA is passive/cautious (namely on the part of potential beneficiaries). There is thus the real threat that the Monitoring Committee that approves the transfer of resources from the operational programme to the holding fund/urban development fund will not be willing (e.g., for political reasons) to approve such change.</p>	High	Individual, depends on operational programme	Ensure sufficient communication on the part of the Managing Authorities with respect to the monitoring committees, including any pre-negotiations. Support of argumentation for approval of the transfer, e.g. through organisation of pilot projects.	MA

## 5. Identified risks and barriers (continued)

Description	Magnitude	Probability of occurrence	Mitigation/remedial measures	Risk owner
<b>Lack of projects – low absorption capacity</b>				
<p><b>Insufficient absorption capacity of the JESSICA financial instrument caused by erroneous or distorted perception of this instrument by potential beneficiaries</b></p> <p>At this time there is no specific idea as to the existence of a sufficient number of projects and eligible beneficiaries for the utilisation of this financial instrument. Based on interviews with the Managing Authorities and on the information workshops, no clear interest in such type of financing was confirmed. Among the potential beneficiaries (even among certain Managing Authorities), a passive and cautious approach prevailed due to, in their view, an non-specifically defined type of financing (e.g., the municipalities are expecting specific conditions to be presented, such as loan parameters, so that they can take a clearer stance on such type of financing). At the same time, the municipalities are finding themselves in the situation where it is for them relatively easy to obtain sufficient resources to implement their projects; therefore they do not show sufficient interest in the type of financing provided by the financial engineering instrument. Nevertheless, this situation can also be caused by the fact that this is a new instrument for which precise terms and conditions have not been set for its functioning.</p>	Medium	High in the case of OPs that have not begun to examine JESSICA at their own initiative.	An important step is organisation of an information campaign for representatives of municipalities and other entities, namely with respect to sample projects, the benefits of the new instrument and these bodies' involvement in defining the terms and conditions for implementation of the financial instrument.	MA

## 5. Identified risks and barriers (continued)

Description	Magnitude	Probability of occurrence	Mitigation/remedial measures	Risk owner
<b>Lack of projects – low absorption capacity</b>				
<p><b>Inability of cities and other beneficiaries/partners to prepare appropriate projects</b></p> <p>JESSICA projects, in the way they are set up and function, vary greatly from projects that have so far been executed by the municipalities (or other beneficiaries). To a certain extent, it is possible to perceive them as projects executed on the basis of sub-contracting agreement and so-called PPP projects. Setting up a project for JESSICA then requires, in particular for the municipality, a new way of thinking and creation of workable partnerships or projects that will also function in part on a commercial basis.</p>	Medium	Medium	Municipalities should be given full support. It is good to inform them about any projects, setup possibilities, etc. According to the extent of experience enjoyed by the beneficiaries, the services of advisors should also be used in connection with setting up projects.	MA/UDF

## 5. Identified risks and barriers (continued)

Description	Magnitude	Probability of occurrence	Mitigation/remedial measures	Risk owner
<b>Lack of projects – low absorption capacity</b>				
<p><b>Current setup of IUDP, which does not support JESSICA instruments</b></p> <p>The current IUDP rules are relatively restrictive for the municipalities and are an obstacle for JESSICA especially for the following reasons:</p> <ul style="list-style-type: none"> <li>- Inconsistent approach to the strategies of municipalities (within one municipality there is, as a rule, a strategic urban development plan and then one or sometimes more IUDPs);</li> <li>- Preparation of IUDPs is administratively and time demanding</li> <li>- As a rule, projects that contain an existing IUDP already have financial resources allocated and promised. Adding more projects to the IUDP is administratively demanding</li> <li>- IUDP resolves only certain areas of the urban environment</li> <li>- Criteria for preparing IUDPs (e.g., defining development areas) can be binding and restricting for JESSICA projects</li> <li>- As a rule, only bigger municipalities have IUDPs (in the case of ROP, municipalities with over 50 thousand inhabitants; in the case of IOP, municipalities with over 20 thousand inhabitants)</li> <li>- Financial limits for each IUDP (in the case of ROP, the IUDP has to have a value of EUR 10 million; in the case of IOP, the IUDP has to have a value of EUR 3 million for cities with a population exceeding 50 thousand, EUR 2 million for cities with a population exceeding 20 thousand).</li> </ul>	Medium	Certain – barrier	<p>Although the requirement to include projects financed from the JESSICA financial instrument into the IUDP is set out in the General Regulation (Art. 44), this regulation does not provide a precise definition of an IUDP. At the same time, this article does not speak directly about the IUDP but about the integrated plan for sustainable urban development. We are aware that the current setup of the IUDP rules is the result of negotiations between the Czech Republic and the European Commission at the beginning of the programming period. Nevertheless, in the case of a decision on the implementation of the JESSICA financial instrument in the Czech Republic, it will be necessary to simplify the current rules. It is necessary to point out that this risk was seriously identified by the beneficiaries themselves. Conversely, according to the opinion of the Managing Authority, the IUDP rules are not a fundamental problem.</p> <p>A possible solution would be to lay down that the IUDP will be deemed a strategic urban development document.</p>	NCA

## 5. Identified risks and barriers (continued)

Description	Magnitude	Probability of occurrence	Mitigation/remedial measures	Risk owner
<b>Limited timeframe for implementing JESSICA</b>				
<p><b>Time demanding nature of establishing implementation structures with account taken of the moment of implementation of the programme period leading to the resources not being allocated to projects by the end of the programming period</b></p> <p>Setting up the implementation structure is extremely time demanding:</p> <ul style="list-style-type: none"> <li>- On the side of implementation, it is necessary to carry out the reallocation of resources, obtain approval for the transfer from the monitoring committee, possibly establish a holding fund, create an investment strategy, establish an urban development, and set out specific terms and conditions for the granting of assistance</li> <li>- On the side of the beneficiary, it is necessary to prepare projects (arrange partnerships, land-use decisions, construction permits, obtain additional financing etc.). It can be expected that the beneficiaries will not be implementing these steps entirely in parallel with the set up of the implementation structure but rather will be waiting for the specific terms and conditions of the financial instruments; this will rather tie them to the previous step.</li> <li>- More time needs to be added for the selection of projects, i.e., the assessment process itself.</li> </ul> <p>The timeframe for the previous three steps is limited to the need of 2015 under rule n+2.</p>	Medium	Medium-high	<p>Set up an action plan, including the time schedule, and ensure observance thereof. At the same time, provide sufficient support and information to potential beneficiaries to allow them to start preparing projects in parallel with established structures.</p> <p>At the same time, the implementation of the financial instrument, including the level of utilisation of financial resources, should be carefully monitored. We recommend setting a moment in advance to assess utilisation in such a way to allow sufficient time to return resources to the Managing Authorities for use on different projects in the form of grants.</p>	NCA/MA

## 5. Identified risks and barriers (continued)

Description	Magnitude	Probability of occurrence	Mitigation/remedial measures	Risk owner
<b>Erroneous setup of implementation structure</b>				
<p><b>Unattractive setup of the terms and conditions for the granting of assistance in the framework of the JESSICA financial instrument</b></p> <p>Already the fact that this is a credit instrument decreases the level of attraction it has for the municipalities that are grant beneficiaries. In the case of excessively strict terms for utilisation, not only would interest on the part of beneficiaries be limited but also the number of projects that would meet the set criteria would be significantly reduced.</p>	Medium	Medium	<p>The conditions for the granting of assistance should be set up in such a way as to represent a substantially more advantageous form of financing than regular commercial loans (namely in terms of interest rate, maturity, instalments, etc.).</p> <p>At the same time, administrative requirements should be set up so as not to be demanding on the beneficiaries or discourage them from utilisation this financial instrument.</p>	NCA/MA/ UDF
<p><b>Erroneous setup of the decision-making mechanism at the project selection level</b></p> <p>The involvement of entities with specific banking expertise (assessing creditworthiness, rates of return on investments etc.) is expected. These entities do not have experience with assessing the socio-economic impacts of the investments, which should be positive in the case of financing through the JESSICA financial instrument. There is the risk that the project selection criteria aimed at sufficient profitability will not reflect their importance and priority in terms of public interest and will thus lead to approval of projects that will not fulfil the criteria of the operational programme in question (e.g., fulfilment of the stipulated indicators).</p>	Medium	Medium	<p>This risk can be eliminated by involving experts from the Managing Authorities in the evaluation process at the urban development fund level. We believe it must be emphasised that it is in the framework of the evaluation to ensure a balance between the financial assessment with regard to the profitability of the project and the impact assessment. For example, projects that have a strong, positive impact on the development of the given area but investment into them is risky should not be given assistance, this with regard to the fact that this is a recoverable form of assistance and the projects should be able to repay the contributed resources.</p>	MA/UDF

## 5. Identified risks and barriers (continued)

Description	Magnitude	Probability of occurrence	Mitigation/remedial measures	Risk owner
<b>Erroneous setup of the implementation structure</b>				
<p><b>Discrepancy between supply and demand</b></p> <p>When setting the terms and conditions of the JESSICA financial instrument, it can happen that the focus of the assistance (e.g., from the thematic point of view) will not correspond to the focus of the projects that the municipalities will be interested in executing. This fact could result in a lack of interest on the part of the municipalities, thereby leading to the non-utilisation of resources from the fund, which would then have to be returned to the European Commission.</p>	Medium	Low	<p>We believe that the representatives of the municipalities should be involved in the process of setting the terms and conditions in such a way to allow their true needs to be reflected and guard against rules being set up that make the implementation of these needs impossible.</p> <p>At the same time, it is necessary to provide such a communication platform that ensures that the municipalities are sufficiently informed about the course of implementation of the JESSICA financial instrument.</p>	NCA/MA
<b>Lack of interest of the Managing Authorities</b>				
<p>In the case of the JESSICA financial instrument, this is a new method of using resources from the EU structural funds where the terms and conditions for its functioning are still not clear. This fact can be reflected in the passive approach of the Managing Authorities to this topic, which could be caused for one by the worries arising from an unknown issue or insufficient information.</p>	High	Medium	<p>In this case, the coordination role of the Ministry for Regional Development, as the National Coordination Authority, needs to be emphasised. The Ministry needs to provide information and coordination assistance to the Managing Authorities that show interest in utilising the financial engineering instrument and arrange for those issues that exceed the competency of each of the Managing Authorities to be addressed.</p>	NCA

## 5. Identified risks and barriers (continued)

Description	Magnitude	Probability of occurrence	Mitigation/remedial measures	Risk owner
<b>Administrative capacity of the Managing Authorities</b>				
With regard to the fact that this is a new method of utilising resources from the EU structural funds, with there being practically no experience with setting up and subsequently managing it in the Czech Republic, a certain risk can also be insufficient administrative capacity on the part of the implementing structure, the lack of administrative capacity on the part of the implementing structures caused by a lack of experience and awareness on the part of the staff of the Managing Authorities. This fact can lead to the risk that the JESSICA financial instrument will not be executed in the Czech Republic or time delays may occur with respect to its implementation.	Medium	Medium	Those institutions that already have experience with financial engineering instruments, e.g., from abroad, should be involved.	MA
<b>Lack of interest on the part of external entities</b>				
<b>Unclear conditions for involving external subjects</b> Due to the fact that at this time no clearly defined rules are in place for how the JESSICA financial instrument is to function in the Czech Republic, it is not possible to determine the extent and terms and conditions of involving external entities (be they private or public institutions). Furthermore, there is insufficient information being provided at this time to the implementation structures and external entities regarding these terms and conditions, which can result in a lack of interest on the part of the external entities in any tendering procedures for holding fund/urban development fund managers, provided the tendering documentation does not contain all information and aspects for the decision-making process.	Medium	Medium	A communication platform between the implementation structures and external entities should be established to allow for the involvement of these entities in defining the terms and conditions.	NCA/MA/ HF

## 5. Identified risks and barriers (continued)

Description	Magnitude	Probability of occurrence	Mitigation/remedial measures	Risk owner
<b>Lack of interest on the part of external entities</b>				
<p><b>Incompatibility with the internal procedures of external entities</b></p> <p>Banking institutions in particular have their own procedure for approving the provision of resources, and these procedures need not be in compliance with the procedures of the holding fund/urban development fund manager.</p>	Low	Low	A communication platform should be created between the implementation structures and external subjects that would allow their involvement in connection with the set up of internal processes under the holding fund/urban development fund.	NCA/MA/ HF
<b>Lack of experience with managing similar types of projects</b>				
<p>The JESSICA financial instrument represents a new method of project financing that requires a different project management approach by the municipalities, in particular for the reason that the projects will require the involvement of private partners or use various sources of financing etc. If sufficient attention is not paid to project management, the situation can occur where projects are not executed successfully and the resources provided by the urban development fund are not recovered.</p>	Medium	Medium	<p>It is entirely necessary to continue with the information campaign in such a way that the municipalities are informed on an ongoing basis about the state of implementation of the JESSICA financial instrument in the Czech Republic. At the same time, we believe that municipal representatives should be involved in the process of setting up the terms and conditions.</p> <p>During the project implementation, assistance with management should be provided to the municipalities, either by the urban development fund or the Managing Authority.</p>	NCA/MA/ UDF

## 5. Identified risks and barriers (continued)

Description	Magnitude	Probability of occurrence	Mitigation/remedial measures	Risk owner
<b>Legislative and procedural obstacles</b>				
<p><b>State Budgetary Rules</b></p> <p>According to Section 33(7) of the State Budgetary Rules, financial resources from the State treasury may not be placed outside of accounts subordinated to the State treasury. This provision means a restriction on the involvement of foreign institutions such as fund managers, be it the HF or UDF (e.g., the EIB could not be involved as the HF manager if it did not set up a branch in the Czech Republic). This fact can be seen as a breach of the principle of non-discrimination on the EU internal market (see 3.1.2(vi) Management of resources outside the Czech Republic).</p>	High	High	Although in this phase of the pilot verification it is not anticipated that the holding fund manager would be a financial institution (such as the EIB), it would be suitable, with regard to the preparation of the future programming period, to resolve the issue of budgetary rules, especially with regard to allowing resources subordinated to the State treasury to be managed outside of the State treasury accounts either by having the various institutions adjust to the legal interpretation or changing the State Budgetary Rules.	MA/NCA
<p><b>Programme financing rules</b></p> <p>One of the conditions and one of the possible options for implementing the JESSICA financial instrument in the Czech Republic is its implementation via a pilot project financed by the OPTA and whose beneficiary would be the NCA. In such case, the NCA would be responsible for selecting the UDF manager and transferring the resources. Nevertheless, the NCA, from the point of view of the programme financing rules, is not in the role of the programme administrator and therefore cannot issue grant award decisions based on which the resources are transferred to the UDF for management.</p>	High	High	We believe that is it necessary, in cooperation with the MfRD's budgetary department, to arrange for the possibility to have the NCA to issue decisions to award grants. A possible solution would be to create a sub-programme within the framework of the OPTA to implement the financial instrument and have the NCA be the manager of this sub programme. In connection with the creation of the sub-programme, it would also be necessary for the NCA, as the manager, to create managing and controlling systems.	MA/NCA

## 5. Identified risks and barriers (continued)

Description	Magnitude	Probability of occurrence	Mitigation/remedial measures	Risk owner
<b>Legislative and procedural obstacles</b>				
<p><b>Regulation on establishment of public institutions</b></p> <p>Public institutions whose involvement in the implementation of the JESSICA instrument in the Czech Republic can be considered are established based on statutory regulations that also define the subject of their activities and the purpose for which these institutions contribute their resources. These aspects always have to be in compliance with the requirements and rules of the JESSICA financial instrument.</p>	Medium	High	We recommend that a legislative process be initiated sufficiently in advance to execute the changes in regulations pertaining to these public institutions if it is decided in favour of their involvement.	MA/NCA
<p><b>Financial flows within the OPTA</b></p> <p>According to valid rules, financial flows within the OPTA are set up as ex-post financing where the share of the State budget on national co-financing and pre-financing of resources that should be covered by the EU structural funds are first paid from the pertinent budgetary chapters.</p>	Medium	Medium	In the event that the EIB is involved in the implementation structure as the holding fund manager or a private entity is involved as the urban development fund manager, it will be necessary to change the financial flows to allow for the resources for management to be sent in ex-ante form.	MA
<p><b>Funding agreements</b></p> <p>The setup of contractual terms and conditions in the funding agreements can also be perceived as a certain risk. In this connection, the contractual conditions have to be favourable for both parties and not lead to an increase in the level of risk for the Managing Authority.</p>	High	Medium	<p>It is apparent that it is the obligation of the Managing Authority of the respective operational programme in particular to place emphasis on arranging favourable terms and conditions when signing the funding agreement.</p> <p>Nevertheless, in this connection, we believe that a sample of the business terms and conditions covering all important areas and arrangements should be drafted at the national level (i.e., in cooperation with the NCA and MA). These areas are specified in Chapter 6.2.3 hereof.</p>	MA/NCA

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic

This chapter of the report focuses on the proposed options for the implementation structures of the JESSICA financial instrument in the Czech Republic. It describes both the options for the implementation of the JESSICA financial instrument that are based on assumptions stated in chapter 2.3. of this study (i.e. implementation through the OPTA), and the options based on the use of regional operational programmes or thematic operational programmes.

### 6.1. Basic assumptions for drawing up models of implementation of the JESSICA financial instrument

In general, the implementation model of the JESSICA financial instrument can be described in diagrammatic form as shown in Figures 2 and 3. The model is based on the provisions of Article 44 of the General Regulation and Articles 43 – 46 of the Implementing Regulation.

Upon approval by the monitoring committee the managing authority will transfer part of the operational programme financial allocation intended for urban regeneration into a holding fund and will conclude a funding agreement with it. If this optional element, i.e. the holding fund, is not established, the financial resources will be transferred directly to urban development funds. The urban development funds may be supplemented with additional funding resources (e.g. from private sector investors, municipal councils or financial institutions). The funding may also be supplemented with financial resources from other operational programmes. The urban development funds can then make their resources available through loans, guarantees and equity.

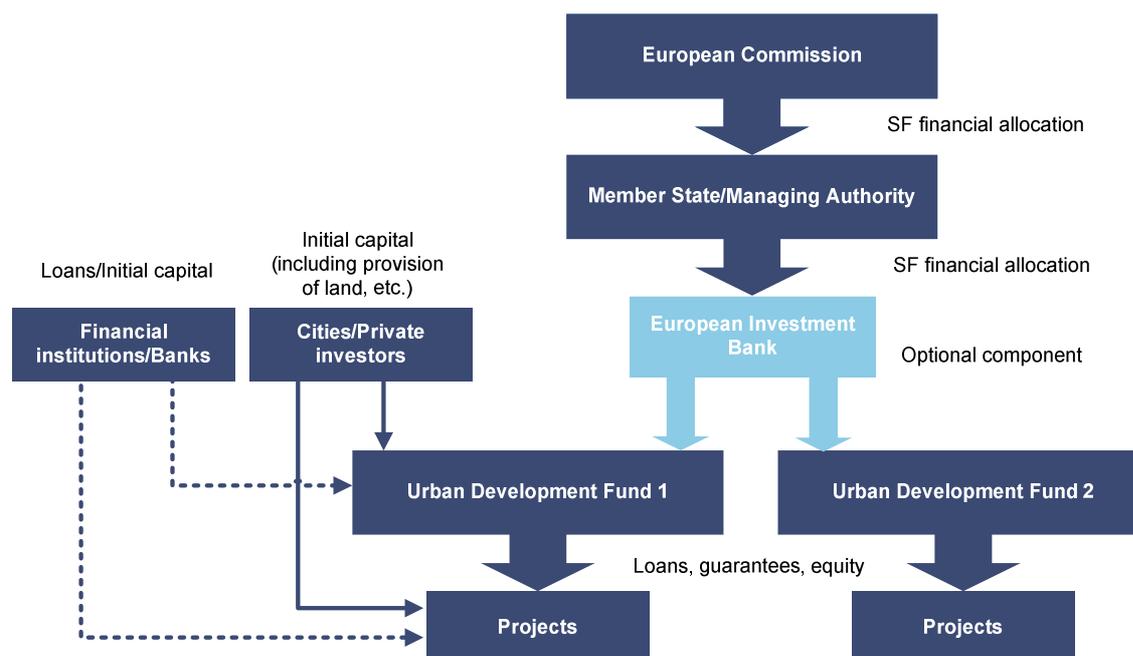
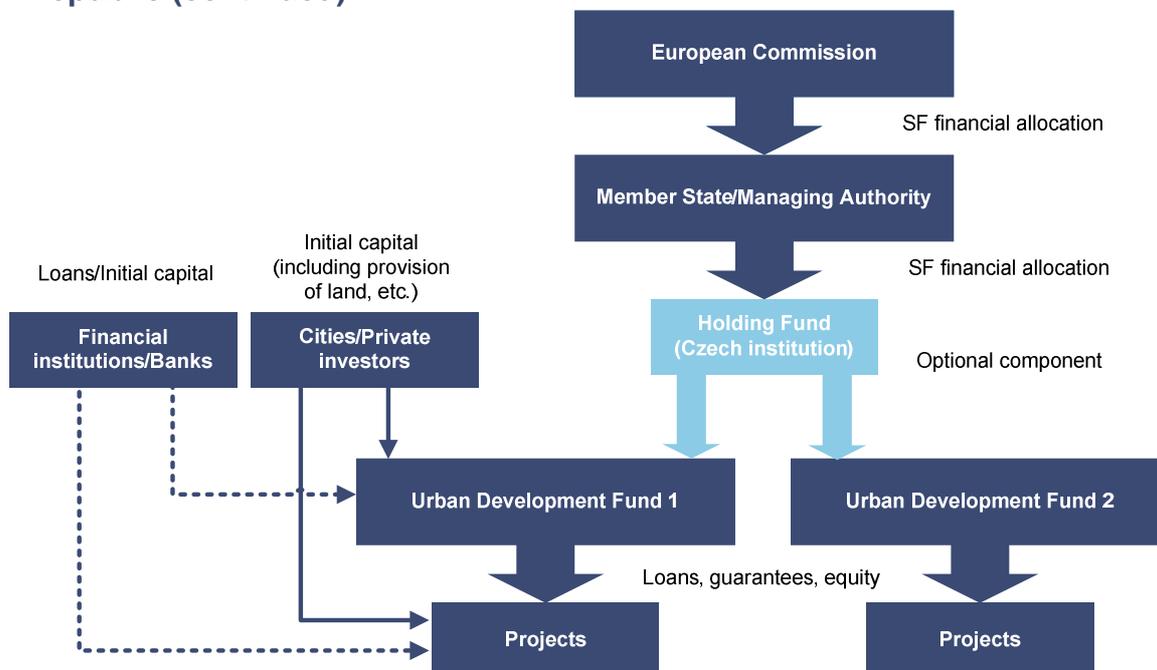


Figure 2 Basic diagram of the JESSICA financial instrument implementation with the participation of EIB as the holding fund manager

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)



**Figure 3 Basic diagram of the JESSICA financial instrument implementation with the participation of a Czech institution as the holding fund manager**

### 6.1.1. Assessment of the possibility of involving a Czech and European institution as the fund manager

There are several possibilities of involving an external partner as the fund manager (of the holding fund or the urban development fund):

- Participation of an international banking institution (EIB) as the holding fund manager;
- Participation of a private banking/financial institution registered in the Czech Republic as the holding fund/urban development fund manager;
- Participation of a public banking/financial institution registered in the Czech Republic as the holding fund/urban development fund manager (ČMZRB);
- Participation of a national public institution (e.g. a national agency or a state fund) as the holding fund/urban development fund manager;
- Establishing a completely new institution which would act as the holding fund and the urban development fund manager.

