COMMISSION DECISION  
OF  2002

Establishing a Phare multi-beneficiary programme on “The Municipal Finance Facility with the CEB/KfW” in 2002,

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EEC) N° 3906/89 of 18 December 1989 on economic aid to certain countries of Central and Eastern Europe¹, as last amended by Regulation (EC) N° 2500/2001 of 17 December 2001², and in particular Article 8 thereof,

Whereas Regulation No 3906/89 lays down the rules and conditions for the granting of economic aid to certain countries of Central and Eastern Europe,

Whereas the measures provided for by this Decision are in accordance with the opinion of the Committee on Aid for Economic Restructuring in certain countries of Central and Eastern Europe,

HAS DECIDED AS FOLLOWS:

Article 1

The programme described in the Annex to the present decision is hereby adopted.

Article 2

The maximum amount of Community assistance shall be 14 MEUR to be financed through Budget line B7-030 in 2002.

Done in Brussels,

For the Commission

¹ OJ n° L375 of 23/12/1989  
² OJ n° L342 of 27/12/2001
FINANCING PROPOSAL

1. IDENTIFICATION

Beneficiary countries: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovenia, Slovakia

Programme: Municipal Finance Facility with the Council of Europe Development Bank in co-operation with Kreditanstalt für Wiederaufbau

CRIS-Number: 2002/000-618

Year: 2002

Cost: €14 million

Expiry Dates:
- Contracting: 30 November 2005
- Completion: 31 May 2010
- Disbursement: 30 November 2010

Group: L

Sector: FI

DAC Code: 24030

Budget Line: B7-030

Programming Task Manager: Judith Novak (DG ELARG)

Implementation Task Manager: N.N. (DG ECFIN Unit L2; Programme Management)

2. SUMMARY

In the context of the Copenhagen economic criteria, both the Accession Partnerships and the Regular Reports 2001 call for a strengthening of institutions in the area of financial inter-mediation. The reform and strengthening of the financial sector is an issue likewise addressed in the June 2002 “Action Plans for administrative and judicial capacity”.

The depth and strength of the municipal credit markets in the candidate countries is an important aspect of the functioning of the financial sector in the candidate countries. There are numerous municipalities in the candidate countries, which have investment needs in areas such as water supply, sewerage, roads, public transport, solid waste, heating etc. At the same time, in particular, smaller municipalities have still a limited

\(^1\) Date by which the Contribution Arrangement with the CEB/KFW and Project Agreements with Participating Banks must be concluded.
access to long term credits needed for infrastructure investment, even in the candidate countries with more advanced financial markets. Market-based municipal lending broadens the range of finance available to municipal authorities for ensuring sustainable living conditions to their populations.

The overall objective of the Facility is to assist the candidate countries in meeting the Copenhagen economic criteria and to contribute to the reform and strengthening of the financial sector.

To this end, Council of Europe Development Bank (CEB) and Kreditanstalt für Wiederaufbau (KfW) will co-operate under the Facility and combine loans from their resources with non-reimbursable Phare support in order to incite banks in the candidate countries to expand their lending to municipalities for the financing of small infrastructure investments, to extend loans over longer maturities, and to enhance their capacity to assess and monitor the related risks and to manage their loans.

3. Strategy and Background

Strategy

The revised Accession Partnerships adopted in November 2001 define, for each chapter, priorities for the adoption and the enforcement of the Acquis in the candidate countries. They are in line with the Regular Reports 2001, which assessed the progress made by the candidate countries, as well as the overall situation in terms of the adoption of the Acquis and the capacity to enforce it. The Accession Partnerships include the priorities which the candidate countries are expected to take forward within the next two years.

In the context of the Copenhagen economic criteria, both the Accession Partnerships and the Regular Reports 2001 call for a strengthening of institutions in the area of financial inter-mediation. The reform and strengthening of the financial sector is an issue likewise addressed in the June 2002 “Action Plans for Administrative and Judicial Capacity”.

The depth and strength of the municipal credit markets in the candidate countries is an important aspect of the functioning of the financial sector in the candidate countries. Moreover, market-based municipal lending broadens the range of finance available to municipal authorities for ensuring sustainable living conditions to their populations.