It is necessary to consider both advantages and potential disadvantages of individual options before deciding which one to take. In the table below we summarize an assessment of the five options mentioned above. In defining the advantages and disadvantages we use the assumption that the groups consist of entities specified in Table 3.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

The advantages and disadvantages defined in the basic framework relate both to the holding fund manager (in all five specified groups) and to the urban development fund manager (in four groups, i.e. with the exception of the EIB). The option with the participation of the EIB as the urban development fund was not considered, especially because of the behaviour framework in other countries so far, which is characterized by time limited operations connected with the starting up of the JESSICA financial instrument and by a higher scope which can be expected from an international financial institution.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

	Relevant experience	Compliance with legislation	Time demand	Costs	Other
International banking institutions (EIB)	+ experience in implementing the JESSICA financial instrument as a holding fund manager both in the conditions of the Czech Republic (Moravian-Silesian NUTS II Cohesion Region) and other EU countries, which will make transfer of current know-how possible + experience in the assessment of investment projects and provision of financial products, including customer reliability and solvency assessment + experience in the provision of products for public administration in the CR and in the area of structural funds	+ no need to act in accordance with the PPA			+ institutional closeness to the EC (an advantage, e.g. for consulting on non-standard situations, discussing new issues, etc.)
		- limitations arising from State Budgetary Rules (according to the latest indirect information from the Ministry of Finance, if the HF was created from a thematic operational programme, the EIB would have to establish a Czech branch for the purpose of managing the fund or the State Budgetary Rules would have to be amended)	- higher time demand of implementation due to limitations arising from State Budgetary Rules (see Compliance with legislation)	- such an institution will be interested in managing the fund only if a minimum requested amount is provided in the HF	- negotiating the contract conditions – the EIB applies its standard conditions and uses the already concluded contracts for management of holding funds. When negotiating the contract, it is necessary to ensure that its conditions conform to the specific “business case” of the order party.
				- higher fund management costs	
Private banking/financial institutions registered in the CR	+ experience in the provision of financial products, including customer reliability and solvency assessment + experience in the provision of products for public administration in the CR and in the area of structural funds	+ there are no measures needed to ensure compliance with the Act on State Budgetary Rules			
	- no previous experience in the JESSICA financial instrument		- time demanding due to the necessity to act in accordance with the PPA	- more demanding requirements for the return on the provided service	- absence of experience on the part of the entity may burden the managing authority
				- higher fund management costs	

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

	Relevant experience	Compliance with legislation	Time demand	Costs	Other
Public banking/financial institutions registered in the CR (ČMZRB)	+ experience in the provision of financial products, including customer reliability and solvency assessment + experience in the provision of products for public administration in the CR and in the area of structural funds	+ there are no measures needed to ensure compliance with the Act on State Budgetary Rules		+ lower management costs than in the case of private institutions	
	- no previous experience in the JESSICA financial instrument	- amendments to legal documents establishing such institutions would be necessary in view of the extended subject of their activity (in the case of ČMZRB)	- time demanding due to the necessity to act in accordance with the PPA  - time demanding due to the necessity to amend legal documents		- absence of experience on the part of the entity may burden the managing authority
Czech public institution	+ experience in the provision of financial products, including customer reliability and solvency assessment + experience in the provision of products for public administration in the CR	+ there are no measures needed to ensure compliance with the Act on State Budgetary Rules		+ lower management costs than in the case of private institutions	
	- no previous experience in the JESSICA financial instrument  - no experience in structural funds (SHDF)	- amendments to legal documents establishing such institutions would be necessary in view of the extended subject of their activity	- time demanding due to the necessity to act in accordance with the PPA  - time demanding due to the necessity to amend legal documents		- absence of experience on the part of the entity may burden the managing authority
New institution		+ there are no measures needed to ensure compliance with the Act on State Budgetary Rules			
	- in general, no previous experience (in JESSICA, structural funds, financial instruments or e.g. the customer reliability and solvency assessment) – highly demanding establishment of a functional institution		- highly time demanding due to the necessity to establish the institution, prepare its statutes, take on employees, start operations, etc.		- absence of experience on the part of the entity may burden the managing authority - it is highly demanding to ensure sufficiently smooth running of an institution which has no previous experience because, as a matter of fact, it has started “from scratch”

Table 3 Assessment of advantages and disadvantages of involving different entities in the implementation of the JESSICA financial instrument.

Advantages are written in black and disadvantages in red.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### 6.1.2. Assessment of the holding fund involvement

Pursuant to the provisions of the General Regulation, involvement of a holding fund in the implementation structure of the JESSICA financial instrument is optional. Therefore, we recommend that both advantages and potential disadvantages of the use of this instrument be considered.

In our opinion, the following are the main advantages of establishing a holding fund:

- Transfer of know-how of financial engineering instruments – the holding fund manager should be an institution which has experience in similar schemes and will share the experience. Know-how can be passed, for example, if the EIB is the holding fund manager. At present the EIB plays the role of the JESSICA activity coordinator and is the manager of established holding funds of the JESSICA financial instrument already in several EU countries;
- Marketing experience transfer and identification of strategic players/potential investors with a view to achieve funds leverage;
- Simplification of procedures for the selection and monitoring of urban development funds from the perspective of managing authorities – the procedures may be quite demanding for managing authorities as far as finance and administration is concerned, particularly if several urban development funds are established;
- If only one urban development fund is established at the beginning and, therefore, setting up a holding fund may seem unnecessary, its establishing will make further potential development of the JESSICA financial instrument possible, e.g. through seeking other possibilities for establishing urban development funds – the holding fund manager will have sufficient potential to identify further opportunities for establishing other urban development funds according to the market demand;
- In general, reduction in administrative demands on managing authorities. If the holding fund is not established, staff numbers and facilities of the managing authorities will have to be increased so that the managing authorities can perform all the activities necessary;
- Possibility to influence the time framework of drawing on the allocation of operational programmes and thus also the possibility to meet the N+2 or N+3 rule. Under Article 78 of the General Regulation, the total expenditure paid in establishing the holding fund/urban development fund is included in the expenditure statement. At the closure of the operational programme, eligible expenditures are calculated as the total of all payments made from the urban development fund for investment in projects within the integrated plan for urban development and of any guarantees provided. An advantage of setting up a holding fund could be the fact that the holding fund can be established ahead of urban development funds, the establishing of which requires a thorough examination of demand for such type of instrument and detailed definition of project selection criteria.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

- Possibility to influence the time framework of drawing on the allocation of operational programmes and thus also the possibility to meet the N+2 or N+3 rule. Under Article 78 of the General Regulation, the total expenditure paid in establishing the holding fund/urban development fund is included in the expenditure statement. At the closure of the operational programme, eligible expenditures are calculated as the total of all payments made from the urban development fund for investment in projects within the integrated plan for urban development and of any guarantees provided. An advantage of setting up a holding fund could be the fact that the holding fund can be established ahead of urban development funds, the establishing of which requires a thorough examination of demand for such type of instrument and detailed definition of project selection criteria.

Among the main disadvantages of or obstacles to establishing a holding fund are:

- Administrative demands tied to the need to select a holding fund manager, as it will be necessary to organize a competitive tender in accordance with the Public Procurement Act. In the event that the holding fund manager is the EIB, there will be no need to proceed in accordance with the PPA;
- Financial instrument management costs – the holding fund manager’s fee is calculated as a percentage of the resources entrusted to the HF manager. According to Article 43 of the Implementing Regulation, the maximum amount of the fee is 2 % of the resources allocated from the operational programme.

### 6.1.3. Focus of urban development funds

Rules of the JESSICA financial instrument enable setting up of the implementation structure according to the conditions in the relevant Member State (or region). Equally flexible is also the set-up and focus of urban development funds. Therefore, urban development funds can be set up on the basis of territorial division and their thematic or product focus.

#### Regional focus of urban development funds

Urban development funds with regional focus are established at the level of administration units (such as municipalities, regions, cohesion regions, etc.). In the Czech Republic conditions, the most suitable level for setting up urban development funds seems to be regions or cohesion regions.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

Urban development funds established **at the cohesion region level** would reflect the current structure of regional operational programmes, which – from the point of view of thematic congruence with areas supported by the JESSICA financial instrument – seem to be the most suitable for the implementation of the instrument. However, we cannot omit the fact that cohesion regions are artificially created units and their purpose is set by law for the current programming period. It means that we cannot anticipate what their role will be in the 2014+ programming period. Moreover, as cohesion regions mostly consist of two to three administrative regions and the conditions in them may differ, such scope might not fully respect regional needs.

On the other hand, **regions** are natural administrative units and their functioning is not time limited. However, using funds of regional and thematic operational programmes would require agreement on the division of funds among individual regions, which may not be politically feasible.

Another possibility is to establish urban development funds **at the level of individual municipalities** (e.g. with a certain level of participation of the relevant municipality). An indisputable advantage of it is that every municipality knows exactly what its needs are and thus the scope of its urban development fund would comply with local conditions. On the other hand, it has to be pointed out that this arrangement is suitable especially for cities (e.g. statutory cities), which have sufficient resources for establishing an urban development fund or which may even allocate resources to it from their budget.

### Thematic focus of urban development funds

Urban development funds may also focus on individual areas requiring support (e.g. regeneration of brownfields, development of educational or sporting facilities, etc.). This option makes it possible to target support directly to problem areas in the relevant Member State or region. However, a thematic fund at the national level would require agreement on the theme of support, which may not be always easy to achieve.

This option appears suitable for the Czech Republic, provided that thematic operational programmes are included in the implementation of the JESSICA financial instrument. It is also possible to combine the regional and thematic focus of urban development funds (e.g. focus on the support of regeneration of brownfields in the Ústí nad Labem Region).

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### Focus of urban development funds according to the products provided

Urban development funds may also be set up according to the products provided (i.e. special funds for the provision of loans, guarantees and capital in the form of equity). Each of the instruments requires different management from the perspective of the financial fund and it would be advisable to modify the implementation structure accordingly. This is also confirmed by current experience of investment banks. Managers of funds oriented towards providing loans primarily focus on the evaluation and hedging of their products. On the other hand, equity fund managers actively follow market trends and take part in managing the companies to which equity has been transferred.

In view of the available capital level and extent of demand, we did not consider this option for the Czech Republic conditions.

### 6.2. Scope of the holding fund

#### 6.2.1. Legal form and participation of the holding fund

According to the EU legislation, managing authorities may not invest resources allocated from operational programmes in urban development projects by themselves. Such investments must be made by urban development funds. As the EIB explains in its document “JESSICA – Preliminary Evaluation Study”, 2007, UDFs should create within the implementation structure incentives that would bring in complementary funding in addition to resources allocated from operational programmes, i.e. other national contributions, if appropriate, and private capital, and thus accelerate investment in urban areas. Ideally, UDFs should act not only as an interface in the cash flows between operational programme and projects, but also as economically viable managers of the invested resources and above all as an institutionalized driving force encouraging long-term and sustainable participation of other investors in urban development.<sup>129</sup>

Unlike urban development funds, holding funds are not an obligatory element of the implementation structure of the JESSICA instrument. According to the General Regulation<sup>130</sup>, Member States or their managing authorities may, but are not obliged to, employ holding funds in the implementation structure in order to ensure proper cooperation between them and urban development funds.

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<sup>129</sup> EIB document “JESSICA – Preliminary Evaluation Study”, page 16 et seq.

<sup>130</sup> Clause 41 of the Preamble and Article 44 of the General Regulation.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

Under the EU legislation and according to the laws of the Czech Republic<sup>131</sup>, holding funds can take the following legal structures:

### (i) Funds as legal entities

In most cases the holding funds will be in the form of limited liability companies (s.r.o.), joint-stock companies (a.s.) or special funds of qualified investors<sup>132</sup>.

### (ii) Funds as separate financial units

Financial resources will be managed separately by private financial institutions (especially by commercial banks) or by public financial institutions, such as the EIB, EIF, Czech-Moravian Guarantee and Development Bank, State Housing Development Fund or State Environmental Fund of the Czech Republic.

Under the EU legislation and according to the laws of the Czech Republic, a holding fund can be included in the implementation structure in the following ways<sup>133</sup>:

### (i) Through the award of a public contract

In general, the holding fund will provide to the managing authority financial and investment services<sup>134</sup> consisting in the identification of suitable UDFs and investments in UDFs. Because, according to the Public Procurement Act, managing authorities will always be in the position of the contracting authority, they will have to organize a competitive tender for the services in accordance with the above Act (except for cases when the HF manager is the EIB or the EIF, see Article 44 of the General Regulation). In this context it is appropriate to mention that holding funds- providers of such services are not restricted to Czech entities.

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<sup>131</sup> Article 43(2) of the Implementing Regulation. For details see Legal analysis, chapter 3.1.1., Forms of financial engineering tools, and chapter 3.1.2., Forms of financial engineering tools.

<sup>132</sup> In general, we cannot exclude even some other legal forms, e.g. benevolent societies or legal entities' associations. We recommend that before selecting the HF legal form, especially in the case of these “alternative” forms, you thoroughly consider what form would be the best for the expected way of the HF operation (business or non-business subject of activity, number of entities involved, duration, focus on a certain area or type of projects, experience of the subjects with the relevant legal structure, etc.).

<sup>133</sup> Article 44 of the Implementing Regulation. For details see Legal analysis, chapter 3.1.1., Selection of a holding fund, and chapter 3.1.4., Public procurement contracts (EU, CR).

<sup>134</sup> Services 66000000 of the Common Procurement Vocabulary (CPV).

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### (ii) Through its establishing by the managing authority

Although the General Regulation does not explicitly mention this possibility, we are of the opinion that the managing authority may set up a holding fund-legal entity and take services from the holding fund without organising a competitive tender (in the case of the MfRD, services of the SHDF or CRD CR may be used in this way)<sup>135</sup>.

### (iii) Through awarding the contract to the EIB/EIF

A contract for services can be awarded directly to the EIB or EIF, without holding a competitive tender<sup>136</sup>.

### (iv) Through the provision of a subsidy or grant

Financial institutions may receive a subsidy from the relevant managing authority in order to make investments in urban development projects within their public mission. However, this way of involving the holding fund is viable only provided that the relationship between the managing authority and the holding fund does not meet the conditions that would require acting in accordance with the Public Procurement Act.<sup>137</sup>

### 6.2.2. Position and activities of holding funds

The position and activities of holding funds to a great extent depend on the characteristics of UDFs (see above) because holding funds should act as an “intermediate body” between the managing authority and the UDF there, where the managing authority does not have enough experience or staff for direct investment in the UDF.

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<sup>135</sup> An exception from the application of the Public Procurement Act pursuant to Section 18(1)(j) of the Act. The possibility to apply derogations from the general competitive tendering is also mentioned in clause 41 of the Preamble of the General Regulation. We are of the opinion that if the holding fund is established by several entities (though governed by public law), the exception under Section 18(1)(j) will not be applicable and we are also doubtful about the applicability of the exception under Section 18(1)(k). We recommend that for the purpose of legal safety the services be contracted through competitive tendering in accordance with the Public Procurement Act.

<sup>136</sup> Article 44 of the General Regulation (EC). For more details, see Legal analysis, chapter 3.1.1. JESSICA – EU legal regulations and documents, Selection of a holding fund.

<sup>137</sup> For examples of such circumstances, see Legal analysis, chapter 3.1.1., Selection of a holding fund.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

On the basis of applicable EU legislation and interpretation currently available from the EC and EIB<sup>138</sup> we believe that the function and areas of activity of a holding fund can be defined as follows (“JESSICA Services”):

- Encouragement of the involvement of relevant entities (regions, municipalities, private investors, developers, etc.) and the involvement/establishing of UDFs especially with the help of a suitable communication and support programme.
- Identification and involvement of suitable UDFs.
- Implementation of the investment plan agreed with the managing authority through investments in selected UDFs.
- Continuous checking of the implementation of UDFs investment plans and reporting information to the managing authority.
- Taking investments out from UDFs and refunding the resources to the managing authority<sup>139</sup> or other relevant entity<sup>140</sup>.
- Assistance provided to the managing authority so that it can fulfil its legal obligations arising out of its position within managing resources from the EU funds (assistance in the process of reporting expenditures, certification, notifications of state aid, etc.).

Besides the JESSICA Services, the holding fund can provide also other related services to the managing authority. The funding agreement concluded between the holding fund and the managing authority should sufficiently clearly define these two flows of services, both for reasons of legal safety and for the purpose of reporting expenditures incurred by the HF in managing resources from the EU funds.

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<sup>138</sup> Article 44 of the General Regulation, Communication (EC) of 2007, 2008 and 2009 and the EIB document “JESSICA – Preliminary Evaluation Study”, 2007.

<sup>139</sup> If the resources are refunded to the managing authority in the current programming period, the managing authority can use them in accordance with its operational programme. This is possible even with regard to the State Budgetary Rules because the resources have already been certified and refunded by the EC and the refund represents income to the state budget. However this will be possible only in the case when financial resources will be returned to the managing authority in the same year as they were used. If it be to the contrary the financial resource have to be returned to the state budget (MoF accounts) immediately. Managing authority will have unused financial allocation but this will not be included in the state budget. It will be the duty of the managing authority to include the amounts into the state budget again.  
If the resources are refunded after the programming period end, that part of the allocation will have to be taken out from the certification performed and, if applicable, resources will have to be refunded to the European Commission.

<sup>140</sup> Unless otherwise agreed in the case of a holding fund involved through the provision of a subsidy.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

The holding fund does not have to be present in the implementation structure of the JESSICA financial instrument up to the closure of the relevant operational programme<sup>141</sup>. If it stays in the structure until the operational programme, it will assist the managing authority with adjusting the statement of expenditure (besides eligible expenditure for the management of financial engineering instruments, only the cost of investment made by the UDF may be included in finally eligible expenditure<sup>142</sup>).

### 6.2.3. Funding agreement and other relevant documents

Among the main documents defining the scope and conditions of the holding fund functioning are the business plan and the funding agreement. The funding agreement will also contain the decision to provide a subsidy/subsidy contract or conditions of such decision/contract<sup>143</sup>. Potential holding fund managers will submit their business plans to the managing authority within a competitive tender for the provider of the JESSICA Services in accordance with the relevant tender documents.<sup>144</sup> Conditions of presented business plans and draft funding agreements, which tenderers for the HF management will submit within the competitive tender, will supplement each other to a great extent (the business plan will form part of the funding agreement).

The two documents should define basic parameters of the HF functioning and of cooperation with the managing authority<sup>145</sup>, in particular:

- **Owners and relationships**  
Identification of the holding fund owners as well as other entities participating in the financing of the fund’s activities, explanation of principles on which relations among the entities are based.
- **Business and investment plan**  
Tender documents should define the investment strategy of the managing authority (in accordance with the conditions of the relevant operational programme and integrated plans for sustainable urban development). Tenderers for the holding fund management should draw their business and investment plan according to the defined investment strategy. The business and investment plan should specify in particular the following:

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<sup>141</sup> The answer to question no. 11 of the Communication of 2008.

<sup>142</sup> See Legal analysis, chapter 3.1.1., Eligibility of expenditure.

<sup>143</sup> Article 43(3) of the Implementing Regulation and Legal analysis, chapter 3.1.2., Financial flows.

<sup>144</sup> EIB/EIF obviously do not have to submit the business plan. Nevertheless, the managing authority will be obliged to award the contract to these entities on the basis of evaluating the EIB/EIF capacity and proposed terms of co-operation. Moreover, we believe that financial institutions - holding funds which are to be involved through the provision of a subsidy – will submit business plans as one of the main documents for the purposes of the application for a subsidy. For more details, see Legal analysis, chapter 2.1.1., Business plan.

<sup>145</sup> If the HF is to be included in the form of a grant, such clauses will be part of the decision to provide a subsidy/subsidy contract.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

- Target projects of urban development in which the urban development funds involved through the holding fund should make investments.
  - Funding conditions of such projects (types of the provided financial engineering products, target return on investment, project risk rate, other expected benefits of the investment, e.g. socio-economic, environmental benefits, etc., investment implementation schedules, comparison of the investment conditions with market conditions, etc.).
  - The holding fund operational budget (volume and structure of financial resources which will be used together with the operational programme resources for funding urban development projects).
  - Involvement of other investors (method and conditions of the involvement, in particular whether different conditions will apply to revenue payments; inclusion of resources of the financial engineering instrument itself, etc.).
- **Services and consideration**
    - Definition of JESSICA Services and other services, if applicable (see above).
    - Definition of the relevant consideration (its amount and method of calculation; external management costs and definition of the managing authority’s control over the level of such costs; method of payment of consideration and costs). In order to be eligible, the consideration must comply with the provisions of Article 43(4) of the Implementing Regulation<sup>146</sup>.
- **Flows and management of financial resources**
    - Legal treatment of financial flows in accordance with budgetary rules<sup>147</sup>.
    - Terms and conditions under which financial resources to be managed are paid out (tranche amount, relation to the already contributed capital).
    - Terms and conditions under which financial resources are managed before they are contributed to the UDF.

<sup>146</sup> Management costs may not exceed, on a yearly average, for the duration of the assistance any of the following thresholds, unless a higher percentage proves necessary after a competitive tender:

- a) 2 % of the capital contributed from the operational programme to holding funds, or of the capital contributed from the operational programme or holding fund to the guarantee funds;
- b) 3 % of the capital contributed from the operational programme or the holding fund to the financial engineering instrument in all other cases, with the exception of microcredit instruments directed at micro-enterprises;
- c) 4 % of the capital contributed from the operational programme or the holding fund to micro-credit instruments directed at micro-enterprises.

<sup>147</sup> See Legal analysis, chapter 3.1.2., Financial flows.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

- The (im)possibility to manage financial resources outside accounts controlled by the Treasury within the meaning of Section 33(7) of State Budgetary Rules and, consequently, potential limitations of identifying banks in which the funds could be kept (in practice this is relevant mainly in the case of foreign managers of HFs). A detailed description of the issue is given in chapter 3.1.2. (subpar. (vi) Financial resources management outside the CR).
- Responsibility of the HF for the implementation of the investment plan agreed with the managing authority and for the fulfilment of other contractual obligations, ensuring compliance with contractual obligations.
- **Activities in relation to UDFs**
  - Parameters of UDFs in which the HD will invest in accordance with the managing authority’s investment strategy and the HF’s business plan (capital strength, investment focus, market position and experience in investing and regional development, etc.).
  - Procedures for selecting UDFs (transparency, publicity, compliance with the Public Procurement Act or Obligatory Procedures for the Award of Contracts).
  - Principles that have to be included in funding agreements made with UDFs (the obligation of UDFs to disclose information, possibility of checks by the HF and other entities, document storage, ensuring compliance with the state aid rules and the award of contracts, etc.).
  - Liability of the HF for the failure of UDFs to comply with the funding agreement conditions (definition of general liability of the HF; definition of its liability for the observance of selected conditions of the agreement; exclusion of the HF’s liability; definition of the HF’s liability if it fails to meet its contractual obligations, e.g. the obligation to monitor its investments in UDFs).
  - Procedures to recover debts from UDFs (the obligation of the HF to use any legal means to recover such debts; a tighter obligation of the HF to disclose information to the managing authority).
  - Exit from investments at the UDFs level (conditions under which UDFs engaged by the holding fund will exit from investments in projects and under which the holding fund will exit from investments in UDFs).

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

- **Internal procedures and administrative capacity**
  - Internal rules and procedures relevant from the point of view of the holding fund functioning (ensuring due administration and management of the HF; professionalism and competence).
  - Capacity (description of the HR and professional expertise available; conditions under which subcontractors will be engaged and the level of their involvement).
  - Other activities of the HF and their influence on the provision of the JESSICA Services, approach to conflicts of interests.
- **Decision-making processes**
  - Inclusion of the managing authority in the HF decision-making processes, ex ante and ex post control and monitoring procedures.
  - The possibility of institutionalising the inclusion of the managing authority in, e.g. the investment board or other “body”, definition of the position of such “bodies” in the HF’s decision-making process and related processes (e.g. in awarding public contracts).
  - Specification of whether the HF acts in its name in relation to third parties or whether it represents the managing authority; specification of how to apply provisions of the Commercial Code on the agency contract or consignment contract; specification of legal consequences of breaching the rules for the managing authority involvement.
- **Duration of cooperation**
  - Duration of the holding fund existence and its inclusion in the implementation structure of the JESSICA instrument, conditions under which yields of investments may be reutilised, cooperation conditions after the operational programme closure.
  - Winding-up provisions of the HF.
- **Other obligations**
  - Publicity, document storage, assessment of application of the state aid rules, compliance with the Public Procurement Act or Obligatory Procedures for the Award of Contracts, protection of the managing authority’s interests, cooperation if the wording or interpretation of applicable legal regulations or guidelines is changed.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### 6.3. Urban development funds

#### 6.3.1. General definition of the urban development fund

In general, the scope of activity of urban development funds is laid down in Article 44 of the General Regulation, which defines UDFs as funds investing in public-private partnerships and other projects included in an integrated plan for sustainable urban development. We also based our definition of its scope of activity on the Communication (EC) of 2007, 2008 and 2009 and the EIB document “JESSICA – Preliminary Evaluation Study”, 2007. According to the mentioned documents, the main activities of UDFs can be defined as follows:

- Identify and select projects suitable for funding,
- Allocate contributions to projects selected,
- Collect instalments of and interest on loans / returns on equity (remuneration on the UDF’s investment) and distribute returns to the contributors to the fund,
- Monitor and report on the progress of the projects to the holding fund (to the managing authority, where holding funds are not used),
- Manage investment policy,
- Keep separate accounts for the case that also non-eligible expenditure is covered from the fund,
- Prepare regular accounts and financial statements.

If a holding fund is not employed in the implementation of the JESSICA financial instrument, it will be appropriate to include selected tasks, which would otherwise be performed by the HF, in the scope of services provided by the UDF. They would be, in particular:

- Encourage the involvement of relevant entities (regions, municipalities, private investors, developers, etc.),
- Implement the investment plan agreed with the managing authority,
- Exit from investments in completed projects and refund the financial resources to the managing authority or other relevant entity,
- Assist the managing authority in the performance of its statutory obligations arising out of its position within the management of resources from the EU funds (assistance with expenditure statements, certification, state aid notifications, etc.).

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

As noted in chapter 2.1. of this study, urban development funds can invest their financial resources in projects in the form of loans, guarantees and equity. From the perspective of the basic activities of the UDF’s manager, there will be no principal difference in the scope of services provided. However, if the funding is contributed as equity, the UDF will essentially become a shareholder of the project and as such will participate in exercising its shareholder rights.

Similarly as with the services provided by the holding fund (see chapter 6.2.2. of this study), it is necessary to specify clearly the services that the managing authority will require and that will, therefore, be included in the management costs calculation, and the services that will be provided in addition, including the fee for their provision. The management costs may not exceed the thresholds set out in Article 43(4) of the General Regulation.

### 6.3.2. Funding agreement

Among the main documents defining the scope and conditions of the functioning of the urban development fund are the business plan and the funding agreement. The funding agreement will also contain the decision to provide a subsidy/subsidy contract or conditions of such decision/contract. Potential managers of the urban development fund will submit their business plans to the managing authority within a competitive tender in accordance with the relevant tender documents. Conditions of thus presented business plans and draft funding agreements, which tenderers for the HF management will submit within the competitive tender, will to a great extent supplement each other (the business plan will form part of the funding agreement).

Both documents should define the basic parameters of the UDF functioning and of its cooperation with the managing authority/holding fund and they should include at least the following terms and conditions set out in Article 43(6) of the Implementing Regulation:

- The investment strategy and planning;
- Monitoring of implementation in accordance with applicable rules;
- An exit policy for the contribution from the operational programme out of the financial engineering instrument;
- Winging-up provisions of the financial engineering instrument, including the reutilisation of resources returned to the financial engineering instrument from investments or left over after all guarantees have been honoured, attributable to the contribution from the operational programme.

We also recommend that the parameters that we defined in chapter 6.2.3. be reasonably included in the funding agreement between the UDF manager and the managing authority/holding fund.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### 6.4. Basic assumptions of the proposed implementation models

In drawing up potential models of the JESSICA financial instrument implementation through regional and thematic operational programmes we took account of the following criteria:

- **Absorption capacity.** This study is not primarily intended to provide a detailed analysis of the absorption capacity. However, on the basis of the JESSICA market research and unofficial information from similar studies done in the Czech Republic we can more or less state that projects of the JESSICA type inherently exist and the only question is whether cities and other entities are able to prepare and implement such projects. It also closely relates to the identified risks. For the purpose of potential implementation structures we assumed that such risks would be managed and, therefore, the capacity for absorption would be sufficient.
- **Inclusion of operational programmes.** The analysis of operational programmes showed that the implementation of the JESSICA instrument may be considered mainly for regional operational programmes (and potentially for the Operational Programme Prague - Competitiveness<sup>148</sup>), the priority axes/areas of intervention of which focus on the support of urban environment and which have so far most closely collaborated with cities. The “closeness” means both an advantage of a more detailed knowledge of the urban environment and the possibility to take up the current structure, which the cities as well as entities engaged in urban development are familiar with. Besides the regional operational programmes, there is a national level programme that may be considered, namely the Integrated Operational Programme<sup>149</sup>. Therefore, the proposed structures make it possible to include programmes both at the regional level and the central level.
- **Volume of resources for the initial stage (current programming period).** The proposed structures reflect the fact that the programmes considered do not have bigger volumes of free funds available for transfer into the JESSICA instrument (a significant portion of the funds is either already committed or IUDPs for specific projects which are to be subsidized have already been approved, etc.). A general assumption was made that it will be possible to transfer funds in the amount of CZK 200 – 500 million from each operational programme and support 2 – 3 smaller “pilot projects” in this way.

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<sup>148</sup> For the present we leave a question mark over the inclusion of the Operational Programme Prague – Competitiveness, particularly because of a) a small volume of resources in the operational programme and b) the overall comprehensiveness of the urban environment of the capital city Prague and the necessity to analyze the options of the JESSICA instrument in its territory in more detail.

<sup>149</sup> No other programmes have been considered for the time being. However, in case of interest the structure can be supplemented with them.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

- **Number of urban development funds / their level (national / regional / regional at the level of regions as territorial administrative units).** In view of the assumptions above (inclusion of operational programmes and the volume of funds for the initial stage) it seems suitable to apply a structure targeted at regions (NUTS 2) or higher territorial administrative units of the Czech Republic (i.e. administrative regions). UDFs in the options below are at the level of administrative regions (with the exception of option 3b). The reasons for it are essentially these:
  - Regions are natural administrative units and their capitals are seen by other cities as “gravity centres”. This concept is symbolically approved also by the requirement of cities to hold JESSICA workshops within market research not jointly for several regions in the cohesion region centre (e.g. in Ústí nad Labem), but to hold two separate workshops in regional capitals (i.e. in Ústí nad Labem and Karlovy Vary).
  - On the other hand, NUTS 2 regions are artificially created units consisting of one to three regions. At the moment it is not clear whether regional councils will exist in this form in the next programming period or whether the number of operational programmes will not be reduced and, e.g. resources for regional development centralized into one unified operational programme. Division to the NUTS 2 level has been considered only for option 3b, which was conceived as an option with the simplest set-up.
- **Focus of urban development funds.** In view of the volume of resources the urban development funds will generally focus on the urban environment development (i.e. they will not be defined more closely from their theme point of view). If thematic operational programmes are involved, the option of establishing the urban development fund at the central level seems appropriate.
- **UDF manager.** The UDF manager will be selected through a competitive tender and it is not expected to influence the implementation structure form. Therefore, the manager is not further specified.
- **Holding fund.** The setting up of a holding fund is proposed for several options. The guideline for the decision whether the holding fund should be established or not is thus the output for a group of variant structures proposed by the SWOT analysis. We recommend that the setting up of a holding fund be considered especially if several operational programmes are included in the JESSICA instrument implementation, which will allow to use the synergetic effect (a uniform set-up of the administrative procedure, which will make it easier for applicants to use resources of various UDFs, lower demands on managing authorities, transfer of experience, etc.).
- **Holding fund manager.** The “Czech option” is considered (i.e. putting out a public tender for the HF manager) and the option of the EIB participation, which does not require holding a public tender under the Public Procurement Act.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### 6.5. Proposed implementation options for the utilisation of ROPs and TOPs

The description of each proposed option starts with assumptions that we used in drawing it up. Its graphic representation is followed by an evaluation using the SWOT analysis tool in accordance with specifications.

For the purpose of simpler presentation we use general identification of **regional operational programmes** – e.g. ROP A, **thematic operational programmes** – e.g. TOP X, **regions** – e.g. region AX in our diagrams. Different colours within the holding fund (e.g. in options 1a and 1b) are used to differentiate contributions from various operational programmes and their separate management.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### 6.5.1. Option 1

Option 1 is based on the following assumptions:

- |                         |   |
|-------------------------|---|
| Holding fund            | <ul style="list-style-type: none"> <li>- It is established under the management of one institution on the basis of a multilateral agreement among managing authorities and the holding fund manager.</li> <li>- <b>Option 1a</b> uses the assumption that the fund manager is the EIB. In such a case no public tender for the fund manager will have to be held (in accordance with the Public Procurement Act).</li> <li>- In <b>option 1b</b> we make the assumption that a competitive tender for a joint fund manager will be held. For this purpose the managing authorities will act under the PPA as a “joint contracting authority”. Another assumption is that the manager is an institution (public or private) registered in the Czech Republic. In this option the PPA will not have to be applied only if the managing authorities provide a grant to a fund manager which is an institution having the status of a public sector body (see chapter 3.1.4. of this study).</li> </ul> |
| Urban development funds | <ul style="list-style-type: none"> <li>- In regional operational programmes they generally focus on the “urban area development”, especially because of the low volume of funding in the initial phase of the JESSICA instrument, and in thematic operational programmes they are thematically focused.</li> <li>- They respect the current division of operational programmes and in the case of regional operational programmes they are further divided according to territorial competence (by regions).</li> </ul>   |

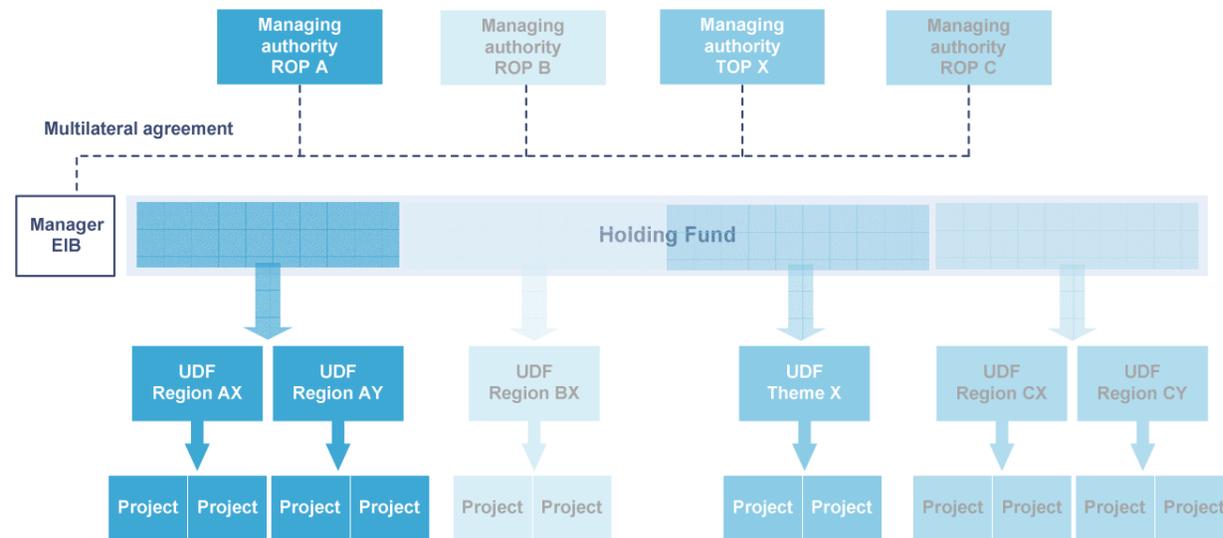


Figure 4 Option 1a

### SWOT analysis (option 1a)

S	W
<ul style="list-style-type: none"> <li>- The possibility to coordinate the JESSICA at the national level (among all the operational programmes involved).</li> <li>- It allows a uniform set-up of the JESSICA functioning at the urban development funds level (e.g. administrative requirements for the submission of applications).</li> <li>- Lower administrative demands on managing authorities.</li> <li>- UDFs at the level of regions respect natural administrative boundaries.</li> <li>- The structure created through the participation of several operational programmes makes the use of the holding fund manager’s services possible even for operational programmes which would not be attractive for the manager because of small volume of resources.</li> <li>- Higher attractiveness for co-investors at the holding fund level.</li> </ul>	<ul style="list-style-type: none"> <li>- Demanding coordination of requirements of individual managing authorities before conclusion of the multilateral agreement.</li> <li>- Higher administration costs as a result of the holding fund participation.</li> <li>- Overall complexity of the implementation structure.</li> <li>- Less space allowed for additional modification of the contract terms and conditions with the holding fund manager (approval by all parties will be needed).</li> <li>- In current conditions the structure is suitable only if several operational programmes are involved.</li> <li>- The holding fund manager is unable to ensure separate management of financial resources of individual operational programmes.</li> </ul>
O	T
<ul style="list-style-type: none"> <li>- Transfer of know-how and experience if the EIB participates as the holding fund manager.</li> <li>- Motivation of the managing authorities on the JESSICA implementation – the possibility to involve even rather passive managing authorities.</li> <li>- Lower time demands resulting from the fact that the selection does not have to be arranged in accordance with the PPA.</li> <li>- If the EIB is involved, a faster negotiation process and, therefore, faster establishment of the holding fund resulting from the fact that the EIB has already concluded several holding agreements.</li> </ul>	<ul style="list-style-type: none"> <li>- The contract is drawn up in a way which does not allow different velocity of the JESSICA implementation, i.e. a potential delay within one managing authority may hold up the other managing authorities.</li> </ul>

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

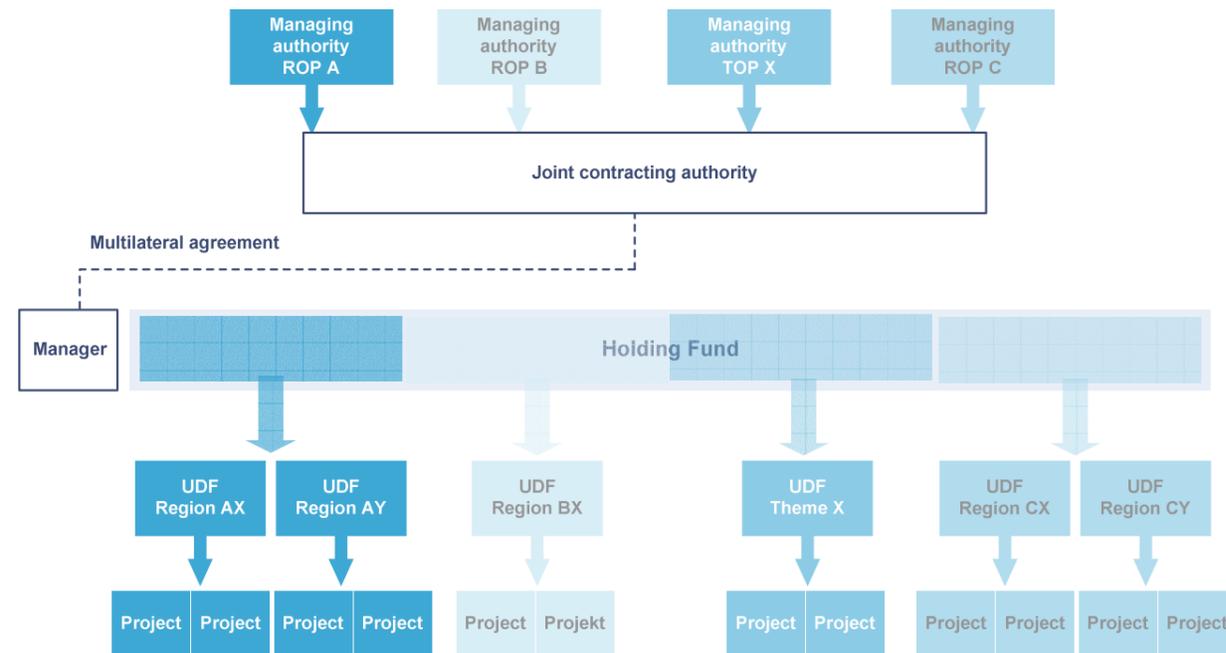


Figure 5 Option 1b

### SWOT analysis (option 1b)

S	W
<ul style="list-style-type: none"> <li>- The possibility to coordinate the JESSICA at the national level (among all operational programmes involved).</li> <li>- It allows a uniform setting up of the JESSICA functioning at the urban development funds level (e.g. administrative requirements for the submission of applications).</li> <li>- Lower administrative demands on managing authorities.</li> <li>- UDFs at the level of regions respect natural administrative boundaries.</li> <li>- The structure created through the participation of several operational programmes makes the use of the holding fund manager 's services (identification of managers of urban development funds, investment strategy proposals) possible even for operational programmes which would not be attractive for the manager because of small volume of resources.</li> <li>- Higher attractiveness for co-investors at the holding fund level.</li> </ul>	<ul style="list-style-type: none"> <li>- Demanding coordination of requirements of individual managing authorities on defining their joint requirements for the contracting entity and on organising a competitive tender.</li> <li>- Higher administration costs as a result of the holding fund participation.</li> <li>- Overall complexity of the implementation structure.</li> <li>- Less space allowed for additional modification of the contract terms and conditions with the holding fund manager (approval by all parties will be needed).</li> <li>- In current conditions the structure is suitable only if several operational programmes are involved.</li> <li>- Higher time demands resulting from the fact that it is necessary to agree on a joint contracting entity and, potentially, select the fund manager in accordance with the PPA.</li> </ul>
O	T
<ul style="list-style-type: none"> <li>- Motivation of the managing authorities on the JESSICA implementation – the possibility to involve even rather passive managing authorities.</li> </ul>	<ul style="list-style-type: none"> <li>- The contract is drawn up in a way which does not allow different velocity of the JESSICA implementation, i.e. a potential delay within one managing authority may hold up the other managing authorities.</li> <li>- The holding fund manager is unable to ensure separate management of financial resources of individual operational programmes.</li> <li>- Higher time demands resulting from the fact that the selection will have to be carried out in accordance with the PPA rules</li> </ul>

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### 6.5.2. Option 2

Option 2 is based on the following assumptions:

- |                         |  |
|-------------------------|--|
| Holding fund            | <ul style="list-style-type: none"> <li>- It is established separately for each operational programme, and that only for those operational programmes that envisage the establishing of several urban development funds. The graphical representation shows the HF as funded only from one operational programme, in this case the ROP. However, even an HF established by the ROP may be partly funded from a thematic operational programme.</li> <li>- It is not established in the case of operational programmes envisaging only one urban development fund.</li> </ul>  |
| Urban development funds | <ul style="list-style-type: none"> <li>- The manager is either the EB or a Czech institution (private or public). In the latter case it will be necessary to organise a competitive tender for the services of a manager according to the PPA. In this option the PPA will not have to be applied only if the managing authorities provide a grant to a fund manager which is an institution having the status of a public sector body (see chapter 3.1.4. of this study).</li> <li>- In the case of regional operational programmes they generally focus on the “urban area development”, especially because of the low volume of funding in the initial phase of the JESSICA instrument, and in the case of thematic operational programmes they are thematically focused.</li> <li>- They respect the current division of operational programmes and in the case of regional operational programmes they are further divided according to territorial competence (by regions).</li> </ul> |

### SWOT analysis (option 2)

S	W
<ul style="list-style-type: none"> <li>- Lower administrative demands on managing authorities which will establish several UDFs.</li> <li>- UDFs at the level of regions respect natural administrative boundaries.</li> <li>- The structure is independent of the number of operational programmes involved.</li> <li>- JESSICA can be implemented by every managing authority independently (slower regions do not slow down implementation in more progressive ones).</li> </ul>	<ul style="list-style-type: none"> <li>- Higher administration costs incurred by managing authorities which establish several UDFs.</li> <li>- Less attractive for managers of holding funds.</li> <li>- Administrative demands on the managing authorities which will not establish holding funds.</li> <li>- Less attractive for co-investors at the holding fund level.</li> <li>- Smaller motivation for less active managing authorities – if there is no unifying element, such managing authorities will not consider JESSICA.</li> <li>- Limited possibility of coordination and experience and know-how transfer among individual operational programmes.</li> <li>- Less attractive for external entities to participate as fund managers.</li> </ul>
O	T
<ul style="list-style-type: none"> <li>- Transfer of know-how and experience if the EIB participates as the holding fund manager.</li> </ul>	<ul style="list-style-type: none"> <li>- Setting up various rules and conditions within individual operational programmes may make funding less achievable for potential applicants.</li> </ul>

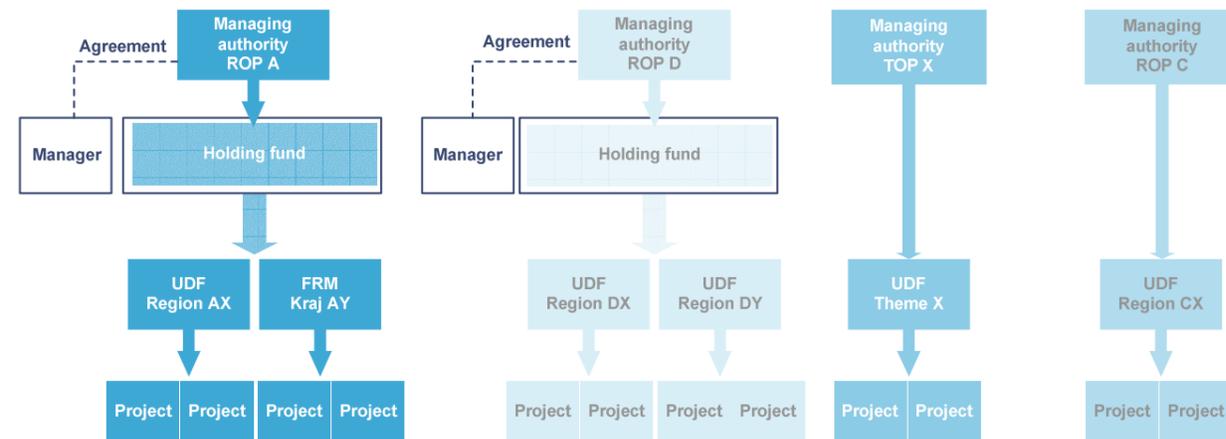


Figure 6 Option 2

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### 6.5.3. Option 3

Option 3 is based on the following assumptions:

<p>Holding fund</p>	<p>- It is not established.</p>
<p>Urban development funds</p>	<p>- In the case of regional operational programmes they generally focus on the “urban area development”, especially because of the low volume of funding in the initial phase of the JESSICA, and in the case of thematic operational programmes they are thematically focused.</p> <p>- In <b>option 3a</b> the current division of operational programmes is respected and in the case of regional operational programmes they are divided according to territorial competence (by regions). Each managing authority holds a separate competitive tender for the managers of the urban development funds.</p> <p>- <b>Option 3b</b> respects the current division of operational programmes (i.e. regional operational programmes stay at the level of cohesion regions.) Each managing authority holds a separate competitive tender for the managers of the urban development funds.</p> <p>- In <b>option 3c</b> we make the assumption that a competitive tender for a joint manager will be held. For this purpose the managing authorities will act under the PPA as a “joint contracting authority”. Urban development funds respect the current division of operational programmes and in the case of regional operational programmes they are further divided according to territorial competence (by regions).</p> <p>- <b>Option 3d</b> assumes that one of the UDFs established with the financial resources of the ROP will be funded also by a thematic operational programme. The TOP will not establish its own UDF, but will use part of its allocation to fund other UDF. Each managing authority will hold a separate competitive tender for the managers of the urban development funds.</p> <p>- <b>Option 3e</b> assumes that UDFs will be established at the level of cities (with potential participation of the relevant city). Each managing authority holds a separate competitive tender for managers of the urban development funds (or in cooperation with the relevant city).</p>

A support consulting group is established for MAs which implement JESSICA. The purpose of it is to ensure coordination and enable synergies among the structures. The group should substitute the holding fund through performing its coordination and consulting role. That is, among its most important roles should be:

- an advisor to the managing authorities involved – this role will ensure maximally unified framework of processes and rules;
- seeking solutions to issues which do not come within the competence of individual managing authorities;
- a communication platform for all institutions involved, enabling discussion on problem areas (e.g. unifying the interpretation of legislation, etc.);
- transfer of information and experience among individual bodies.