The European Commission and CEB working in co-operation with KfW (CEB/KfW) have therefore decided to combine Phare grant money with CEB/KfW lending, where possible, in order to help the financial sector in the Eastern and Central European candidate countries develop its municipal lending business. From the European Commission point of view the combination with CEB/KfW funding will bring additional leverage to grants from Phare and therefore substantially broaden the reach of the Programme.

The CEB/KfW intends to start rolling out the Facility in Poland, Czech Republic, Lithuania, Estonia, Latvia and Slovakia. In these countries CEB and KfW could already rely on well established contacts to Institutions, which are already active in lending to municipalities and which see the necessity for additional support for a further enhancement of lending for smaller infrastructure projects.
It is expected that other International Financial Institutions (IFIs) such as the European Bank for Reconstruction and Development (EBRD) or the European Investment Bank (EIB) will also develop the Facility. Through the involvement of several IFIs, the Commission intends to reach a maximum coverage of eligible countries within a short time period.

Background

The relationship between the European Commission and the CEB in the field of cooperation for pre-accession preparation of the Central and Eastern European candidate countries is based on the Memorandum of Understanding of March 31, 2000.

This Memorandum underlines the shared desire to foster the reform process in the candidate countries. In this context the European Commission and the CEB seek to cooperate and co-finance suitable projects and programmes in the candidate countries, taking into account accession priorities i.e. building up the administrative and institutional capacities of these countries and financing investments to help them comply with EC law as soon as possible.

In order to maximise the success of the operations under this Programme, CEB co-operates with the Kreditanstalt für Wiederaufbau (KfW). KfW is preparing and financing projects with an approach similar to the one of the IFIs (international know-how in the entire project cycle, non-profit-orientation). KfW has been active in the candidate countries for many years and its activities comprise a wide range of promotional measures.

KfW has developed and is still developing promotional credit programmes either with promotional banks or with commercial banks doing business with the target group in the countries of Central and Eastern Europe. KfW’s assistance is not limited to giving advice, but includes also re-financing of the co-developed credit programmes at attractive conditions.

In the context of the Phare programme, co-operation between the European Commission and the CEB/KfW includes in particular the promotion of lending to small and medium-sized enterprises in the candidate countries under the SME Finance Facility.

4. Objectives and Description

4.1. Objectives

The overall objective of the Programme is to assist the candidate countries in meeting the Copenhagen economic criteria and to contribute to the reform and strengthening of the financial sector.

The Programme’s specific objective is to

- build the confidence of commercial banks to extend loans to municipalities and their utility companies for the financing of small infrastructure investments;
- increase the willingness of banks to extend such loans over long-term maturities;
- enhance the capacity of banks to assess and monitor the related risks and to manage their loans;
• enable municipalities to present loan applications that demonstrate the feasibility and financial soundness of the planned infrastructure investments and thereby to strengthen and deepen the municipal credit markets in the long term, and in particular lending to smaller municipalities, in the candidate countries.

4.2. Results

Results obtained under this programme include

• staff from banks will be familiar with the concept of lending to municipalities and its implications for their business;
• bank management will appreciate the benefits of long-term lending to municipalities;
• the volume of bank loans extended to municipalities will be larger than at present;
• bank loans extended to municipalities will have longer maturities than at present;
• staff from municipal borrowers will be experienced in financial management and the development of bankable projects.

These results will be particularly pronounced regarding lending to small or medium-sized municipalities that do not have the capacity to tap the capital markets.

4.3. Activities

4.3.1. Summary

The CEB/KfW will identify local financial institutions in the designated candidate countries as partners under this Programme. The CEB/KfW will provide loans to these institutions, which, in return, will engage in lending operations to municipalities or private or public companies providing a municipal service.

The Phare allocation will be transferred in tranches to an interest bearing special account at the CEB.

Building the network of financial intermediaries and creating the “Projects”

The KfW will select local financial institutions, which have the capacity, strength and interest to expand their operations to financing small municipal infrastructure investments in the candidate countries. An agreement on a financial package between KfW and the local financial institution providing a CEB/KfW loan together with a Phare Contribution will represent the “Project”. Before signing this agreement the CEB/KfW has to propose the Project to the competent Commission services for their approval. In its proposal the CEB/KfW will inform the Commission about the total loan amount allocated to this local financial institution and the corresponding Phare Contribution. Upon approval, the KfW will sign a Project Agreement with the local financial institution, which then becomes the Participating Bank under this Programme.

Creating the “Sub-Projects”

The Participating Bank will engage in the promotion of the Facility among municipalities and aim at receiving loan applications for small infrastructure investments. On the basis of a thorough analysis of the applications, the Participating Bank will sign a Loan Agreement with a municipality or utility company providing a municipal service (hereinafter referred to as the Promoter). This Loan Agreement becomes the “Sub-Project”.


4.3.2 Phare Contribution

The Phare Contribution represents €14 million allocated to this Programme and all income (including interest) accruing to the special account. These monies may be used for the following purposes:

(1) Technical Assistance to the Participating Banks
Technical assistance may include activities such as the training of staff in supporting municipal clients and in the appraisal, supervision and administration of loans extended to municipalities, or the introduction of the related organisational and managerial procedures and practices.

(2) Technical Assistance to the Municipal Promoters
Technical Assistance to Promoters would help the Participating Banks in creating effective demand from the municipal market, by, for example, strengthening their capacity to prepare bankable loan applications and to monitor the progress of Sub-Projects.

(3) Performance Fee for Participating Banks
As an incentive to the Participating Banks to meet the objectives of the Programme, performance fees may be paid in proportion of the number and the volume of Investments financed and completed.

(4) Financial Incentives for Participating Banks
These incentives will allow the Participating Bank to increase effective demand by introducing cost reducing elements into the Sub-Projects. The disbursement of these incentives to the Participating Bank will be linked to the signature of Sub-Projects, their completion and the loan conditions offered.

(5) Loan Guarantee
To cover the risks involved in municipal project lending the Participating Bank may benefit from a partial guarantee on their portfolio of loans subject to the definition of appropriate limits.

If in a Project, the Phare funds dedicated to the Loan Guarantee are not fully used at the end of the guarantee period agreed between KfW and the PB, this amount amount will be recovered by the Commission.

(6) Management Fee
A management fee shall be paid to the CEB/KfW as 1.25% of each tranche transferred to the special account and corresponding to a maximum amount of €175,000. The annual cost for auditing the special account is included in the management fee.

The Commission shall not provide any additional amount to support the ordinary CEB/KfW cost resulting from the implementation of this Programme, except where duly justified.

The mix and level of the different components (1) to (5) will be tailored by the CEB/KfW to the particular national or regional markets in which the Programme will operate.
Moreover, in addition to the items listed above, and with a view to enhancing the implementation of the Programme, the Commission may in light of experience agree to other appropriate incentives for the benefit of Participating Banks in the framework of a Project Proposal from CEB/KfW.

4.4. Financial Support Ratios

1. The overall ratio between the CEB/KfW resources and the Phare allocation for this Programme shall be equal to or higher than 5/1. The CEB/KfW will provide at least €70 million in the form of loans and the EC will provide a maximum of €14 million.

2. The ratio between the CEB/KfW loans and the Phare Contribution allocated to one Project will be equal to or higher than 4/1 except for Romania and Bulgaria where it will be equal or higher than 3/1. The ratio shall be equal to or higher than 8/1 if no Technical Assistance is financed by the Phare Contribution.

3. The size of each Project will be, in principle, between €5 - 15 million and the maximum size of an investment financed with a loan will be €5,000,000. Taking the co-financing ceiling of the CEB/KfW into account, each Project will, therefore, cover several Sub-Projects.

4. For each Project the average amount of Technical Assistance to municipalities will not be higher than €25,000 except in Romania and Bulgaria where this limit will be EUR €50,000.

4.5. Eligibility Criteria

4.5.1 Eligible Participating Banks (PB)

Eligible Participating Banks are those operating in the beneficiary countries including locally registered, licensed or incorporated entities and subsidiaries or branches of EC banks.