The group should include representatives of the NCA, all managing authorities participating in the implementation of the JESSICA financial instrument and, if appropriate, also representatives of other bodies included in the implementation of structural funds in the CR (e.g. the CA, AA, etc.). The support group role could be performed by one of the existing work teams of the NCA, if need be.

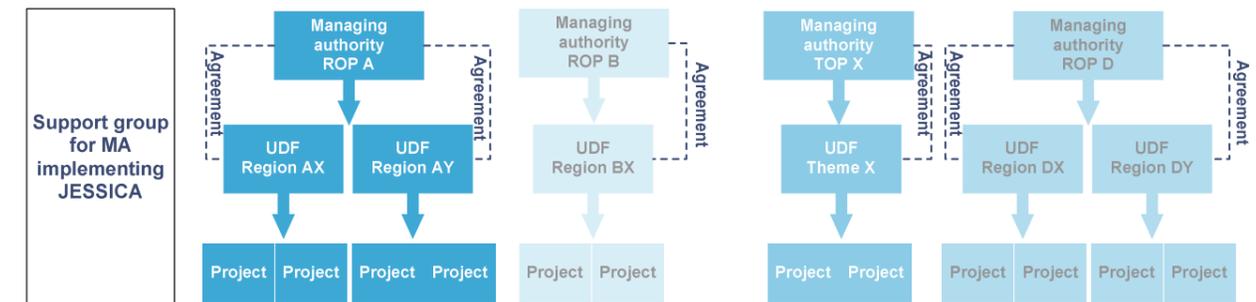


Figure 7 Option 3a

### SWOT analysis (option 3a)

S	W
<ul style="list-style-type: none"> <li>- Simplicity of setting up the structure (lower expenses of managing authorities).</li> <li>- Establishing a support group partly substituting the holding fund activity will contribute to the coordination of JESSICA across operational programmes.</li> <li>- UDFs at the level of regions respect natural administrative boundaries (option 3a)</li> <li>- The structure is independent of the number of operational programmes involved.</li> <li>- JESSICA can be implemented by every managing authority independently (slower regions do not slow down implementation in more progressive ones).</li> </ul>	<ul style="list-style-type: none"> <li>- Less attractive for co-investors (leverage of resources at the level of funds).</li> <li>- Higher administrative demands on individual managing authorities (especially if they establish several urban development funds).</li> <li>- Smaller motivation for less active managing authorities – if there is no unifying element, such managing authorities will not consider JESSICA.</li> <li>- Less attractive for external entities to participate as fund managers.</li> <li>- Higher administrative demands on the NCA and MA in view of establishing the support group.</li> </ul>
O	T
<ul style="list-style-type: none"> <li>- If processes in the support group are set up well, information and know-how may be transferred among/between individual operational programmes.</li> </ul>	<ul style="list-style-type: none"> <li>- Managing authorities do not make sufficient use of possibilities of cooperation with the support group.</li> <li>- Processes in the support group cannot be set up well due to insufficient know-how in financial engineering instruments.</li> <li>- Setting up various rules and conditions within individual operational programmes may make funding less achievable for potential applicants.</li> </ul>

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

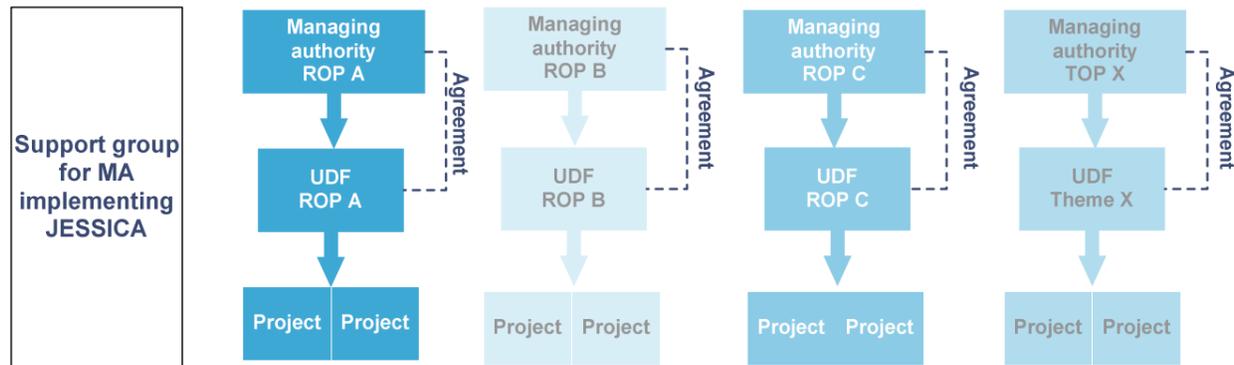


Figure 8 Option 3b

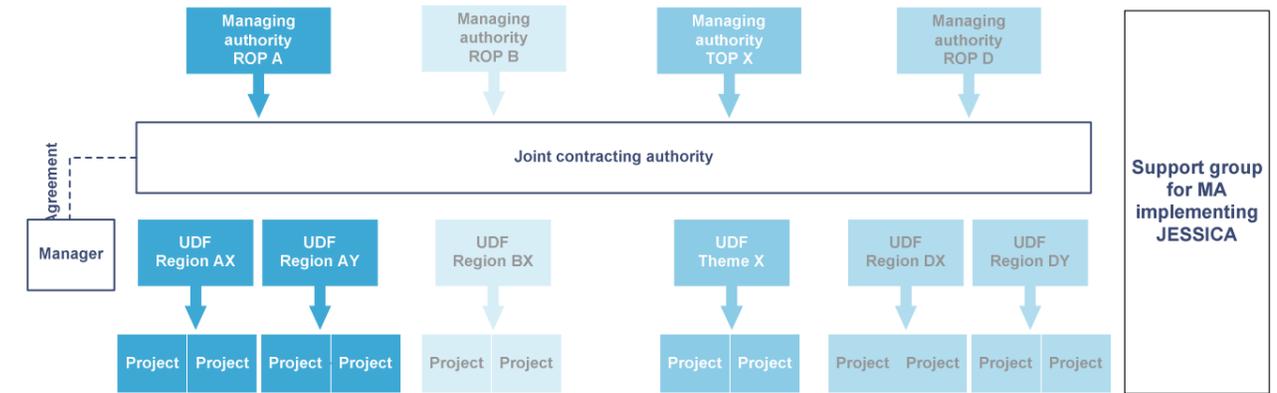


Figure 9 Option 3c

### SWOT analysis (option 3b)

S	W
<ul style="list-style-type: none"> <li>- Simplicity of setting up the structure (lower expenses of managing authorities).</li> <li>- Establishing a support group partly substituting the holding fund activity will contribute to the coordination of JESSICA across operational programmes.</li> <li>- UDFs at the NUTS 2 level are the simplest option of JESSICA.</li> <li>- The structure is independent of the number of operational programmes included.</li> <li>- JESSICA can be implemented by every managing authority independently (slower regions do not slow down implementation in more progressive ones).</li> </ul>	<ul style="list-style-type: none"> <li>- Less attractive for co-investors (leverage of resources at the level of funds).</li> <li>- Higher administrative demands on individual managing authorities.</li> <li>- Smaller motivation for less active managing authorities – if there is no unifying element, such managing authorities will not consider the possibility of JESSICA.</li> <li>- Less attractive for external entities to participate as fund managers.</li> <li>- Higher administrative demands on the NCA and MA in view of establishing the support group.</li> </ul>
O	T
<ul style="list-style-type: none"> <li>- If processes within the support group are set up well, information and know-how may be transferred among/between individual operational programmes.</li> </ul>	<ul style="list-style-type: none"> <li>- Managing authorities do not make sufficient use of possibilities of cooperation with the support group.</li> <li>- Processes in the support group cannot be set up well due to insufficient know-how in financial engineering instruments.</li> <li>- Setting up various rules and conditions within individual operational programmes may make funding less achievable for potential applicants.</li> </ul>

### SWOT analysis (option 3c)

S	W
<ul style="list-style-type: none"> <li>- Simplicity of setting up the structure (lower expenses of managing authorities).</li> <li>- Establishing a support group partly substituting the holding fund activity will contribute to the coordination of JESSICA across operational programmes.</li> <li>- UDFs at the level of regions respect natural administrative boundaries.</li> <li>- The structure is independent of the number of operational programmes involved.</li> <li>- If a competitive tender is organised jointly and one manager is selected for all UDFs, external entities may consider their participation as fund managers more attractive.</li> </ul>	<ul style="list-style-type: none"> <li>- Less attractive for co-investors (leverage of resources at the level of funds).</li> <li>- Higher administrative demands on individual managing authorities.</li> <li>- Higher administrative demands on the NCA and MA in view of establishing the support group.</li> <li>- Higher time demands resulting from the fact that it is necessary to agree on a joint contracting entity and, potentially, select the fund manager in accordance with the PPA rules.</li> </ul>
O	T
<ul style="list-style-type: none"> <li>- Simpler coordination and transfer of experience in the case of a joint UDF manager.</li> </ul>	<ul style="list-style-type: none"> <li>- Managing authorities do not make sufficient use of possibilities of cooperation with the support group.</li> <li>- Processes in the support group cannot be set up well due to insufficient know-how in financial engineering instruments.</li> <li>- Setting up various rules and conditions within individual operational programmes may make funding less achievable for potential applicants.</li> </ul>

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

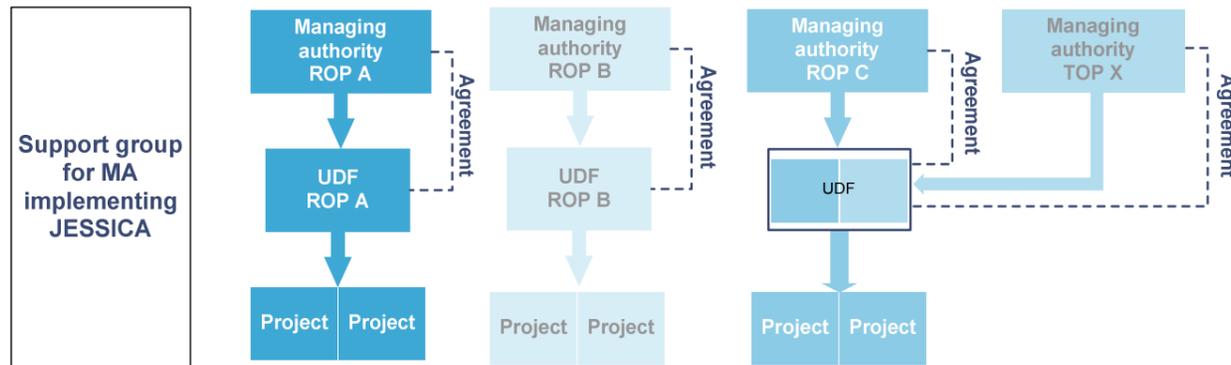


Figure 10 Option 3d

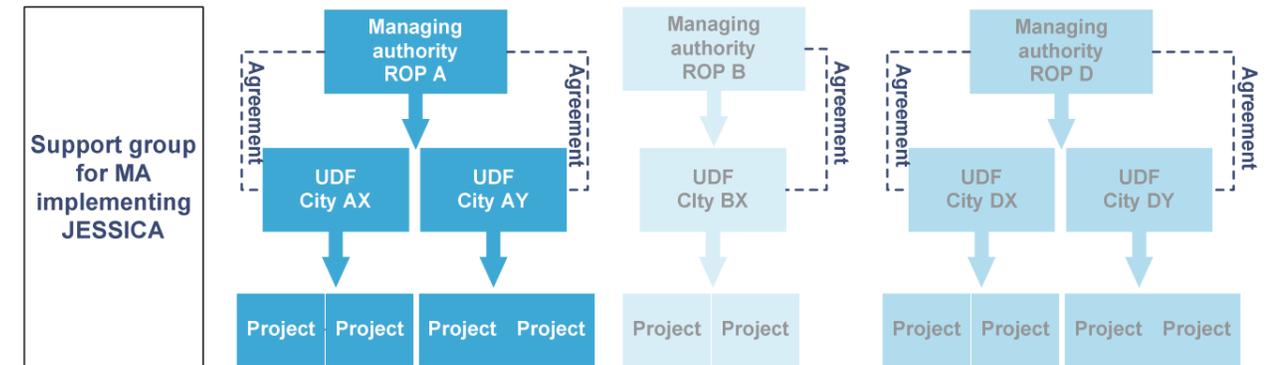


Figure 11 Option 3e

### SWOT analysis (option 3d)

S	W
<ul style="list-style-type: none"> <li>- Simplicity of setting up the structure (lower expenses of managing authorities).</li> <li>- Establishing a support group partly substituting the holding fund activity will contribute to the coordination of JESSICA across operational programmes.</li> <li>- UDFs at the NUTS 2 level are the simplest option of JESSICA.</li> <li>- The structure is independent of the number of operational programmes involved.</li> <li>- JESSICA can be implemented by every managing authority independently (slower regions do not slow down implementation in more progressive ones).</li> </ul>	<ul style="list-style-type: none"> <li>- Less attractive for co-investors (leverage of resources at the level of funds).</li> <li>- Higher administrative demands on individual managing authorities.</li> <li>- Smaller motivation for less active managing authorities – if there is no unifying element, such managing authorities will not consider the possibility of JESSICA.</li> <li>- Less attractive for external entities to participate as fund managers.</li> <li>- Higher administrative demands on the NCA and MA in view of establishing the support group.</li> <li>- The necessity to manage separately resources at the level of a UDF funded both from a ROP and TOP.</li> </ul>
O	T
<ul style="list-style-type: none"> <li>- If processes in the support group are set up well, information and know-how may be transferred among/between individual operational programmes.</li> </ul>	<ul style="list-style-type: none"> <li>- Managing authorities do not make sufficient use of possibilities of cooperation with the support group.</li> <li>- Processes in the support group cannot be set up well due to insufficient know-how in financial engineering instruments.</li> <li>- Setting up various rules and conditions within individual operational programmes may make funding less achievable for potential applicants.</li> </ul>

### SWOT analysis (option 3e)

S	W
<ul style="list-style-type: none"> <li>- Simplicity of setting up the structure (lower expenses of managing authorities).</li> <li>- Establishing a support group partly substituting the holding fund activity will contribute to the coordination of JESSICA across operational programmes.</li> <li>- UDFs at the level of cities are able to address the development needs of the relevant cities better.</li> <li>- The structure is independent of the number of operational programmes involved.</li> <li>- JESSICA can be implemented by every managing authority independently (slower regions do not slow down implementation in more progressive ones).</li> </ul>	<ul style="list-style-type: none"> <li>- Less attractive for co-investors (leverage of resources at the level of funds).</li> <li>- Higher administrative demands on individual managing authorities (especially if they establish several urban development funds).</li> <li>- Smaller motivation for less active managing authorities – if there is no unifying element, such managing authorities will not consider the possibility of JESSICA.</li> <li>- Less attractive for external entities to participate as fund managers.</li> <li>- Higher administrative demands on the NCA and MA in view of establishing the support group.</li> <li>- At present the structure is usable only for bigger cities (statutory towns).</li> </ul>
O	T
<ul style="list-style-type: none"> <li>- If processes in the support group are set up well, information and know-how may be transferred among/between individual operational programmes.</li> </ul>	<ul style="list-style-type: none"> <li>- Managing authorities do not make sufficient use of possibilities of cooperation with the support group.</li> <li>- Processes in the support group cannot be set up well due to insufficient know-how in financial engineering instruments.</li> </ul>

“Feasibility study on the implementation of the JESSICA financial instrument  
in the Czech environment for the 2007-2013 programming period”

Final report

2 September 2010

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### 6.5.4. Assessment of proposed options

We assessed the models of implementation using SWOT analysis, the results of which are shown at each of the proposed options. For clarity reasons we further evaluated the suitability of proposed options according to predetermined criteria, which are shown in Table 3.

Criterion	Explanation
Simplicity of structure and administrative demands	This criterion is used to assess whether the given structure allows for the fastest allocation of resources from the moment of the decision to use the instrument until the resources are allocated to the first projects through the urban development fund. Also assessed will be whether the structure is set up in the most simple way for the purpose of minimising any negative impacts of a multiple-level structure, meaning, e.g. how many levels exist for evaluating state aid issues, and so on. The structure should also minimise administrative demands on entities providing the resources.
Quality of resource utilisation and securing OPs objectives	The quality of resource utilisation will depend on the selection of the fund manager and on how the funding agreement is set up. The structure should allow capitalisation on the know-how of experienced experts and their involvement both in project selection and in the process of monitoring/selecting additional urban development funds. The quality of resource utilisation should be assessed in particular with regard to the implementation of the projects, the focus of the projects on urban regeneration, the public benefit of these projects, and so on. In this regard, assessment should also focus on whether the structure is able to help ensure utilisation of the allocation in accordance with the N+2/N+3 rule and the financial forecasts of the managing authority, i.e. that the projects receive the transferred allocation in accordance with the General Regulation no later than at the time of closure of the operational programme. The structure should also ensure the fulfilment of the programme objectives, including the set programme indicators.
Safety of resource utilisation	The structure should be established in a way that minimises risks in resource utilisation from the resource provider point of view. Risks should be minimised primarily with respect to on time resource utilisation, i.e. the N+2 rule, and expenditure eligibility and with respect to the investment rate of return from the UDF/UDFs point of view). The involvement of experts to assess the projects based on economic analyses (cost-benefit analysis, etc.) will be key.
Flexibility of resource allocation	The structure should allow the greatest amount of flexibility for selecting the projects for funding.
Administrative demands on RC MS	The structure should also ensure the minimisation of administrative demands on the aid provider.
Adequacy of the volume of available funds and the number of projects	When selecting a suitable configuration, account should also be taken of the expected amount of resources available for the JESSICA financial instrument. In the same time it has to be ensured that the implementing structure should be effective from the point of view of its management costs. On the other hand, it can be assumed that the demand for resources from the JESSICA financial instrument will be several times higher in the Czech Republic than the initial contribution into the holding fund. It would, therefore, be appropriate if the setting up allowed for future expansion/adjustment to this demand.
Independence and viability	A suitable implementation structure should be set up in a way that will allow its smooth working even after the closure of the programming period. At the same time it is necessary to ensure its independence of the managing authorities of operational programmes so that the provision of aid could continue after the cessation of managing authorities of the operational programmes.

Table 4 Criteria for the assessment of implementation options

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### Simplicity of structure and administrative demands

Although the original assumption was that the speed of resource allocation will depend on the simplicity of the structure, e.g. through only one urban development fund, closer analysis of the environment has shown that the speed of resource allocation depends on other factors as well:

- a) **Degree of preparedness of projects.** Degree of preparedness means the existence of urban regeneration projects that have been elaborated to such a degree that aside from the project documentation to be drawn up for the purposes of applying for funding from the urban development fund, there are no other obstacles in the way in the form of time-demanding activities, such as zoning proceedings, etc.
  
- b) **Their number and quality of preparation** that allows the conditions for establishing an urban development fund to be determined, including the selection criteria for these projects, etc.

Only upon fulfilling these factors/assumptions is it possible from the perspective of this criterion to recommend the selection of the simplest implementation structure.

Our study shows that with regard to innovative configuration of this instrument and zero experience, these prerequisites are not entirely fulfilled. For this reason it cannot be said that configuration of a more complicated implementation structure (for example by involving a holding fund) would mean the postponement of resource allocation. Establishment of a holding fund managed by an institution that has experience with the JESSICA financial instrument would allow the holding fund to be established much more quickly than the urban development fund. In the time saved, it would be possible to focus more on the demand side (defining the urban development fund) and the supply side (municipalities or private investors) in connection with finalising the projects. In this regard, it is not possible to give preference to any of the proposed structures.

Without a doubt, the administrative demands on managing authorities will be reduced by the establishment of a holding fund, which will carry out a number of activities that would otherwise have to be carried out directly by managing authorities. Nevertheless, some limitation may also arise from the options which assume joint activity of several managing authorities. In such a case it will first be necessary to identify joint aspects of the operational programmes involved.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### Quality of resource utilisation and securing OPs objectives

In our opinion, the quality of resource utilisation stems from the following:

- a) Sufficient experience and professional capacity of the fund managers,
- b) Quality configuration of the project selection process, including capital risk assessment,
- c) Search for new project plans and the possibility to establish new urban development funds.

We believe that involving a strategic partner that has sufficient experience with fund management and project funding using relevant financial instruments would help the quality of resource utilisation.

We further recommend that in the event of sufficient demand for JESSICA resources, the possibility to establish additional urban development funds is considered. This diversification could lead to improvement of the professional qualifications of the relevant persons involved in the project selection process or fund management.

Establishing a holding fund may speed up the allocation drawdown. In our opinion, it will be possible to establish the holding fund ahead of establishing the urban development fund. In this way the managing authority will be able to report the allocation as exhausted. It is important to ensure that the allocation is really used for urban regeneration projects by the end of the programming period. It will place increased demands not only on the assessment process, but also on marketing the instrument among the demand side. For this reason we also recommend that participation of a strategic partner be considered.

### Safety of resource utilisation

Similarly as in the previous case, safety of resource utilisation will depend on setting up processes of assessment and selection of projects for funding, including increased demands on investment risk analyses. The setting up of parameters will be specified in the funding agreement. From the implementation structure perspective, we consider as convenient involvement of an experienced partner, e.g. in the form of a holding fund, which will finalise the rules. If the EIB is involved as the fund manager, its experience in establishing other shares funds and urban development funds could be used, as well as best practice to the extent that this information is available.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### Flexibility of resource allocation

The flexibility of resource allocation will be determined on the one hand by the terms and conditions of the funding agreement concluded between the managing authority and the respective fund. With respect to flexibility of resource allocation, we consider a structure that has a more diversified base of urban development funds more appropriate. Such a structure should enable attracting highly qualified evaluators, who will be able to assess projects even under conditions of less rigid selection criteria. If the structure includes rather generally oriented urban development funds, one can expect these evaluators to be generalists. Evaluation should, of course, be carried out with regard to the fulfilment of the programme conditions, for which the managing authority bears responsibility, and with regard to the feasibility of the projects in terms of feasibility of the investment plan. On the other hand, excessive diversification of the funds could lead to the risk of excessive thematic specialisation of the funds, which would limit the use of the allocation for other types of projects.

### Adequacy of the volume of available funds

From the costs point of view, the most suitable implementation structure is one that includes the smallest number of funds (be they holding funds or urban development funds).

In view of the limited volume of resources, we recommend to start with a structure that would have the smallest number of urban development funds, so as not to break up the allocation too much.

Although it may seem from the research undertaken that demand for resources from the JESSICA financial instrument is not high, it is expected to grow in the future as subsidy resources will be gradually exhausted. It can also be assumed that the resources in the JESSICA financial instrument will be smaller in the 2014+ programming period and thus cities will have to find new resources for their projects funding.

For this reason we recommend that priority be given to creating a structure that will, e.g., enable to increase the number of urban development funds in the future and that can be adjusted so as to be able to accept other contributions.

### Independence and viability

As regards this criterion, independence of the JESSICA instrument implementation structure of operational programmes' managing authorities, we recommend options which include an external element and also the necessity of agreement among several operational programmes.

A suitable implementation structure should be set up in a way that will allow its smooth functioning even after the programming period end. At the same time it is necessary to ensure its independence of the managing authorities of operational programmes so that the provision of aid could continue after the cessation of managing authorities of the operational programmes.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

From the point of view of the implementation structure viability after the closure of the current programming period, no option is preferred in view of the fact that the role of managing authorities may change and the issue of succession will have to be addressed in any case. Moreover, if one fund (be it a holding fund or urban development fund) receives resources from several operational programmes, agreement among all the managing authorities involved will have to be reached first.