Participating Banks will be selected on the basis of their capacity, financial strength and interest to participate in and promote the Facility and its objectives. Selection of Participating Banks will also take into account their credit worthiness, their previous record in municipal lending and, in general, their sound banking practice. In principle, those banks that CEB/KfW considers to fulfil these requirements based on an ongoing relationship with CEB/KfW, are eligible to participate in the Facility.

4.5.2. Eligible Promoters

Eligible Promoters are municipalities or private or public companies delivering municipal services, who are directly responsible for the implementation of the Investments. They are, generally, the owners of the assets of the Investment.

4.5.3. Eligible Investments

Eligible investments relate to the building, up-grading or refurbishing of small municipal infrastructure.

The total cost of an investment is less than €5 million.
4.5.4. Eligible Sectors

Investments are eligible in the sectors involving municipal infrastructure except for sectors included in the KfW exclusion list.

4.5.5. Eligible Investment Costs

Eligible components of investment costs will be determined by KfW eligibility criteria.

5. BUDGET

The European Commission will support the Municipal Finance Facility with €14 million.

6. IMPLEMENTATION ARRANGEMENTS

The Commission entrusts CEB and KfW with the implementation of this Programme and will conclude a Contribution Arrangement with them for this purpose. The management of the Programme by the Commission will be sub-delegated to Directorate General Economic and Financial Affairs.

The financial and operational management of the special account shall be the responsibility of the CEB, while KfW will be responsible, in particular, for the selection, implementation aspects and monitoring of Projects, including monitoring of Technical Assistance contracts.

The Commission shall exercise its responsibility over the use of funds through the duration of the programme in accordance with its Financial Regulation applicable to the General Budget of the European Communities of 21st December 1977 as amended. It will be replaced by the Financial Regulation applicable to the General Budget of the European Communities of 25 June 2002 upon its application as of January 1, 2003. The provisions of article 167 of the Financial Regulation of June 25, 2002 shall apply to KfW procurement of services financed by Community funds.

In the light of Article 56 of the Financial Regulation of June 25, 2002 the Commission accepts that the audit, accounting and procurement systems of the KfW are equivalent to its own, with due account for internationally accepted standards.

6.1. Process of Project Approval

The CEB/KfW will prepare a Project proposal for each new or amended Project Agreement with a Participating Bank and submit it for the approval by the competent Commission services. The CEB/KfW will provide all relevant information to assess the Project proposals including information on the selected bank, amounts from CEB/KfW and Phare Contribution allocated to the Project, type of incentives provided, compliance with eligibility criteria, indicators of achievement for monitoring and evaluation and disbursement schedule. A standard project proposal format will be included in the Contribution Arrangement.

The Commission shall assess Project proposals according to their compliance with the following criteria:
the compliance with the Contribution Arrangement and its annexes, including the
degree of compliance with the eligibility criteria;
the degree to which the requested Phare Contribution grant leverages additional
funds from the PBs;

By their approval of the Project, the Commission authorises the mobilisation of the
Phare Contribution from the special account set up at the CEB. The Commission also
ensures the confidentiality of the Projects proposed by the CEB/KfW.

Each Sub-Project must have received the authorisation of the CEB/KfW after
verification that the relevant eligibility criteria are met.

The Contribution Arrangement will specify a limited time period between the signature
of the Project and the signature of individual loan agreements (i.e. Sub-Projects).
Beyond that limit, the CEB/KfW may allocate the uncommitted resources to other
Projects subject to the agreement of the Commission.

Subject to the legal obligation of bank secrecy and the rules of confidentiality, the
Commission shall have access to all relevant information in connection with the Project
proposals.

6.2. Interest Earned on Special Account

The CEB will set up and manage a separate interest bearing special account for this
Programme. Upon proposal of the CEB/KfW and subject to approval by the
Commission in accordance with section 6.1, interest may be reinvested in the
Programme as set out in section 4.3.2.

The modalities for managing the special account will be set in the Contribution
Arrangement.

6.3. Recovery of Funds

In the case of default on Projects, the CEB/KfW will undertake recovery proceedings of the
Phare Contribution in a manner consistent with the care and diligence applied in CEB/KfW
projects financed out of its ordinary resources. The Commission will assist in this process
where required.