In general we can state that if several operational programmes decide to implement the JESSICA financial instrument, the most appropriate structure will be the one which envisages inclusion of a holding fund (options 1a/1b). The inclusion of a holding fund should be considered also if the managing authority considers establishing more than one urban development fund (e.g. option 2). Employment of a holding fund will ensure both coordination between the managing authorities involved and assistance to managing authorities, which would otherwise have to allocate part of their capacity for selection and subsequent management of all urban development funds.

As regards the focus of urban development funds, at present the regional focus seems to be the most suitable (NUTS II, region or city).

An overall assessment of the options is shown in Table 4. Options considered as the most appropriate are marked green.

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

Criterion	Questions / Explanations	Weight	Option 1a	Option 1b	Option 2	Option 3a	Option 3b	Option 3c	Option 3d	Option 3e
<b>Simplicity of structure and administrative demands</b>	<p>Is the structure set up to allow projects to be selected and resources allocated to them as quickly as possible?</p> <p>Is the implementation structure set up in the simplest possible way?</p> <p>Are the negative impacts of a multiple-level structure minimised? (E.g. is the number of points where the public contribution is assessed as small as possible?)</p> <p>What structure is the most suitable with regard to decreasing administrative demands on managing authorities?</p>	25%	●	●	●	●	●	●	●	●
<b>Quality of resource utilisation and securing OPs objectives</b>	<p>Does the given structure ensure the selection of projects of sufficient quality?</p> <p>Does the given structure allow the involvement of players with professional experience to give added value to the utilisation of the resources?</p> <p>Will resources be utilised in accordance with the N+2 rule and financial forecasts of operational programmes?</p> <p>Will the programme targets and indicators be fulfilled?</p>	25%	●	●	●	●	●	●	●	●
<b>Safety of resource utilisation</b>	<p>Is the structure set up to minimise the risks associated with the utilisation of the resources from the perspective of the provider of resources from the ERDF?</p> <p>Is the structure set up to minimise the risks associated with the use of the resources from the perspective of the return on investment?</p>	15%	●	●	●	●	●	●	●	●

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

Criterion	Questions / Explanations	Weight	Option 1a	Option 1b	Option 2	Option 3a	Option 3b	Option 3c	Option 3d	Option 3e
<b>Flexibility of resource utilisation</b>	Will the provision of the funds through the JESSICA financial instrument be tied to rigid rules or will the given structure allow their flexibility?	5%	●	●	●	●	●	●	●	●
<b>Adequacy of the volume of available funds and the number of projects</b>	Does the structure correspond to the total volume of resources that will be available? Is the number of structural levels appropriate? Does the structure correspond to the total expected number of projects, i.e. to the demand?	25%	●	●	●	●	●	●	●	●
<b>Independence and viability</b>	Will be implementation structure be viable even after the closure of the programming period?	5%	●	●	●	●	●	●	●	●
	<b>Summary assessment of the suitability of the options</b>		●	●	●	●	●	●	●	●

Table 5 Summary assessment of options 1 - 3

### Legend to assessment of implementation structures:

- The option fully meets the given criterion
- The option meets the given criterion only partly
- The option does not meet the given criterion at all

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### 6.6. Proposed implementation model with funding from OPTA

In this section of the study we provide an overview of options for the implementation structure of the JESSICA financial instrument if funding from the OPTA is used. Similarly as in chapter 6.5 of the study, we show each option also in a diagrammatic form and assess it using the SWOT analysis tool. Summary assessment of the options is provided at the end of the chapter, similarly as in chapter 6.5.4.

#### 6.6.1. Option 4

Option 4 is based on the following assumptions:

Holding fund	- It is not established.
Urban development fund	- It is central and generally focused on the “urban area development”. - It is managed by a Czech institution.
Pilot project	- Resources for the benefit of the financial instrument will be provided through the OPTA as a project of pilot verification of the financial engineering mechanism. - The beneficiary of the pilot project will be the NCA. - The investment board with the participation of the NCA, OPTA MA, UDF manager and/or other experts will be set up at the MfRD level (see chapter 7.2. of the study). - The funding agreement between the NCA and the UDF manager will consist of the decision to provide a subsidy and of the business contract.

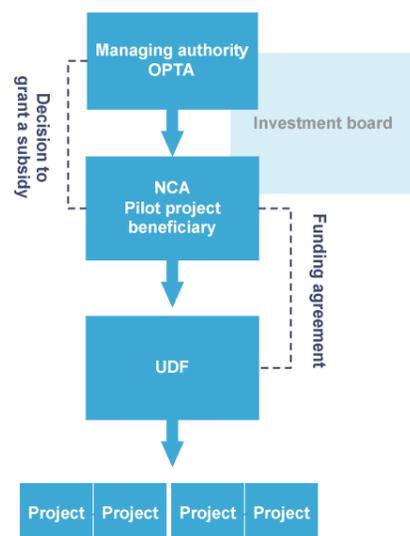


Figure 10 Option 4

### SWOT analysis (option 4)

S	W
<ul style="list-style-type: none"> <li>- Setting up the investment board with participation of experts will contribute to the financial instrument implementation in accordance with national strategies.</li> <li>- The structure corresponds to the total volume of resources available.</li> <li>- Experience of the fund manager in the provision of products for public administration in the CR and in the area of structural funds.</li> <li>- Experience of the fund manager in the provision of financial products, including customer reliability and solvency assessment.</li> <li>- Potential saving of time, since it will not be necessary to proceed in accordance with the PPA if a Czech public institution subordinate to the MfRD is involved.</li> <li>- Lower management costs than the EIB.</li> </ul>	<ul style="list-style-type: none"> <li>- Less attractive for co-investors (leverage of resources at the level of funds).</li> <li>- Higher administrative demands on the OPTA managing authority and NCA.</li> <li>- It is not a standard procedure for the implementation of the JESSICA financial instrument and, therefore, will have to be approved by the European Commission.</li> <li>- It requires changes in the OPTA (both in terms of contents and processes).</li> <li>- Amendments to legal documents establishing such institutions would be necessary in view of the extended subject of their activity (e.g. in the case of the SHDF).</li> <li>- The fund manager has no previous experience in the JESSICA financial instrument.</li> <li>- Limitations arising from State Budgetary Rules, since the NCA is not the fund manager and cannot issue aid decisions.</li> <li>- Time-demanding due to the necessity to prepare a call for proposals for the pilot project and tackle process issues, including financial flows and the setting up of management and control systems.</li> <li>- The focus of a central UDF may not fully correspond to the needs of potential projects.</li> </ul>
O	T
<ul style="list-style-type: none"> <li>- Transfer of know-how and experience if experts from the public sector as well as private sector are on the investment board.</li> </ul>	<ul style="list-style-type: none"> <li>- The European Commission will not approve implementation of the JESSICA financial instrument in the form of a pilot project funded from the OPTA.</li> <li>- Higher time demands if the UDF manager is a banking institution because it will be necessary to proceed in accordance with the PPA.</li> </ul>

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### 6.6.2. Option 5

Option 5 is based on the following assumptions:

<p>Holding fund</p> <p>Urban development fund</p>	<ul style="list-style-type: none"> <li>- It is not established.</li> <li>- It is central and generally focused on the “urban area development”.</li> <li>- It is managed by a Czech institution.</li> <li>- The funding agreement with the UDF manager will consist of the decision to provide a subsidy and of the business contract.</li> </ul>
<p>Pilot project</p>	<ul style="list-style-type: none"> <li>- Resources for the benefit of the financial instrument will be granted through the OPTA only provided that changes in the OPTA which would make it possible are approved.</li> <li>- The investment board with the participation of the NCA, MA of OPTA, UDF manager and/or other experts will be set up at the MfRD level (see chapter 7.2. of the study).</li> </ul>

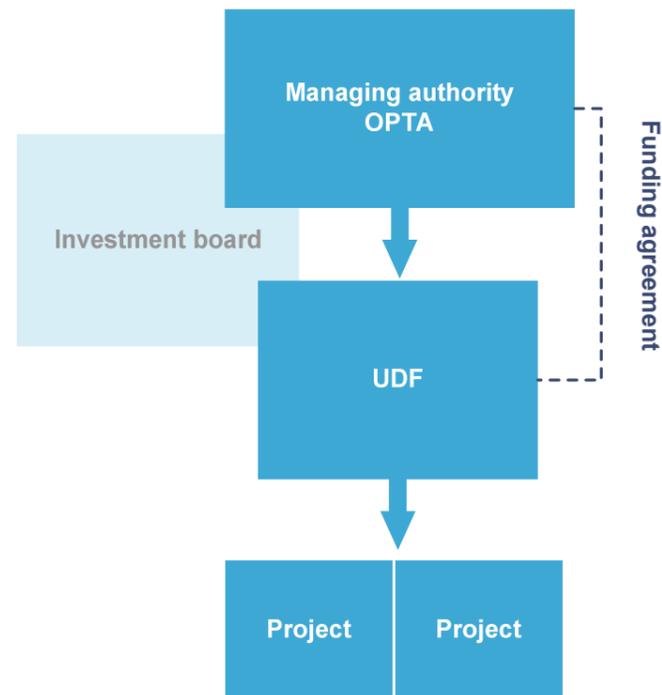


Figure 11 Option 5

### SWOT analysis (option 5)

S	W
<ul style="list-style-type: none"> <li>- Setting up the investment board with participation of experts will contribute to the financial instrument implementation in accordance with national strategies.</li> <li>- The structure corresponds to the total volume of resources available.</li> <li>- It is a standard procedure (compared to option 4).</li> <li>- Potential saving of time in view of the fact that the structure will have only one component and if a Czech public institution subordinate to the MfRD is involved, it will not be necessary to proceed in accordance with the PPA.</li> <li>- Experience of the fund manager in the provision of financial products, including customer reliability and solvency assessment.</li> <li>- Experience of the fund manager in the provision of products for public administration in the CR and in the area of structural funds.</li> <li>- It does not require any measures to ensure compliance with the Act on State Budgetary Rules if the UDF manager is a Czech entity.</li> <li>- Lower management costs than the EIB.</li> </ul>	<ul style="list-style-type: none"> <li>- Less attractive for co-investors (leverage of resources at the level of funds).</li> <li>- Higher administrative demands on the OPTA managing authority.</li> <li>- It requires changes in the OPTA (both in terms of contents and processes), which need to be approved by the EC.</li> <li>- Amendments to legal documents establishing such institutions would be necessary in view of the extended subject of their activity (e.g. in the case of the SHDF).</li> <li>- The fund manager has no previous experience in the JESSICA financial instrument.</li> <li>- The focus of a central UDF may not fully correspond to the needs of potential projects.</li> <li>- Limitations arising from State Budgetary Rules in cases when the UDF manager is a foreign institution – according to the latest indirect information from the Ministry of Finance, such institution would have to establish its Czech branch for the purpose of managing the fund, or the State Budgetary Rules would have to be amended.</li> </ul>
O	T
<ul style="list-style-type: none"> <li>- Transfer of know-how and experience if experts from the public sector as well as private sector are on the investment board.</li> </ul>	<ul style="list-style-type: none"> <li>- The European Commission will not approve changes in the OPTA.</li> <li>- Higher time demands if the UDF manager is a banking institution, since it will be necessary to proceed in accordance with the PPA.</li> </ul>

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### 6.6.3. Option 6

Option 6 is based on the following assumptions:

Holding fund	<ul style="list-style-type: none"> <li>- It is established under the EIB management.</li> <li>- The funding agreement with the UDF manager will consist of the decision to provide a subsidy and of the business contract.</li> </ul>
Urban development fund	<ul style="list-style-type: none"> <li>- In the first stage it is central and generally focused on the “urban area development”, with an intention to find another UDF with a matching thematic focus.</li> <li>- It is managed by a Czech institution.</li> <li>- Resources for the benefit of the financial instrument will be granted through the OPTA only provided that changes in the OPTA which would make it possible are approved.</li> </ul>

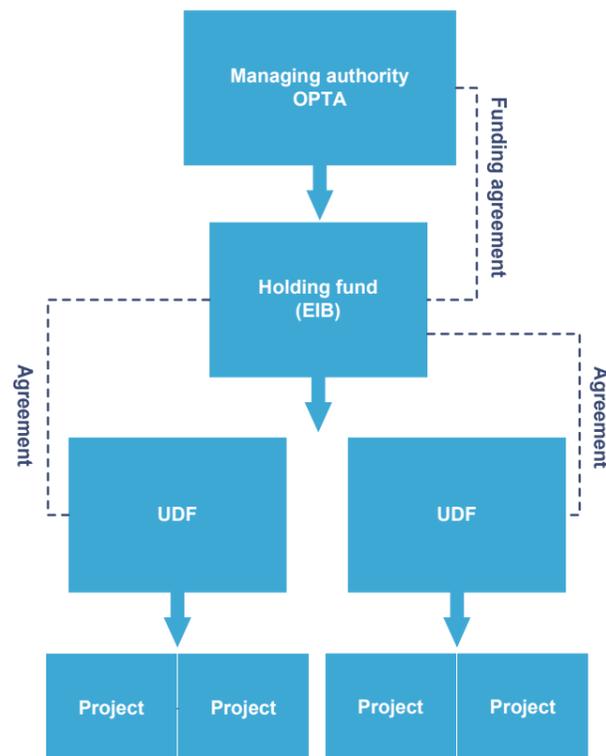


Figure 12 Option 6

### SWOT analysis (option 6)

S	W
<ul style="list-style-type: none"> <li>- Lower administrative demands on the OPTA MA due to the involvement of an institution with experience in the financial instrument.</li> <li>- Experience in implementing the JESSICA financial instrument as a holding fund manager both in the conditions of the Czech Republic (Moravian-Silesian NUTS II Cohesion Region) and other EU countries, which will make transfer of current know-how possible.</li> <li>- Experience in the assessment of investment projects and provision of financial products, including customer reliability and solvency assessment.</li> <li>- Experience in the provision of products for public administration in the CR and in the area of structural funds.</li> <li>- Institutional closeness to the EC (an advantage, e.g. for consulting on non-standard situations, discussing new issues, etc.).</li> <li>- The structure is easy to extend to the 2014+ programming period.</li> </ul>	<ul style="list-style-type: none"> <li>- Demanding both administratively and from the time point of view due to the necessity of principal changes in the OPTA (content focus, financial reallocations, etc.).</li> <li>- Limitations arising from State Budgetary Rules – according to the latest indirect information from the Ministry of Finance, the EIB would have to establish its Czech branch for the purpose of managing the fund, or the State Budgetary Rules would have to be amended.</li> <li>- In view of the volume of resources which will be probably available, the introduction of another component would be prohibitively costly.</li> <li>- Although this option may seem advantageous from the point of view of certification and fulfilment of the N+3 rule (allocations are quickly transferred from the operational programme and can be certified), from the perspective of final eligibility of expenditure the period of time is extended because of the necessity to establish the urban development fund, which will further invest resources in projects.</li> </ul>
O	T
<ul style="list-style-type: none"> <li>- Transfer of know-how and experience if the EIB is involved as the holding fund manager.</li> <li>- Time savings at the establishing due to the fact that it is not necessary to proceed in accordance with the PPA.</li> <li>- If the EIB is involved, faster negotiation process and, consequently, faster establishment of the holding fund resulting from the fact that the EIB has already concluded several holding agreements.</li> </ul>	<ul style="list-style-type: none"> <li>- The European Commission will not approve changes in the OPTA.</li> </ul>

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

### 6.6.4. Assessment of proposed options

The above options 4, 5 and 6 have been assessed using the same criteria as described in chapter 6.5.4. of this study.

In general we can state that at present the most advantageous implementation structures seem to be the ones with fewer management levels, particularly because of the need to set up the implementation structure in a limited period of time so as to provide finance to projects till the end of 2015. Each level of management incurs certain costs, which may not be financially manageable in this pilot stage due to the limited volume of available financial resources. From this perspective, the most beneficial option seems to be option 5, which assumes the existence of one development fund, however, on condition that the European Commission approves such changes in the OPTA that would make the implementation of the JESSICA financial instrument through the OPTA possible.

Similarly, the use of option 4 can be considered. However, in this case account has to be taken of the requirement to organise and evaluate a call for the pilot project. It will also be necessary to create a sub-programme within the OPTA and set up management and control systems at the NCA level, which may elongate the time needed to prepare the implementation structure (see model schedules in chapter 8).

Table 5 shows summary assessment of options 4 – 6.

Criterion	Questions / Explanations	Weight	Option 4	Option 5	Option 6
<b>Simplicity of structure and administrative demands</b>	Is the structure set up to allow projects to be selected and resources allocated to them as quickly as possible? Is the implementation structure set up in the simplest possible way? Are the negative impacts of a multiple-level structure minimised? (E.g. is the number of points where the public contribution is assessed as small as possible?) What structure is the most suitable with regard to decreasing administrative demands on managing authorities?	25%	●	●	●
<b>Quality of resource utilisation and securing OPs objectives</b>	Does the given structure ensure the selection of projects of sufficient quality? Does the given structure allow the involvement of players with professional experience to give added value to the utilisation of the resources? Will resources be utilised in accordance with the N+2 rule and financial forecasts of operational programmes? Will the programme targets and indicators be fulfilled?	25%	●	●	●

## 6. Models of implementation of the JESSICA financial instrument in the Czech Republic (continued)

Criterion	Questions / Explanations	Weight	Option 4	Option 5	Option 6
<b>Safety of resource utilisation</b>	Is the structure set up to minimise the risks associated with the utilisation of the resources from the perspective of the provider of resources from the ERDF? Is the structure set up to minimise the risks associated with the use of the resources from the perspective of the return on investment?	15%	●	●	●
<b>Flexibility of resource utilisation</b>	Will the provision of funds through the JESSICA financial instrument be tied to rigid rules or will the given structure allow their flexibility?	5%	●	●	●
<b>Adequacy of the volume of available funds and the number of projects</b>	Does the structure correspond to the total volume of resources that will be available? Is the number of structural levels appropriate? Does the structure correspond to the total expected number of projects, i.e. to the demand?	25%	●	●	●
<b>Independence and viability</b>	Will the implementation structure be viable even after the closure of the programming period?	5%	●	●	●
	<b>Summary assessment of suitability of options</b>		●	●	●

**Table 6 Summary assessment of options 4 – 6**

**Legend to assessment of implementation structures:**

- The option fully meets the given criterion
- The option meets the given criterion only partly
- The option does not meet the given criterion at all

## 7. Description of basic processes and financial flows

This section of the study summarizes basic processes and describes responsibilities of institutions involved in the implementation of the JESSICA financial instrument in the Czech Republic. In view of the assumptions made in chapter 2.3. of the study, the basic processes and financial flows were prepared only for options discussed in chapter 6.6. (i.e. options 4, 5 and 6).

### 7.1. Assumptions

For the purpose of easier presentation and comparison, below is a summary of assumptions used in the options.

#### Option 4

- The amount of the allocation to be used within the JESSICA financial instrument is approximately CZK 700 – 800 million.
- Resources for the benefit of the financial instrument will be transferred from the OPTA as a project of pilot verification of the financial engineering mechanism.
- In the first stage the implementation structure will consist of one urban development fund, which will be managed by a Czech institution – State Housing Development Fund, or a commercial bank.
- The investment board will be set up at the MfRD level.
- The applicant for the pilot project will be the NSRF management and coordination department (National Coordination Authority).

#### Option 5

- The amount of the allocation to be used within the JESSICA financial instrument is approximately CZK 700 – 800 million.
- Resources for the benefit of the financial instrument will be transferred from the OPTA directly, i.e. not as a pilot project.
- In the first stage the implementation structure will consist of one urban development fund, which will be managed by a Czech institution – State Housing Development Fund, or a commercial bank.
- The investment board will be set up at the MfRD level.
- Resources will be provided directly from the OPTA (on condition that the European Commission approves changes in the operational programmes that will make it possible).

## 7. Description of basic processes and financial flows (continued)

### Option 6

- The amount of the allocation to be used within the JESSICA financial instrument is approximately CZK 700 – 800 million.
- Resources in favour of the financial instrument will be transferred from the OPTA as pilot verification of the financial engineering mechanism.
- In the first stage the implementation structure will consist of one holding fund managed by the EIB and one urban development fund managed by a Czech institution – the State Housing Development Fund or a commercial bank with an intention to extend the structure through the involvement of another UDF with a matching thematic focus.
- Resources will be provided directly from the OPTA (on condition that the European Commission approves changes in the operational programmes that will make it possible).

### 7.2. Institutions involved in the JESSICA financial instrument and their responsibilities

In this section, we provide an overview of institutions that we think will take part in the processes of implementing the JESSICA financial instrument in the Czech Republic and a description of their main responsibilities.

- **European Commission**
  - Approves changes in the operational programme.
  - Makes payments in the form of pre-financing, interim payments and payment of the final balance.
- **OPTA Managing Authority**
  - Prepares changes in the OPTA and submits them for approval to the Monitoring Committee and the EC.
  - Prepares and announces calls for proposals for pilot projects (option 4).
  - Evaluates the application and arranges meetings of the Selection Committee (option 4).
  - Is responsible for taking the decision to provide a subsidy, including its conditions as well as potential changes for the pilot project beneficiary (option 4) or the HF/UDF fund (options 5 and 6).
  - Takes part in the investment board meetings (option 4 and 5).
  - In option 5 performs the role of the investment board establisher.
  - In option 5 and 6 selects the UDF or the HF manager.
  - Carries out pilot project checks – both administrative and on-the-spot (option 4).
  - Checks the fulfilment of contract conditions (option 5 and 6).
  - Bears responsibility for the management of funds provided from the budget chapter of the MfRD for national funding of the OPTA and pre-financing of the OPTA's expenditure which should be paid from the EU resources.

## 7. Description of basic processes and financial flows (continued)

- **National Coordination Authority (pilot project beneficiary – option 4)**
  - Prepares and submits the application for the pilot project to the Managing Authority.
  - Performs the role of the Investment Board establisher.
  - Arranges meetings of the Investment Board.
  - Performs the obligations of the beneficiary (i.e. submits monitoring reports, applications for payment, etc.).
  - Ensures the selection of the urban development fund manager.
  - As the subsidy provider according to State Budgetary Rules, is responsible for the setting up of management and control systems.
  - On the basis of the effective decision and funding agreement it checks the performance of activities of the urban development fund manager.
  - Bears responsibility for the management of funds which it was provided in order to implement the pilot project.
  - In **Option 5** is the Investment Board member and takes part in its meetings.
- **Financial Division (budget department and accounting and financial services department of the MfRD)**
  - Monitors drawing on the state budget funds.
  - In the accounting system of the MfRD (IRAP) carries out accounting operations related to the implementation of the MfRD projects.
  - Takes part in the investment board meetings.
- **Investment Board (options 4 and 5)**

The investment board will be set up as an advisory body for the OPTA MA and NCA. The investment committee should consist of representatives of the pilot project beneficiary, managing authority of the OPTA, and budget dept. of the MfRD and/or other specialists. The selected urban development fund manager should be invited to the investment board’s meetings so as to ensure regular communication between the manager and the contracting authority.

In our opinion, the main activities of the investment board should involve the following:

- Assessment and revision of the business plan submitted by the urban development fund manager;
- Means for monitoring the fulfilment of the funding agreement;
- Means for monitoring the financial instrument implementation;
- Preparation of rules for the selection and operation of the urban development fund, including criteria that the selected fund shall follow in accordance with the relevant funding agreement when selecting a recipient of its investments; participation in the assessment and approval of investments from the point of view of their compliance with the CR’s strategic documents.

## 7. Description of basic processes and financial flows (continued)

- **Holding fund manager (option 6)**
  - Encouragement of the involvement of relevant entities (regions, municipalities, private investors, developers, etc.) and the involvement/establishing of UDFs, in particular with the help of a suitable communication and support programme.
  - Identification and involvement of suitable UDFs.
  - Implementation of the investment plan agreed with the managing authority through investments in selected UDFs.
  - Continuous control and monitoring of implementation of UDFs investment plans and reporting to the managing authority.
  - An exit of the investments from the UDF and repayment of the contribution to the managing authority or other relevant entity<sup>150</sup>.
  - Providing assistance to the managing authority with the performance of its statutory obligations arising out of its position within the management of allocations from the EU funds (assistance with expenditure statements, certification, state aid notification processes, etc.).
  
- **Urban development fund manager**
  - Takes part in the investment board meetings (options 4 and 5).
  - Manages funds allocated in favour of the JESSICA financial instrument.
  - Identifies suitable projects and evaluates them from the financial point of view (reliability and solvency of the project implementing entity, assessment of the return on investment, risk rate, etc.).
  - Takes part in the selecting of projects at the investment board meetings (options 4 and 5).
  - Is responsible for establishing contractual relations with project implementing entities.
  - Draws up regular reports for the NCA on the implementation status of the JESSICA financial instrument.
  - Provides assistance to the managing authority with the performance of its statutory obligations arising out of its position within the management of resources from the EU funds (assistance with expenditure statements, certification, state aid notification processes, etc.).
  - If capital is provided in the form of equity, it will also ensure the exercise of shareholders' rights.
  - In **option 6** it would also select and evaluate projects.

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<sup>150</sup> Nebude-li dohodnuto jinak v případě holdingového fondu zapojeného poskytnutím dotace.

## 7. Description of basic processes and financial flows (continued)

- **Entity implementing a project**
  - Implements its project and applies for resources from the JESSICA financial instrument.
  - Reports on the implementation of its projects to the urban development fund manager.
  - Makes loan repayments in accordance with the contract concluded with the urban development fund manager.
  
- **Certifying Authority**
  - Controls the aggregate application for payment and the certification process.
  - Transfers the EU allocation to income accounts of the budget chapter of the MfRD.
  - Submits to the EU applications for payment / application for the final balance payment as necessary.
  
- **Intermediary Body (e.g. Centre for Regional Development of the CR)**
  - Controls the simplified application for payment.
  - Generates the application for payment (F1) in the IS Monit7+ and sends it to the MA.
  - Controls and monitors the project implementation according to its internal procedures.
  
- **Audit Authority / Delegated Audit Subjects and other audit authorities**
  - Carries out standard audits and checks.

### 7.3. Basic processes

The main processes described in this study are as follows:

- Setting up the investment board
- Selection of the urban development fund manager
- Financial flows and control

For better illustration, each process described below is accompanied by a diagram.

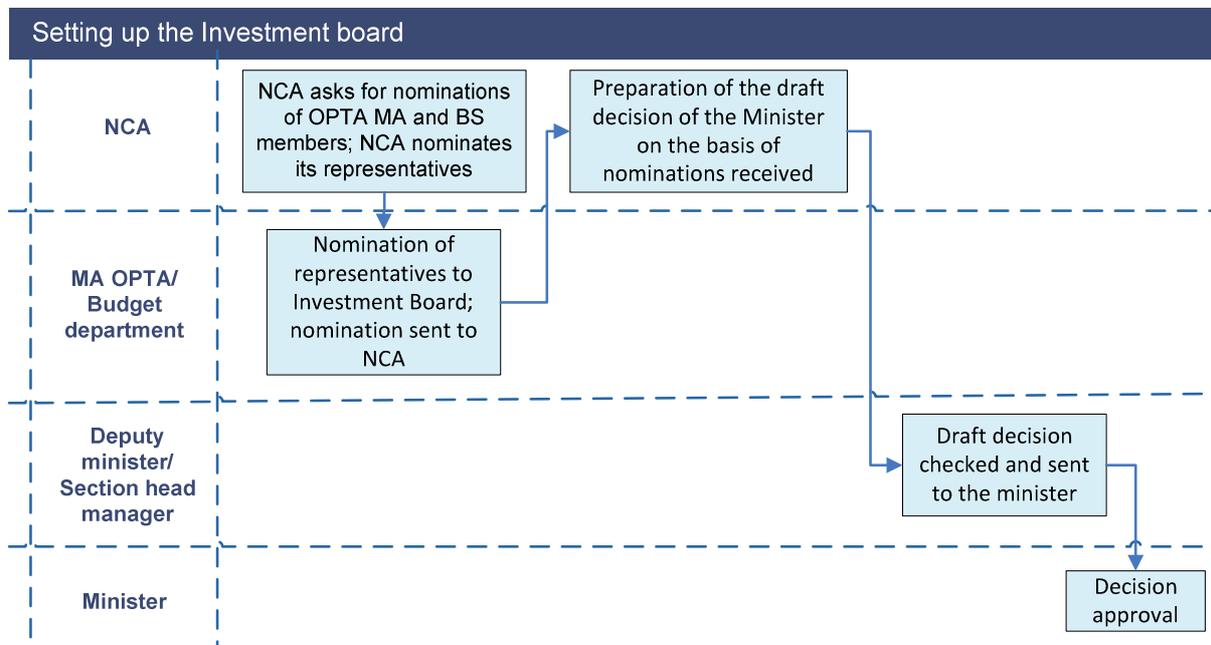
#### 7.3.1. Setting up the investment board

The entity establishing the investment board will be the NCA as the pilot project beneficiary (option 4) or the OPTA MA (option 5). The establishing body will also be responsible for its functioning. It means that upon the request by the establishing body (or the division director) the section of the Managing Authority of the Operational Programme Technical Assistance, budget section and the NCA will appoint their representatives in the investment board.

## 7. Description of basic processes and financial flows (continued)

The investment board will be established upon the decision of the Minister taken on the basis of the proposal submitted by the 1<sup>st</sup> Deputy Minister or the head manager of the NCA and European affairs section. The draft decision will be prepared by the NCA/OPTA MA on the basis of received nominations. If necessary, the draft decision will be discussed at the meeting of the Ministry’s top officials.

A diagram of the process is provided in Figure 13. The diagram was prepared only for option 4. Processes within option 5 would be identical, except for exchanged responsibilities between the NCA and OPTA MA.



**Figure 13 Process of setting up the Investment Board (option 4)**

## 7. Description of basic processes and financial flows (continued)

### 7.3.2. Selection of the urban development fund manager (options 4 and 5)

The urban development fund manager will be selected in the form of a public contract award to a commercial bank. If the urban development fund manager is a public institution under the dominant influence of the MfRD (e.g. the State Housing Development Fund), an exception stipulated in Section 18(1)(j) of the PPA will be applied and competitive tendering will not have to be held.

The decision on the award procedure type will be made by the investment board. In view of the fact that it will be an above-the-threshold public contract, the most appropriate form of it will be an open procedure or competitive dialogue.

Before commencing the award procedure, the investment board will approve the public contract basic parameters. These will be, in particular, clear definition of the fund manager’s tasks, expected management costs (in accordance with the provision of Article 43(4) of the Implementing Regulation). The investment board will also approve criteria for the evaluation of bids. We think it appropriate to include assessment of the submitted business plan in the evaluation criteria. The principal components of a business plan are, among others:

- **Investment strategy** (i.e. description of the target market, geographical and thematic focus, provided products, method of selecting projects, support to project implementing entities).
- **Financial plans and budget of the UDF** (budget of the urban development fund corresponding to available resources, including financial plans – cash flow).
- **Identification and selection of projects** (i.e. the way in which the manager will identify suitable projects and assess them in terms of their suitability for funding from the JESSICA financial instrument).
- **Fund management and involvement of key experts** (i.e. the way in which the fund will be managed and administered, including keeping separate accounts; a list of key experts who have relevant knowledge and experience).
- **Management costs** (i.e. management costs in accordance with Article 43(4) of the Implementing Regulation).
- **Exit from investments** (i.e. conditions under which the UDF will exit out of the investments and under which the resources can be reinvested).

In our opinion, it will be appropriate to include representatives of the investment board in the evaluation committee so as to ensure comprehensive assessment of the bids submitted by tenderers for the urban development fund management.

## 7. Description of basic processes and financial flows (continued)

The funding agreement will then be concluded with the selected tenderer. It will consist of the **decision to provide a subsidy**, which will be issued in accordance with State Budgetary Rules and by which resources to be managed will be transferred to the HF/UDF, and the funding agreement **in the form of a contract under the Commercial Code**, which was awarded to the tenderer in public procurement and on the basis of which he will be paid the management costs. The conclusion of the funding agreement and issuance of the decision will be the responsibility of the NCA (option 4) or OPTA MA (option 5). These two documents will be separate. However, they should be mutually related and must be made with the same effective date (or related in the legal sense). The diagram of the process is provided in Figure 14.

In **option 6** the urban development fund manager would be selected according to the EIB’s internal rules, unless otherwise agreed in the contract conditions between the OPTA MA and the EIB.

## 7. Description of basic processes and financial flows (continued)

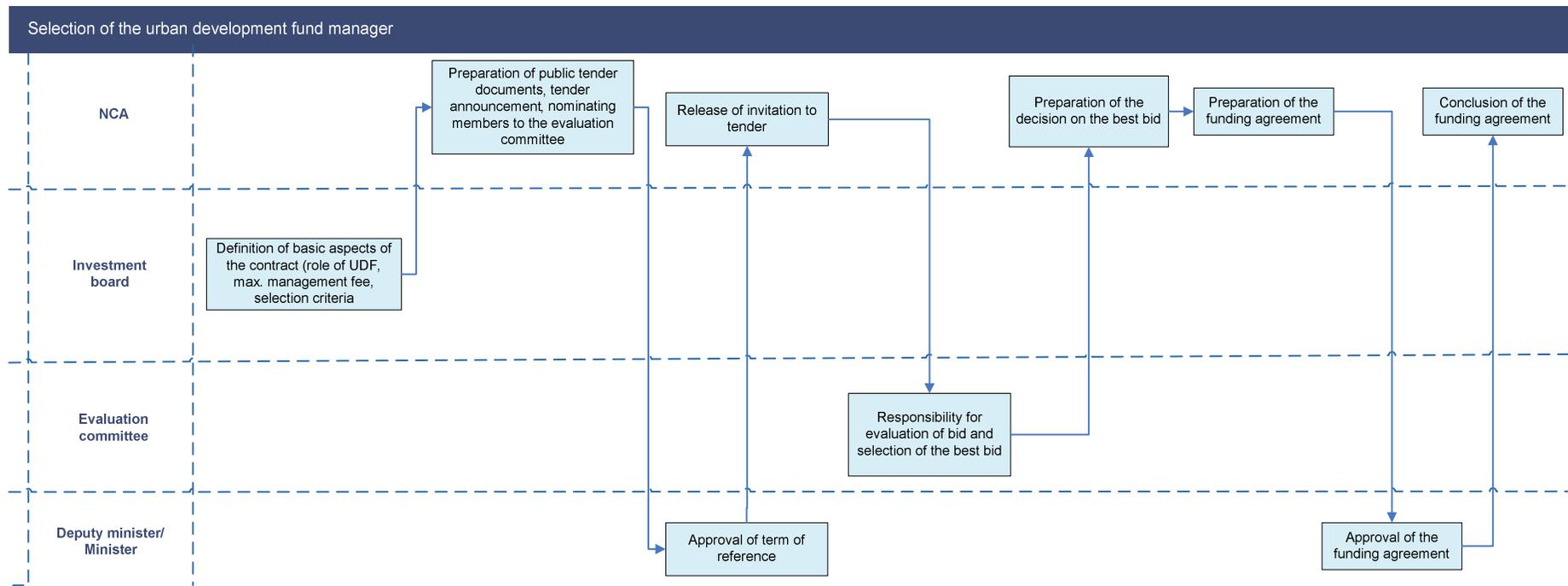


Figure 14 Selection of the urban development fund manager

## 7. Description of basic processes and financial flows (continued)

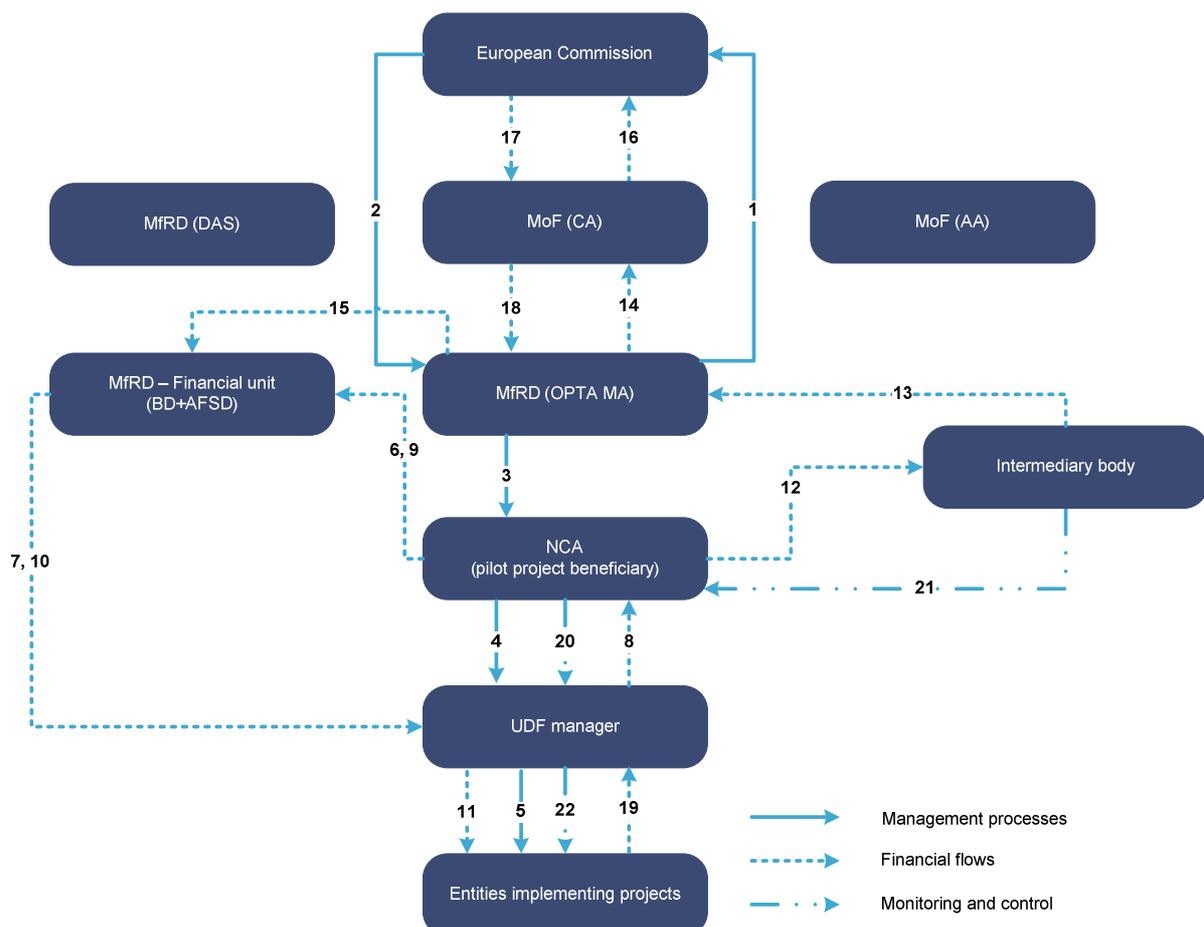
### 7.3.3. Financial flows and control

We understand that projects within the OPTA are funded in the form of ex-post payments, i.e. that the resources of the state budget share in national co-financing and pre-financing of resources that should be covered from structural funds of EU are at first paid from the relevant budget chapter. We based the proposed financial flow and control on the assumption that even if the allocation for the Czech Republic is increased, the European Commission will not provide the resources as ex-ante payment.

In conclusion of this chapter we illustrate the course of financial flows with the participation of a regional operational programme in the JESSICA financial instrument implementation. We have defined these financial flows using the assumptions of option 3b.

#### Option 4

Figure 15 shows our concept of the financial flows and control process in option 4...



**Figure 15 Financial flows and control process (option 4)**

## 7. Description of basic processes and financial flows (continued)

### Management processes

1. OPTA MA asks the European Commission to approve the operational programme or changes to it.
2. The European Commission sets the OPTA financial framework for individual years and individual priorities and areas of support in the 2007-2013 programming period. It also approves reallocations of funds between priority axes and major programme changes.
3. OPTA MA ensures evaluation and selection of the pilot project, the issuing of the decision to provide a subsidy and specification of the pilot project conditions and, if necessary, makes changes in them.
4. Based on the results of the competitive tender for the urban development fund manager the NCA will ensure the preparation and conclusion of the funding agreement (contract under the Commercial Code) and the issuing of the decision to provide a subsidy (according to State Budgetary Rules). The funding agreement or the decision will include the schedule of tranches by which the funds to be managed will be transferred to the manager and also the schedule of invoices on the basis of which the manager’s remuneration will be remitted.
5. The urban development fund manager will ensure the contractual relationship (contract) with the entity implementing the project on the basis of the investment selection and assessment and will gradually transfer funds in accordance with the contract terms and conditions. In this case the investment board will also be involved in the investment assessment. The contract between the UDF manager and the entity implementing the project will be governed by the Commercial Code.<sup>151</sup>

### Financial flows

6. On preparing the budget for next year the NCA as the beneficiary will secure resources for the financial instrument within its appropriation. If the instrument implementation starts after the budget has been drawn up, the NCA will secure the budget by means of a budgetary measure.
7. On the basis of the schedule contained in the conditions of the decision to provide a subsidy the accounting and financial services department will transfer the relevant resources under the UDF management even if the OPTA funding rules are changed from ex-post to ex-ante. If it be to the contrary, tranches would be paid only after the approval of the payment request (F1) and transfer order (F2) by the OPTA MA.

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<sup>151</sup> This arrangement of financial flows and relations between entities involved in the JESSICA financial instrument implementation was discussed with the representatives of the State Budget Dept. of the MoF CR on 2 August 2010 and they did not see any obstacles to such arrangement.

## 7. Description of basic processes and financial flows (continued)

8. On the basis of the schedule contained in the funding agreement and conditions of the decision to provide a subsidy the urban development fund manager sends invoices for his remuneration together with a report on the status of the financial instrument implementation.
9. The NCA checks the formal, factual and financial correctness of the invoice and the reports on the implementation status of the financial instrument and sends the invoice for payment to the accounting and financial services department.
10. The accounting and financial services department will make a payment of the relevant account from the expense budget of the MfRD chapter to the account of the urban development fund manager in accordance with the applicable internal procedures of the Ministry.
11. The UDF manager transfers resources to the accounts of entities implementing projects in accordance with the contract.
12. The NCA as the pilot project beneficiary will complete an e-application for payment in the Benefit7 application (simplified request for payment) and submit it together with the monitoring report on the project implementation and obligatory documents to the intermediate entity.
13. The IB will check the formal, factual and financial correctness of the payment request and will generate the payment request (F1) in IS Monit7+ and send it together with all obligatory documents to the managing authority. The MA will check the request for payment and generate the Statement of approval and the order to pay eligible project expense (F2).
14. On a regular basis the MA prepares aggregate requests for payment, which include approved payment requests (F1), and sends them for checking to the CA.
15. The MA sends a copy of the aggregate request for payment to the AFSD for booking a receivable from the MoF. The CA checks the aggregate application and if it is approved it books it in IS VIOLA.
16. The CA asks the EC to replenish the CA account balance by an interim payment. The CA sends the request to the EC after certification of the expenditures incurred.
17. The EC sends advance and interim payments and the final balance payment in accordance with the approved financial framework.
18. On the basis of the aggregate request for payment the CA transfers resources in the amount of the EU share to income accounts of the MfRD chapter. It checks the aggregate request for payment and performs certification.
19. The project implementing entity repays the principal and interest in accordance with the contract conditions. It also submits regular reports on the project implementation.

## 7. Description of basic processes and financial flows (continued)

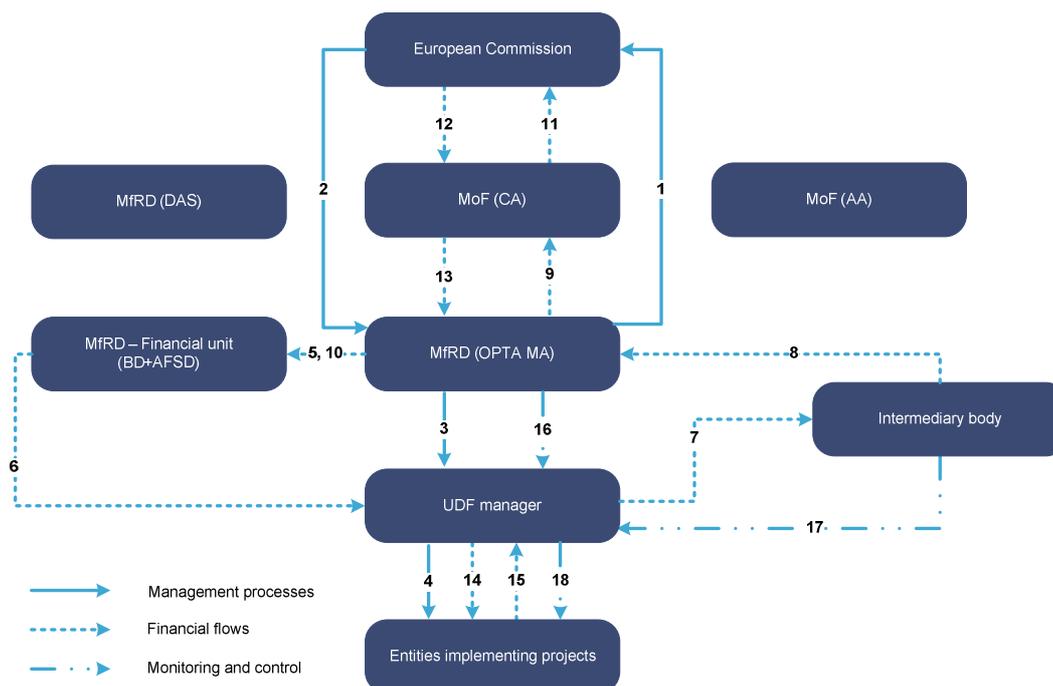
### Monitoring and control

20. The NCA as the pilot project beneficiary and contracting party will regularly check the fulfilment of contractual obligations and monitor the status of the financial instrument implementation on the basis of regular reports on the status of the financial instrument implementation (see step 8) and will also be responsible for discussing the reports at the investment board meetings.
21. The intermediate entity regularly checks and monitors the project implementation according to the set rules.
22. The UDF manager regularly monitors its investment.

Checks of the implementation process of the JESSICA financial instrument can be carried out also by other institutions, namely the Audit Authority, Delegated Audit Subject of the MfRD and other control and audit institutions, including the EU institutions, which will carry out standard audits and check in accordance with their internal procedures and regulations. If the JESSICA financial instrument is implemented through a pilot project, the audits and checks will be carried out to the level of the pilot project beneficiary (NCA).

### Option 5

In option 5, where the JESSICA financial instrument will be implemented from the OPTA funds, but through direct utilisation, i.e. not as a pilot project, financial flows will be arranged in the way shown in Figure 16.



**Figure 16 Financial flows and control process (option 5)**

## 7. Description of basic processes and financial flows (continued)

### Management processes

1. OPTA MA asks the European Commission to approve the operational programme or changes to it.
2. The European Commission sets the OPTA financial framework for individual years and individual priorities and areas of support in the 2007-2013 programming period. It also approves reallocations of funds between priority axes and major programme changes.
3. Based on the decision of the programme monitoring committee to implement the JESSICA financial instrument the OPTA MA will ensure the preparation and conclusion of the funding agreement (contract under the Commercial Code) and the issuing of the decision to provide a subsidy according to State Budgetary Rules (provided that the manager is the SHDF, which means that an exception from Act No. 137/2006 Coll., on Public Contracts, will be applied). In other cases (commercial banks or institutions in which the MfRD does not exercise dominant control) a competitive tender will have to be held. The funding agreement or the decision will include the schedule of tranches by which the funds to be managed will be transferred to the manager and also the schedule of invoices on the basis of which the manager's remuneration will be remitted.
4. The urban development fund manager will ensure the contractual relationship (contract) with the entity implementing the project on the basis of the investment selection and assessment and will gradually transfer funds in accordance with the contract terms and conditions. In this case the investment board will also be involved in the investment assessment. The contract between the UDF manager and the entity implementing the project will be governed by the Commercial Code (see footnote 151, page 144 of this study).