Funds recovered from Projects will be credited to the special account and may be used
for the purpose of the Programme as set out in section 4.3.2.

The Phare Contribution, which has not been allocated to a Project by the contracting
expiry date, will be de-committed by the Commission.

The Phare Contribution allocated to a Project and not disbursed from the special
account of the CEB by the disbursement expiry date, will be recovered by the
Commission.

6.4. Environmental Impact Assessment and Nature Conservation

The procedure for environmental impact assessment as set down in the EIA-directive\(^2\) are
fully applicable for all investment projects under Phare. If the EIA-directive has not yet been

fully transposed; the procedures should be similar to the ones established in the above mentioned directive. All investment projects will be carried out in line with the relevant EU environmental legislation. Project proposals will contain information on specific clauses on compliance with the relevant EU legislation in the field of environment to be included in the legal documentation implementing the Project proposal.

7. **MONITORING AND EVALUATION**

At operational level, the implementation of this Programme will be monitored through technical and financial reports to be submitted by the CEB/KfW and through a Steering Committee including representatives of the Commission, CEB/KfW and any other institution that will have signed a Contribution Arrangement with the Commission under the Municipal Finance Facility.

The Steering Committee will be chaired by a representative of the Commission and will monitor the implementation of the Facility, in particular it will

1. monitor financial and operational progress of the Facility;
2. review, as appropriate, publications reporting on the Facility;
3. review the experiences of the Facility and propose improvements;
4. co-ordinate activities of the Facility, where necessary.

Moreover, the accounts and operations of all activities carried out under the Programme may be checked at regular intervals by an outside auditor contracted by the Commission without prejudice to the responsibilities of the Commission and the Court of Auditors. Also the Commission may carry out any necessary audits and on-the-spot checks to verify the correct use of the Phare Contribution.

To facilitate this, the CEB/KfW, Participating Banks and Promoters will keep accounting, financial and operational documents concerning all activities financed from the Phare Contribution, and will make available to the competent bodies of the European Commission and the European Court of Auditors on request all relevant financial information.

The Commission services shall ensure that ex-post evaluation is carried out after completion of the Programme.

8. **AUDIT AND ANTI-FRAUD MEASURES**

The Financing Decision for this Programme as well as the utilization of the Phare Contribution in Projects and Sub-Projects are subject to supervision and financial control by the European Commission (including the European Anti-Fraud Office, OLAF), and the Court of Auditors. In order to ensure efficient protection of the financial interests of the Community, the European Commission can conduct check-ups and inspections on site, in accordance with the procedures foreseen in Council Regulation (Euratom, EC) No 2185/96\(^3\), concerning on-the-spot checks and inspections

\(^3\) OJ L 292; 15. 11. 1996; p. 2-5
carried out by the Commission in order to protect the European Communities’ financial interests against fraud and other irregularities.

The procedures foreseen in Article 15 para.3 of the Commission Regulation (EC) No 2222/2000 of 7 June on the communication in case of irregularities and the putting in place of a system to administrate the information in this field shall apply.

Project Agreements to be concluded by KfW with the financial intermediaries as well as agreements between the financial intermediaries and beneficiaries of Sub-Projects, shall contain provisions to this effect. Relevant documentation should be maintained at all levels for a period of at least five years after closure of the Project.

There shall be full coordination between the CEB, KfW, the Commission and Court of Auditors to minimise any potential disruption to activities.

9. **Visibility/Publicity**

The CEB/KFW will be responsible for ensuring that the necessary measures are taken to ensure appropriate publicity for all activities financed from the programme. This will be done in close liaison with the Commission Delegation. Phare visibility measures are based on the provisions of the regulations and decisions applicable to the Structural Funds\(^4\).

10. **Special Conditions**

In the event that agreed commitments are not met for reasons which are within the control of the CEB/KFW, the Commission may review the programme with a view, at the Commission’s discretion, to cancelling all or part of it and/or to reallocate unused funds for other purposes consistent with the objectives of the Phare programme.

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