### Financial flows

5. On preparing the budget for next year the OPTA as the managing authority of the operational programme implementing the JESSICA financial instrument will secure resources for the financial instrument within its appropriation. If the instrument implementation starts after the budget has been drawn up, the NCA will secure the budget by means of a budgetary measure.
6. On the basis of the approved schedule of tranches in the funding agreement and in accordance with applicable internal procedures of the Ministry the accounting and financial services department will transfer the relevant amount from the expense budget of the MfRD chapter to the account of the UDF manager even if the OPTA funding rules are changed from ex-post to ex-ante. This would be necessary especially if the urban development fund manager is a commercial bank or other institution in which the MfRD does not exercise dominant influence. If it be to the contrary, tranches would be paid only after the approval of the payment request (F1) and transfer order (F2) by the OPTA MA.

## 7. Description of basic processes and financial flows (continued)

7. On the basis of the schedule contained in the funding agreement and conditions of the decision to provide a subsidy the UDF manager generates an electronic request for payment (simplified request for payment) in the Benefit7 application and submits it together with the monitoring report on the status of the financial instrument implementation and required documents to the intermediate entity.
8. The intermediary entity will check the formal, factual and financial correctness of payment request and will generate the payment request (F1) in IS Monit7+ and send it together with all obligatory documents to the managing authority. The MA will check the request for payment and generate the Statement of approval and the order to pay eligible project expense (F2).
9. On a regular basis the MA prepares aggregate requests for payment, which include approved payment requests (F1), and sends them for checking to the CA.
10. The MA sends a copy of the aggregate request for payment to the AFSD for booking a receivable from the MoF. The CA checks the aggregate application and if it is approved it books it in IS VIOLA.
11. The CA asks the EC to replenish the balance at the CA account by an interim payment. The CA sends the request to the EC after certification of the expenditures incurred.
12. The EC sends advance and interim payments and the final balance payment in accordance with the approved financial framework.
13. On the basis of the aggregate request for payment the CA transfers resources in the amount of the EU share to income accounts of the MfRD chapter. It checks the aggregate request for payment and performs certification.
14. The UDF manager transfers the resources to the accounts of the project implementing entities in accordance with contract conditions...
15. The project implementing entity repays the principal and interest in accordance with the contract conditions. It also submits regular reports on the project implementation.

### Monitoring and control

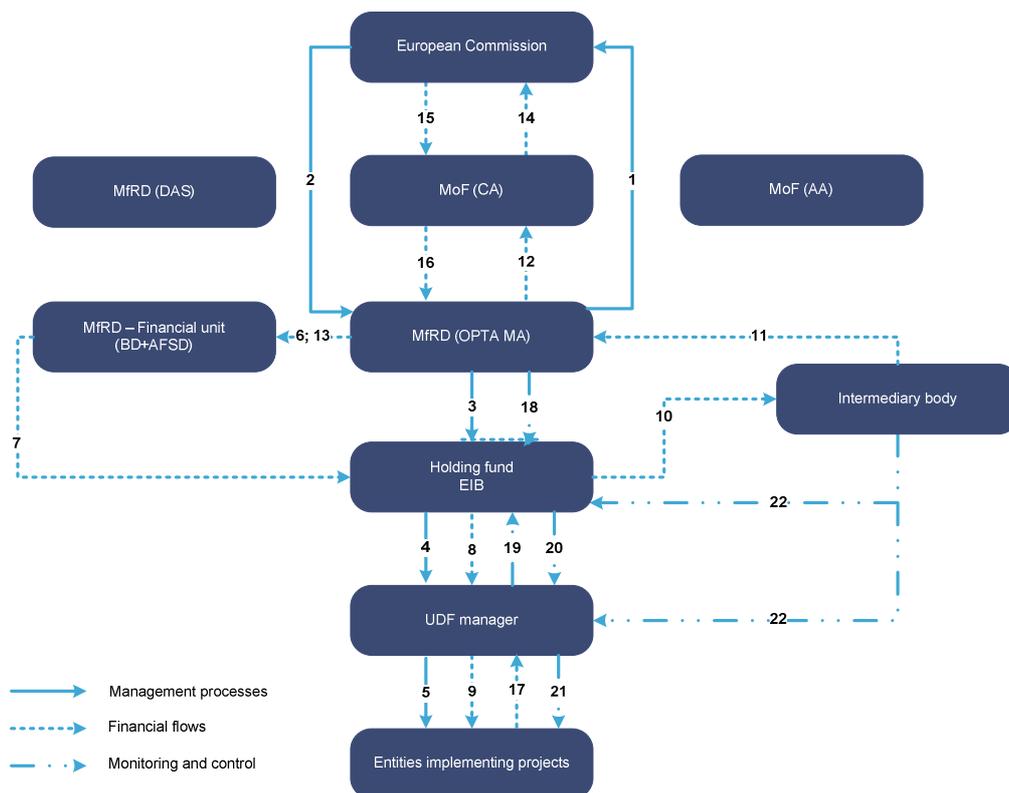
16. The OPTA MA as the contracting party will regularly check the fulfilment of contractual obligations and monitor the status of the financial instrument implementation on the basis of regular reports on the status of the financial instrument implementation (see step 7) and will also be responsible for discussing the reports at the investment board meetings.
17. The intermediate body regularly monitors and checks the implementation of the financial instrument according to the set rules.
18. The UDF manager regularly monitors its investment

## 7. Description of basic processes and financial flows (continued)

Checks of the implementation process of the JESSICA financial instrument can be carried out also by other institutions, namely the Audit Authority, Delegated Audit Subject of the MfRD and other control and audit institutions, including the EU institutions, which will carry out standard audits and check in accordance with their internal procedures and regulations. In this case the activities will be performed to the level of the UDF manager and his investment (see our legal analysis, chapter 3.1.1. of the study).

### Option 6

In option 6, where the implementation structure will involve the holding fund, financial flows will be arranged in the way shown in Figure 17.



**Figure 17 Financial flows and control process (option 6)**

### Management processes

1. OPTA MA asks the European Commission to approve the operational programme or changes to it.
2. The European Commission sets the OPTA financial framework for individual years and individual priorities and areas of support in the 2007-2013 programming period. It also approves reallocations of funds between priority axes and major programme changes.

## 7. Description of basic processes and financial flows (continued)

3. Based on the decision of the programme monitoring committee to implement the JESSICA financial instrument the OPTA MA will ensure the preparation and conclusion of the funding agreement (contract under the Commercial Code) and the issuing of the decision to provide a subsidy according to State Budgetary Rules. The funding agreement or the decision will include the schedule of tranches by which the funds to be managed will be transferred to the manager and also the schedule of invoices on the basis of which the manager’s remuneration will be remitted.
4. The holding fund manager selects the urban development fund manager and ensures the contractual relationship (funding agreement), which will be governed by the Commercial Code.
5. The urban development fund manager identifies suitable projects and ensures the contractual relationship (contract) with entities implementing the projects. The contract between the UDF manager and the entity implementing the project is governed by the Commercial Code (see footnote 151, page 144 of this study).

### Financial flows

6. On preparing the budget for next year the OPTA as the managing authority of the operational programme implementing the JESSICA financial instrument will secure resources for the financial instrument within its appropriation. If the instrument implementation starts after the budget has been drawn up, the NCA will secure the budget by means of a budgetary measure.
7. On the basis of the approved schedule of tranches in the funding agreement and in accordance with applicable internal procedures of the Ministry the accounting and financial services department will transfer the relevant amount from the expense budget of the MfRD chapter to the account of the holding fund manager provided that the OPTA funding rules are changed from ex-post to ex-ante. If it be to the contrary, tranches would be paid only after the approval of the payment request (F1) and transfer order (F2) by the OPTA MA.
8. Based on the selection and according to the conditions of the funding agreement the HF manager transfers the resources in favour of the UDF.
9. Based on the selection and according to the contractual conditions the UDF manager transfers the resources to accounts of entities implementing projects.
10. On the basis of the schedule contained in the funding agreement and conditions of the decision to provide a subsidy the holding fund manager generates an electronic request for payment (simplified request for payment) in the Benefit7 application and submits it to together with the monitoring report on the status of the financial instrument implementation and required documents the intermediate entity.

## 7. Description of basic processes and financial flows (continued)

11. The IB will check the formal, factual and financial correctness of the payment request and will generate the payment request (F1) in IS Monit7+ and send it together with all obligatory documents to the managing authority. The MA will check the request for payment and generate the Statement of approval and the order to pay eligible project expense (F2).
12. On a regular basis the MA prepares aggregate requests for payment, which include approved payment requests (F1), and sends them for checking to the CA.
13. The MA sends a copy of the aggregate request for payment to the AFSD for booking a receivable from the MoF. The CA checks the aggregate application and if it is approved it books it in IS VIOLA.
14. The CA asks the EC to replenish the balance at the CA account by an interim payment. The CA sends the request to the EC after certification of the expenditures incurred.
15. The EC sends advance and interim payments and the final balance payment in accordance with the approved financial framework.
16. On the basis of the aggregate request for payment the CA transfers resources in the amount of the EU share to income accounts of the MfRD chapter. It checks the aggregate request for payment and performs certification.
17. The project implementing entity repays the principal and interest in accordance with the contract conditions. It also submits regular reports on the project implementation.

### Monitoring and control

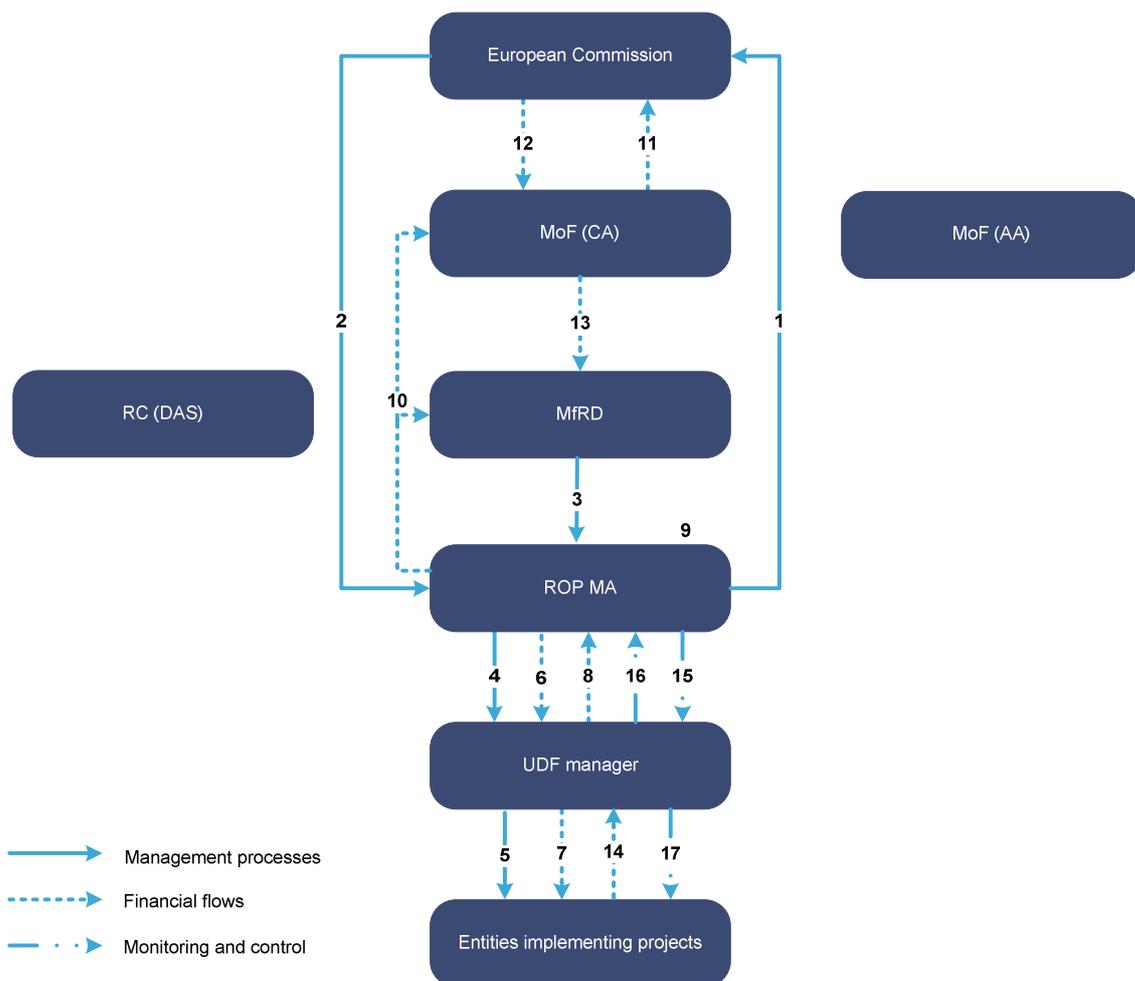
18. The OPTA MA as the contracting party will regularly check the fulfilment of contractual obligations and monitor the status of the financial instrument implementation on the basis of regular reports on the status of the financial instrument implementation (see step 10)
19. The urban development fund manager reports on the fund’s activity and status of the aid implementation in regular intervals stipulated in the funding agreement. Based on the reports, the holding fund manager prepares regular reports on the implementation status of the financial instrument (appendices to the simplified payment request).
20. The HF manager regularly checks and monitors activities of the urban development fund based on regular reports mentioned under point 19 above...
21. The UDF manager regularly monitors its investment.
22. The IB regularly monitors and checks the implementation of the financial instrument according to the set rules. In doing so, it can perform checks up to the level of the urban development fund, if it is established at that time.

## 7. Description of basic processes and financial flows (continued)

Checks of the implementation process of the JESSICA financial instrument can be carried out also by other institutions, namely the Audit Authority, Delegated Audit Subject of the MfRD and other control and audit institutions, including the EU institutions, which will carry out standard audits and check in accordance with their internal procedures and regulations. In this case the activities will be performed to the level of the UDF manager and his investment (see our legal analysis, chapter 3.1.1. of the study).

### Option 3b

In option 3b the implementation structure consists only of the urban development fund, to which the regional operational programme will contribute (see chapter 6.5.4. of this study). Financial flows will be arranged in the way shown in Figure 18.



**Figure 18 Financial flows and control (option 3b)**

## 7. Description of basic processes and financial flows (continued)

### Management processes

1. ROP MA asks the European Commission to approve the operational program or changes to it.
2. The European Commission sets the OPTA financial framework for individual years and individual priorities and areas of support in the 2007-2013 programming period. It also approves reallocations of funds between priority axes and major programme changes.
3. The MfRD issues the decision to provide a subsidy pursuant to Section 14 of State Budgetary Rules at the beginning of each year.
4. Based on the decision of the programme monitoring committee to implement the JESSICA financial instrument the ROP MA will select the UDF manager in a competitive tender held in accordance with Act No. 137/2006 Coll., on Public Contracts, and arrange conclusion of the funding agreement, which will consist of the contract of subsidy provided in accordance with Municipal Budgetary Rules and of a commercial agreement under the Commercial Code. The funding agreement or the contract of subsidy will include the schedule of tranches by which the funds to be managed will be transferred to the manager and also the schedule of invoices on the basis of which the manager’s remuneration will be remitted.
5. The urban development fund manager identifies suitable projects and ensures the contractual relationship (contract) with entities implementing the projects. The contract between the UDF manager and the entity implementing the project is governed by the Commercial Code (see footnote 151, page 144 of this study).

### Financial flows

6. On the basis of the approved schedule of tranches in the funding agreement and in accordance with applicable internal procedures of the regional council the financial division of the ROP MA will transfer the relevant amount from the expense budget of the MfRD chapter to the account of the UDF manager. Similarly as with OPTA, the funding rules would have to be changed from ex post to ex ante. If it be to the contrary, tranches would be paid only after the approval of the payment request (F1) and transfer order (F2) by the ROP MA.
7. Based upon the performed selection and contract conditions, the UDF manager transfers the resources to the accounts of the project implementing entities. The contract between the UDF manager and the entity implementing projects is governed by the Commercial Code.
8. On the basis of the schedule contained in the funding agreement and conditions of the decision to provide a subsidy the UDF manager generates an electronic request for payment (simplified request for payment) in the Benefit7 application and submits it together with the monitoring report on the status of the financial instrument implementation and required documents to the ROP MA.

## 7. Description of basic processes and financial flows (continued)

9. The ROP MA will check the formal, factual and financial correctness of the payment request and will generate the payment request (F1). After an audit the IS Monit7+ will generate the Statement of approval and the order to pay eligible project expense (F2).
10. On a regular basis the MO prepares aggregate requests for payment, which include approved payment requests (F1), and sends them for checking to the CA. A copy of the aggregate request for payment is sent to the MfRD.
11. The CA asks the EC to replenish the balance at the CA account by an interim payment. The CA sends the request to the EC after certification of the expenditures incurred.
12. The EC sends advance and interim payments and the final balance payment in accordance with the approved financial framework.
13. On the basis of the aggregate request for payment the CA transfers resources in the amount of the EU share to income accounts of the MfRD chapter. It checks the aggregate request for payment and performs certification.
14. The project implementing entity repays the principal and interest in accordance with the contract conditions. It also submits regular reports on the project implementation.

### Monitoring and control

15. The ROP MA as the contracting party will regularly check the fulfilment of contractual obligations and monitor the status of the financial instrument implementation on the basis of regular reports on the status of the financial instrument implementation (see step 16).
16. The urban development fund manager reports to the ROP MA on the fund's activity and status of the aid implementation in regular intervals stipulated in the funding agreement. Based on the reports, the holding fund manager prepares regular reports on the implementation status of the financial instrument (appendices to the simplified payment request).
17. The UDF manager regularly monitors its investment.

Checks of the implementation process of the JESSICA financial instrument can be carried out also by other institutions, namely the Audit Authority, Authorised Auditor of the MfRD and other control and audit institutions, including the EU institutions, which will carry out standard audits and check in accordance with their internal procedures and regulations. In this case the activities will be performed to the level of the UDF manager and his investment (see our legal analysis, chapter 3.1.1. of the study).

## 8. Recommendations for implementation

In this section we provide an overview of basic steps leading to the implementation of the JESSICA financial instrument as well as recommendations regarding such steps. Similarly as in the previous chapter, the recommendations are made for options 4, 5 and 6 of the proposed implementations structures. In the end of the chapter we provide a time schedule of individual steps and examples of the JESSICA financial instrument implementation in other countries.

### 8.1. Steps to take to implement the JESSICA financial instrument in the Czech Republic

#### 8.1.1. Decision on the implementation of the JESSICA financial instrument and the implementation structure

The decision on the implementation of the financial instrument can only be made by the managing authority (in this case the OPTA) or by the programme monitoring committee. It is the first step on the basis of which all other steps towards the implementation of the financial instrument will be taken.

Another prerequisite is the decision on the implementation structure option. In chapter 6.6. of this study we have outlined three options which are suitable for the implementation of JESSICA financial instruments in the Czech Republic still in the programming period 2007 - 2013, including their general assessment.

Based on the assessment of the content of the framework of the priority axes and areas of support OPTP can say that the pilot project could be financed from the support "managing the implementation of NSRF or the area of intervention" Promoting absorption capacity". However, in both cases it will be necessary to modify the content of the supported activities so that they had funded a pilot project. Rules for potential beneficiaries will be adjusted, because in both cases, the NCA is listed as a possible beneficiary of support in the area.

#### 8.1.2. Adjustment of the operational programme

This step is necessary in particular because the OPTA / IOP need to be ready for the implementation of the pilot verification of the financial engineering instrument. In terms of adjustment, the following measures will have to be taken:

- **Adjusting the content of the area of intervention from which the pilot project will be funded**

Based on the general assessment of the content of priority axes and areas of intervention of OPTA we can say that the pilot project could be financed from the area of intervention “NSRF Implementation Management” or from the “Absorption Capacity Support” area. Nevertheless, in both cases the content of the supported activities will have to be adjusted so that they can be used for financing the pilot project. Rules for potential applicants/beneficiaries will not have to be adjusted as the NCA is the potential beneficiary in both cases.

In options 5 and 6 the OPTA content will have to be basically changed so that the resources can be taken directly from the programme, and not in the form of a pilot project.

## 8. Recommendations for implementation (continued)

### • Modification of financial flows

Financial flows within the OPTA are currently set on the principle of ex post financing. In the case of implementation of the JESSICA financial instrument it will probably be necessary to introduce ex-ante financing, so that the fund manager (be it HF or UDF) had the resources available for transfer.

### • Review of information systems and their adjustment

Given that the fund manager will perform the role of the beneficiary and thus will submit requests for payment and monitoring reports as the other recipients, it will probably be necessary to review the information systems used (MSC, IS Monit7 + and application Benefit7) and to adapt them to a new way of using resources of Structural Funds (particularly with regard to the administration of temporarily and finally eligible expenses).

Implementation of any revision or modification of information systems will be appropriate when the pattern of basic processes is known (i.e., when it becomes clear what will be the inputs and outputs of each activity).

### • Reallocation of funds to the relevant area of intervention

According to information from other projects, it can be said that within the OPTA it will be possible to find part of the funding for a pilot project in the areas of intervention, which at the moment do not have sufficient absorption capacity. However, it is also possible to consider the reallocation from other operational programme or in the planned increase in the allocation for the Czech Republic.

### • Approval of all changes by the programme Monitoring Committee

According to Article 63(g) of the General Regulation, it considers and approves any proposals to amend the content of the Commission's decision on a contribution from the funds. The above changes will meet the criteria, and therefore the Monitoring Committee will have to approve them.

### • Approval of all changes by the European Commission

In the event that the changes will be subject to approval by the EC (in particular the reallocation of funds between the OPTA priority axes or from other operational programmes, creation of a new area of intervention / priority axes, etc.), it will also be necessary to ensure this step. It will be particularly the decision on the reallocation of resources between the priority axes and operational programmes.

## 8. Recommendations for implementation (continued)

### 8.1.3. Call for the pilot project submission (option 4)

The next step to begin implementation of the financial instrument JESSICA is to prepare and announce a call for the pilot project. The step will involve the applicants preparing applications, the managing authority assessing them and, subsequently, the issuing of the decision on the subsidy and signing the terms of the decision.

In the context of the call and evaluation of applications it will probably be necessary to review the assessment process, including evaluation criteria, to meet the needs of the call. In this case, it will be necessary to ensure approval of the changes by the Programme Monitoring Committee.

### 8.1.4. Setting up the investment board (options 4 and 5)

The Investment Board will be a body at the MfRD level and as such it will cover the functioning of the JESSICA financial instruments even in cases when the holding fund under the management of the EIB is established. The board should consist of the representatives of the NCA, OPTA MA, budget department and/or other specialists. The selected urban development fund manager should be invited to the investment board's meetings so as to ensure regular communication between the manager and the contracting entity.

Responsibilities of the investment board are described in chapter 7.2. of this study.

### 8.1.5. Funding agreement with the EIB (option 6)

If the EIB becomes the holding fund manager, it will be committed with managing the holding fund on the basis of a direct contract letting. In that case the concluded financial agreement will consist of the innominate contract and decision to provide a subsidy. In view of the fact that the bank is the holding fund manager already in several EU countries, it is obvious that it will use its standard contract terms in the funding agreement. We therefore recommend that special attention be given to negotiating the conditions so that the contract is mutually balanced and includes the elements that we emphasize in chapter 6.2.3.

The State Budgetary Rules would have to be addressed first for the possibility of making the EIB the holding fund manager directly (see chapter 3.2.1. (vi) of this study).

## 8. Recommendations for implementation (continued)

### 8.1.6. Selection of the urban development fund manager

Given the assumption that the urban development fund manager is the State Housing Development Fund or one of the commercial banks, the manager will be selected either through a **public procurement procedure** (in the case of a commercial bank) or by **direct contract letting** (in the case of the SFHD or other institution in which the MfRD is the establisher, i.e. where the exception from the PPA, Section 18(1)(j) can be applied). The selection of the manager will be the responsibility of the pilot project beneficiary, i.e. the NCA in option 1 or the OPTA MA in option 2. If option 3 is chosen, the urban development fund manager will be selected according to the EIB’s internal procedures.

In the case of a public procurement procedure we recommend that transparent a non-discriminatory communication be established with potential beneficiaries before the procedure start so as to ensure that tender documents will contain all the important parameters an external entity will need to know to prepare a bid. In particular, the documents should specify in detail the responsibilities of an UDF manager, which are already defined in legal regulations. It will be necessary to state clearly before the tender whether the urban development fund manager will have to perform just the enumerated services or on the contrary, whether a broader scope of service will be expected (e.g. services that we defined as JESSICA Services in chapter 6.2.2.).

In this context we recommend that the UDF manager should be selected, inter alia, on the basis of the submitted business plan, in other words, that business plans be submitted and assessed as part of the bid in the tender. It is also appropriate that in selecting the UDF manager emphasis is laid on thorough assessment of the bidder’s capacity and expertise with regard to the required functions, including the bidder’s economic stability, which is an important aspect of long-term cooperation.

The funding agreement which will be made with the selected urban development must specify at least the following parameters as set forth in Article 43(6) of the Implementing Regulation:

- The investment strategy and planning;
- Monitoring of implementation in accordance with applicable rules;
- An exit policy for the contribution from the operational programme out of the financial engineering instrument;
- Winding-up provisions of the financial engineering instrument, including the reutilisation of resources returned to the financial engineering instrument from investments or left over after all guarantees have been honoured, attributable to the contribution from the operational programme.

We also recommend that items we propose in chapter 6.2.3 are reasonably included in the funding agreement.

## 8. Recommendations for implementation (continued)

### 8.1.7. Communication platform

Due to the fact that it is a relatively new funding instrument in the Czech market, where potential beneficiaries, external entities or institutions which will be part of the implementation structure are not sufficiently familiar with the functioning of the instrument, we think it necessary to build a communication and consultation platform to allow for efficient transfer of information:

- **In relation to potential beneficiaries** - about the rules for receiving aid through the JESSICA financial instrument, its conditions, but also about typified projects and/or foreign experience. In general, communication should mainly be the responsibility of the managing authority of the operational programme through which the instrument will be funded. However, in the first stage the communication will be mainly the responsibility of the pilot project beneficiary.
- **Between entities involved in the implementation** of the financial market – at this level it is especially necessary to ensure resolution of issues (e.g. different interpretation of legal regulations by individual bodies). In this case the existing structure of work teams can be used. The aim of this activity is also to guarantee the transfer of experience between institutions, which is important particularly with regard to the fact that JESSICA has already been implemented in the ROP Moravia-Silesia.
- **In relation to external entities** (potential fund managers) so as to ensure their involvement in defining the terms of public procurement procedure.

### 8.1.8. Resolution of horizontal issues

The following issues will have to be resolved before launching the financial instrument:

#### Rules for the IUDP

As mentioned in chapter 5 of this study, representatives of the cities perceive the current set-up of the rules for the IUDP as an obstacle to the implementation of the JESSICA financial instrument. On the other hand, managing authorities (particularly the ones that already have experience with the financial instrument) do not see this risk

Although the requirement for inclusion of projects funded from the resources of the JESSICA financial instrument to the IUDP is set forth in the General Regulation (Article 44), the regulation does not provide a precise definition of the IUDP. Moreover, the Article does not refer directly to the IUDP, but to the integrated plan for sustainable urban development.

A possible solution would be to establish that the IUDP shall mean a document on the strategic development of the city.

## 8. Recommendations for implementation (continued)

### • Budgetary rules

Although the pilot phase of the verification does not envisage that the holding fund manager could be a foreign institution (e.g. the EIB), it will be appropriate, particularly in view of the preparation of the future programming period, to finalize the budget rules issue, especially with regard to allowing the management of Treasury funds abroad. The best solution seems to be an amendment to the Act on State Budgetary Rules, which will allow it.

### • Status of the NCA (option 4)

If option 1 is chosen, the status of the NCA will have to be addressed in view of the necessity to issue for the UDF manager the decision on granting a subsidy, by which the resources to be managed are transferred to it. Besides the State Budgetary Rules, such a decision may be taken only by the programme manager. The NCA does not perform such a role at present. A possible solution would be to create within the OPTA a sub-programme for the implementation of the financial instrument and make the NCA the sub-programme manager. It will also require creating appropriate management and control mechanisms at the NCA level.

### • Review of laws governing the formation and functioning of public institutions (if applicable)

If the SFHD is chosen as the urban fund manager, its subject of activity will have to be changed. The SFHD was established by Act No. 211/2000 Coll., on the State Housing Development Fund. Under Section 1 of the Act the purpose of SFHD is to support housing development in the Czech Republic in accordance with the concept of housing policy approved by the Government of the Czech Republic. Section 3 of the Act strictly defines the purpose for which funds of the SFHD can be used. If it is not decided to use the financial instrument JESSICA only to support housing development, both sections of the Act will have to be amended.

Diagrams below show our concept of the sequence of individual steps. Schedules are given for each option separately.

## 8. Recommendations for implementation (continued)

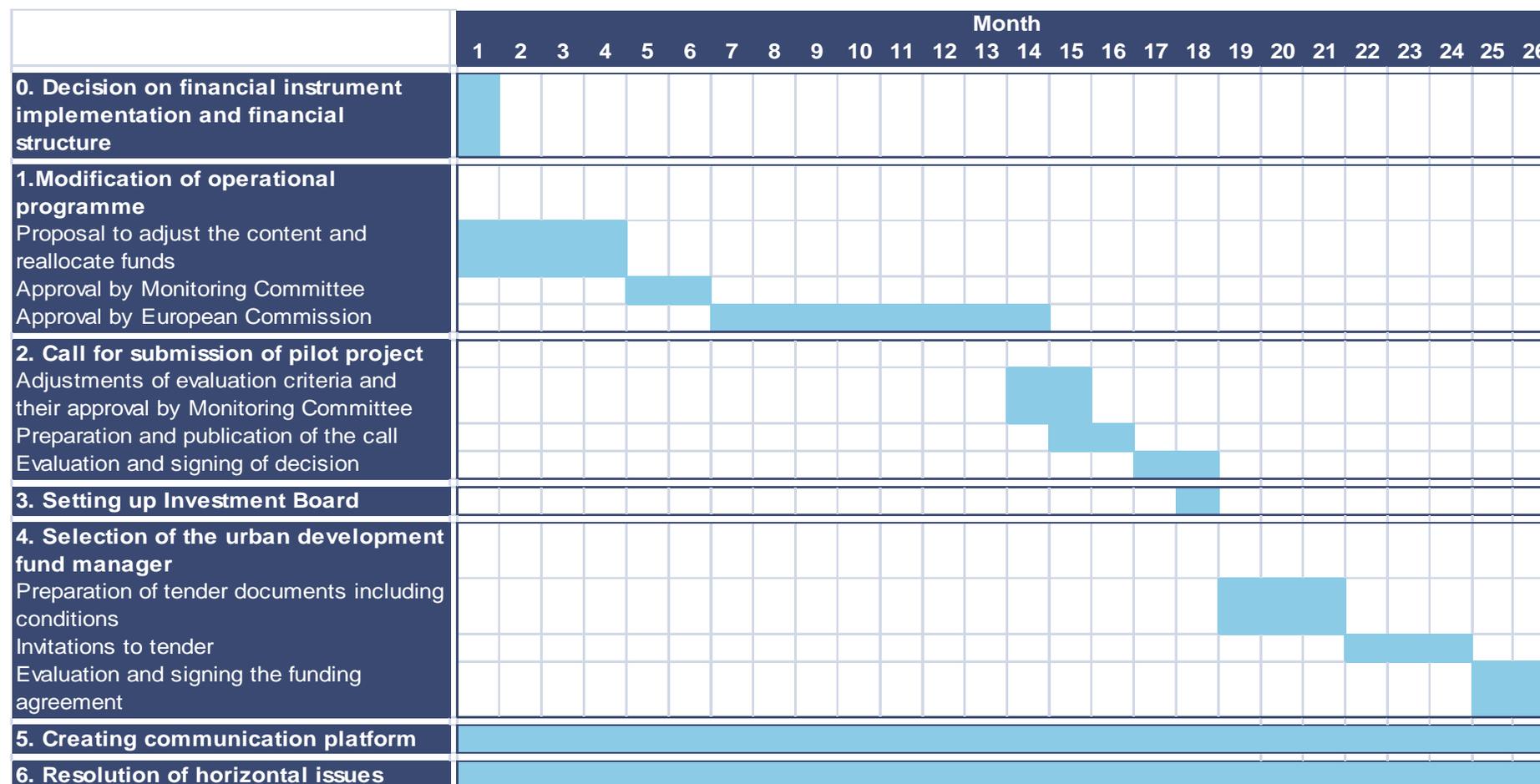


Figure 19 Framework timetable for steps to implement the JESSICA financial instrument (option 4)

## 8. Recommendations for implementation (continued)

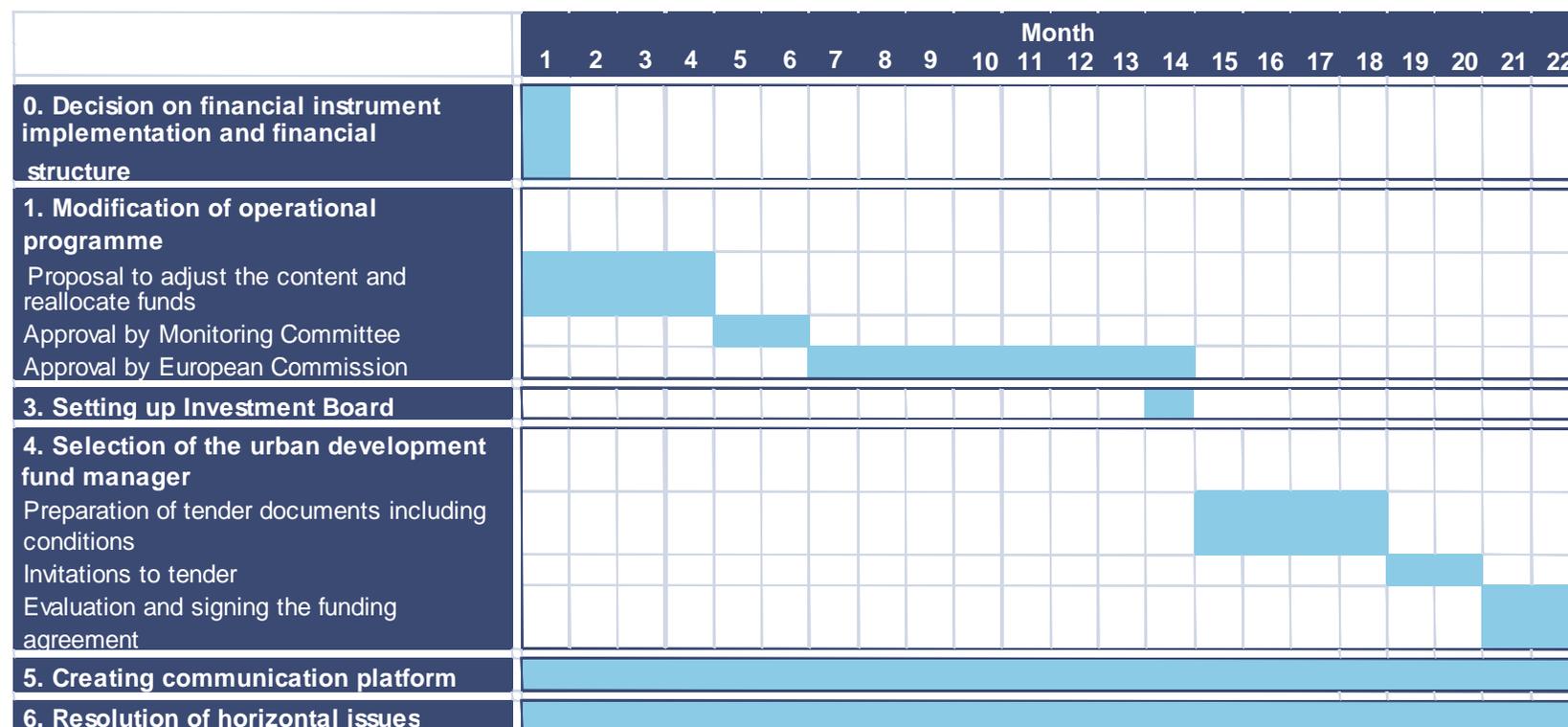


Figure 20 Framework timetable for steps to implement the JESSICA financial instrument (option 5)

## 8. Recommendations for implementation (continued)

	Month																					
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22
<b>0. Decision on financial instrument implementation and financial structure</b>	█																					
<b>1. Modification of operational programme</b>																						
Proposal to adjust the content and reallocate funds	█	█																				
Approval by Monitoring Committee			█	█																		
Approval by European Commission					█	█	█	█	█	█	█	█	█									
<b>2. Funding agreement with the EIB</b>												█	█	█								
<b>3. Selection of the urban development fund manager</b>																						
Preparation of tender documents including conditions																█	█	█				
Invitations to tender																			█	█		
Evaluation and signing the funding agreement																					█	█
<b>5. Creating communication platform</b>	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█
<b>6. Resolution of horizontal issues</b>	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█	█

Figure 21 Framework timetable for steps to implement the JESSICA financial instrument (option 6)

## 8. Recommendations for implementation (continued)

### 8.2. Examples of the JESSICA financial instrument functioning abroad

Approach used for the preparation of the implementation structures is based on the parameters of case projects (bottom-up approach). At first the feasibility of individual projects, including satisfactory financing structures and support parameters of the JESSICA financial instrument, is evaluated. Using this approach, variant financial models of the fund are drawn up so as to allow the comparison of the model benefits for individual implementation structures.

Bearing in mind that the purpose of this study was not specifically to model the parameters of the urban development fund/funds, this chapter has been included in the study mainly for illustration of the scope of considerations in the setting up of UDFs in different European regions and countries. Although the chapter at times reflects foreign experience in Czech conditions, it should be borne in mind that, without further analysis and comparison of the assumptions on which the foreign models were based, the information is partial, and should be seen as such.

The chapter is based on the studies below, which were prepared for the European Investment Bank. They were selected with regard to the level of elaboration detail and closeness of the proposals to implementation.

- JESSICA evaluation study Flanders
- Study on the Legal Implementation of JESSICA in Portugal
- Evaluation study on the Implementation of JESSICA in Andalucía
- JESSICA instruments for energy efficiency In Lithuania

#### 8.2.1. Level of establishing – Fund for the development of town/towns

The Czech name of the fund, “Fund for the Development of Towns”, is misleading to some extent. The Czech translation suggests that urban development funds are established at the level of individual cities (i.e., one fund equals one city) as a financial instrument for their development. Although such option is possible, in international studies we can also see examples of establishing urban development funds from which projects of several cities are to be funded. The two approaches are separated, e.g. in the Belgian study. Urban development funds established for one town are recommended only for larger cities, where a greater number of projects can be implemented, i.e. in a minimum volume appropriate for the establishment of urban development funds<sup>152</sup>. In such cases these financial instruments can become a strategic financial instrument for the development of the city. The fund's investment strategy will then be based, as a matter of fact, on the strategic document of the city.

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<sup>152</sup> The studies usually indicate the amount of EUR 20 million.

## 8. Recommendations for implementation (continued)

In the area of Flanders in Belgium this approach is considered for a maximum of 13 largest cities. Such funds would then be formed by the following partners: the managing authority, the city and a private investor. A similar approach is planned in the Czech Republic for the city of Brno, for which one fund will be established with capital contribution of the managing authority of the ROP South-East, the city and/or other public entity.

Correlation between the size of cities and the establishment of the UDF is also dealt with in the study concerning Spanish Andalusia. The study proposes to establish two urban development funds. One joint UDF for cities over 50,000 population and one joint UDF for smaller cities. It bases the concept on the fact that various large cities have different needs and a set of case projects that can be replicated in more cities depends on the size of the cities.

An example of the implementation of one urban development fund for several cities in the Czech Republic is the urban development fund prepared in the Moravian-Silesian Region.

### 8.2.2. Thematic focus/strategy of the fund

A more frequent example is urban development funds established at the municipality level to fund various projects to promote urban renewal. In order to achieve the desired strategy it is possible to determine, for example, what major themes will be financed through the fund and in what volume ratio.

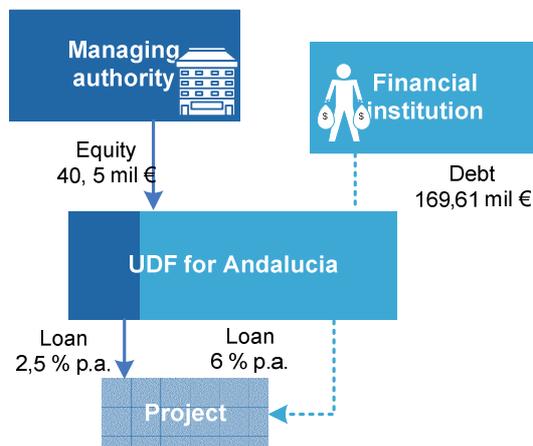
An example of thematic definition of the fund is the Lithuanian fund specially established to support the reduction of demands on energy consumption in residential buildings.

### 8.2.3. Financial volume (size) and leverage debt

The threshold limit used in foreign studied for the establishment of urban development funds is EUR 20 million. Funds are usually established with a higher volume of funds transferred from structural funds (e.g., Spain plans to establish two urban development funds, each of around EUR 40 million).

An interesting aspect, however, is the high degree of expected leverage of resources usually from financial institutions, be it at the level of holding funds or urban development funds. A study aimed at the implementation of projects in Andalusia, for example, assumes that EUR 40 million from the JESSICA instrument will be supplemented with commercial loans in the amount of EUR 160 million. A high increase of the resources is also assumed in the study on Bulgaria and Portugal.

## 8. Recommendations for implementation (continued)



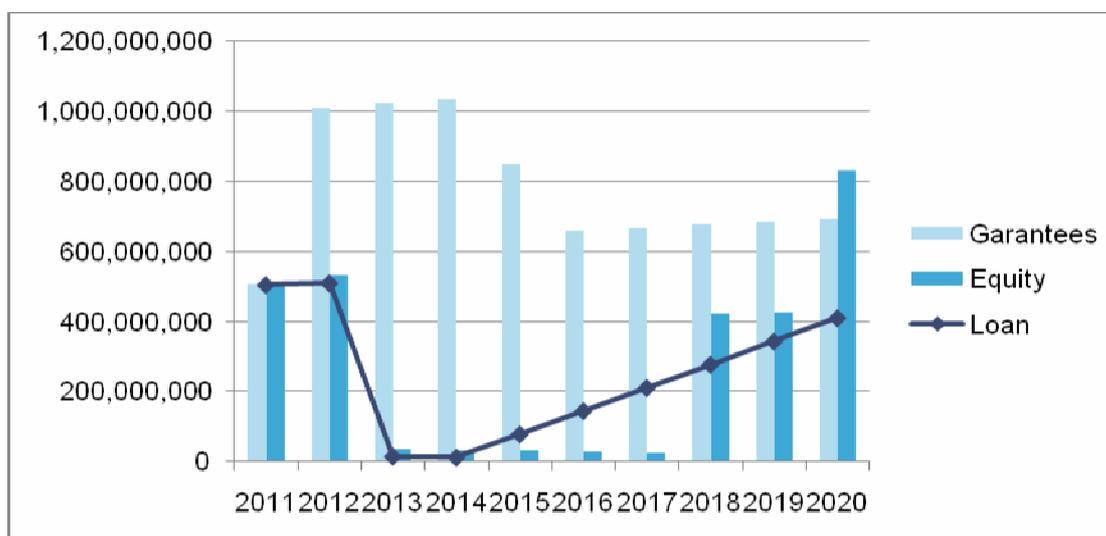
**Figure 22 An example of increasing the resources from commercial sources in the case of urban development funds in Andalucía**

### 8.2.4. Product orientation

Besides the most commonly considered support through loans, another considered possibility is the provision of equity. Some studies consider establishing a separate fund, depending on the type of financial aid (loans versus equity).

In addition to these types of aid, there is also the possibility of providing guarantees to cover commercial loans to cities or the co-financing of interest on commercial loans.

To compare the functioning of product-focused UDFs, cash flow comparison can be used, as shown in Figure 23.



**Figure 23 Comparison of cash flow of product-focused UDFs**

## 8. Recommendations for implementation (continued)

The following assumptions have been used when constructing the cash flow for individual product-oriented UDFs:

- The total allocation for the financial instrument will be CZK 1 billion;
- The allocation to the UDF will be transferred in two tranches in the amount of CZK 0.5 billion;
- Revenues of the fund will be, besides tranches and repayments of the loan (or equity), interest on account balances and interest yield of provided investments;
- Expenditures of the UDF will be mainly the investments and managements costs, a proportional part of which will be paid each year.

### Loans

Figure 23 shows that after the first two years, when resources allocated for the JESSICA financial instrument have been transferred to the UDF, balances of the UDF will drop to minimum as a result of utilising the resources in the form of loans for investments in projects. Balances will then start to grow gradually as project implementing entities will begin to repay the resources to the UDF including interest on the principal. In our model case about a half of the original total allocation for the JESSICA financial instrument would be repaid in 2020 and the funds could be subsequently re-used for investments in the development of urban areas.

### Guarantees

It is obvious in the case of the provision of guarantees that after a single increase in the UDF's balances in the second year (after receiving the second tranche of the allocation) the value of the UDF remains the same, with a slight increase due to interest on balances in UDF's accounts. This is mainly because of the fact that if guarantees are provided, resources are not transferred from the UDF fund, but they remain there and are used only when the guarantee needs to be used (in our example it is in 2016). After that the UDF's level is more or less constant, with slight rising due to interest accrued on balances. The balances could also be used for some other suitable purpose in accordance with the funding agreement terms.

### Equity

If the UDF focused only on equity financing, the balance of the UDF would drop almost to zero after the first two years due to investments in projects. The resources would increase only as a result of completion of projects (e.g. through the sale of investments). The diagram shows this happening in 2018, when the first part of the investment is returned to the UDF, and in 2020, when the second part of the investment is returned. Compared to a UDF as a purely lending entity, the original amount allocated for the financial instrument would be returned earlier.

We can see in all three instruments that there is no decrease in the UDF funds even in the years of almost no activity (i.e. the UDF does not invest resources or receive repayments - e.g. in the case of guarantees between 2012 and 2014). This shows that interest on balances will be able to cover fund management costs.

**“Feasibility study on the implementation of the JESSICA financial instrument  
in the Czech environment for the 2007-2013 programming period”**

Final report

2 September 2010

## List of abbreviations

Abbreviation	Explanation
AFSD	Accounting and financial services department
BD	Budget department
CMGDB	Czech-Moravian Guarantee and Development Bank
Commercial Code	Act no. 513/1991 Col., commercial code, as amended
CR	Czech Republic
CRD	Centre for Regional Development of the CR
DAS	Delegated audit subject
EC	European Commission
EC	European Communities
EIB	European Investment Banka
EIF	European Investment Fund
ERDF	European Regional Development Fund
EU	European Union
General Regulation	COUNCIL REGULATION (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999
HF	Holding fund
Implementing Regulation	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
IOP	Integrated Operational Programme
IUDP	Integrated Urban Development Plan
MA	Managing Authority
MA	Managing Authority
MfRD	Ministry for Regional Development of the Czech Republic
MoF	Ministry of Finance of the Czech Republic
Municipal Budgetary Rules	Act no. 250/2000 Col., on budgetary rules of regional budgets, as amended
NCA	National Coordination Authority
OP	Operational Programme
OPEI	Operational Programme Enterprise and Innovation
OPEI	Operational Programme Environment
OPPC	Operational Programme Prague - Competitiveness
OPRDI	Operational Programme Research and Development for Innovations
OPT	Operational Programme Transport
PPA	Public Procurement Act No. 137/2006 Coll.
PPP	Public Private Partnership
ROP	Regional Operational Programme
SHDF	State Housing Development Fund
State Budgetary Rules	Act. no. 218/2000 Col., on budgetary rules, as amended
TOP	Thematic Operational Programmes
UDF	Urban development fund