COMMISSION DECISION
OF 2003

Establishing a Phare multi-beneficiary programme on the “Municipal Finance Facility with the European Investment Bank” in 2003,

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EEC) No 3906/89 of 18 December 1989 on economic aid to certain countries of Central and Eastern Europe¹, as last amended Regulation (EC) No 807/2003², and in particular Article 8 thereof,

Whereas:

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

(2) 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 €15 million to be financed through Budget line B7-030 in 2003.

Done in Brussels,

For the Commission

¹ OJ no. L375 of 23/12/1989
² OJ L 122, 16.5.2003, p. 36
FINANCING PROPOSAL

1. IDENTIFICATION

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

Programme
Municipal Finance Facility with the European Investment Bank

CRIS-Number
2003/005-784

Year
2003

Cost
€15 million

Expiry Dates
Contracting: 30 November 2004\(^1\)
Execution of Contracts: 30 November 2011

Group
L

Sector
FI

DAC Code
24030

Budget Line
B7-030

Task Manager:
Judith Novak (DG ELARG)

2. SUMMARY

The depth and strength of the municipal credit markets in the acceding and the candidate countries is an important aspect of the functioning of their financial sector. 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 still have a limited access to long term credits needed for infrastructure investment, even in the 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 acceding and the candidate countries in continuing the reform and the strengthening of the financial sector.

To this end, the European Investment Bank (EIB) will combine loans from their resources with non-reimbursable Phare support in order to motivate banks in the acceding and 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.

\(^1\) Date by which the Contribution Agreement with the EIB must be signed.
After one earlier Financing Proposal for a total of €15 million, this Programme makes available a further €15 million for this purpose. Concerning the acceding countries this is the last allocation to the Municipal Finance Facility under the Phare Programme. The EIB will increase its contribution by at least an additional €75 million to achieve the Programme’s objectives.

3. **Strategy and Background**

*Strategy*

The Regular Reports 2002 assessed the progress made by the acceding and the candidate countries, as well as the overall situation in terms of the adoption of the Acquis and the capacity to enforce it.

In the context of the Copenhagen economic criteria the Regular Reports 2002 continue to 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 acceding and 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 access to long term credits needed for infrastructure investment, even in the candidate countries with more advanced financial markets. 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 EIB have therefore decided to combine Phare grant money with EIB lending, where possible, in order to help the financial sector in the Eastern and Central European acceding and candidate countries develop its municipal lending business. From the European Commission’s point of view the combination with EIB funding will bring additional leverage to grants from Phare and therefore substantially broaden the reach of the Programme.

*Background*

The inter-institutional co-operation between the EIB and the Commission includes structural adjustment and regional development, support for smaller businesses, environmental protection and transport.

Co-operation under the pre-accession financial instruments such as PHARE and ISPA has been very intensive. Co-operation with PHARE started already some 10 years ago. Since then, EIB has co-financed a substantial number of projects with an important European interest, particularly projects in the transport sector.

When co-operating with the European Commission, the EIB aims at maximising the leverage effect of Phare support and at reaching as large a number of eligible investments as possible, hence optimising the catalytic role of grants and maximising the overall positive impact of appropriate loan/grant blending.
In the context of the Phare programme, co-operation between the Commission and the EIB includes in particular the promotion of lending to small and medium-sized enterprises in the Candidate Countries under the SME Finance Facility. The Commission’s announcement in July 2001 of a Special EIB Programme has added, most recently, a new area of co-operation involving loans extended to municipalities, namely to accelerate the implementation of small local infrastructure in the candidate countries’ border regions with the EU.

The Municipal Finance Facility was launched in 2002 with a first allocation of €15 million to the EIB and committing EIB resources of at least €75 million. During the first half of 2003 the Commission and the EIB negotiated the Contribution Agreement i.e. the contract determining the implementation arrangements in detail. It is expected that the first Projects with local financial intermediaries will be launched as of the end of 2003.

4. **OBJECTIVES AND DESCRIPTION**

4.1. **Objectives**

The *overall objective* of the Programme is to assist the acceding and the candidate countries in contributing to the reform and the strengthening of the financial sector.

The Programme’s *specific objective* is to

- build the confidence of commercial banks to extend loans to municipalities or public or private companies delivering a municipal service 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.

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 Phare allocation will be paid in instalments to an interest bearing Special Account at the EIB.

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

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

The EIB 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 EIB and the local financial institution providing an EIB loan together with a Phare Contribution will represent the “Project”. Before signing this agreement the EIB has to propose the Project to the competent Commission services for their approval. In its proposal the EIB will inform the Commission about the total loan amount allocated to this local financial institution and the corresponding Phare Contribution. Upon approval, the EIB 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 public or private 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 €15 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 Sub-Projects 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 EIB and the PB, this unused amount will be recovered by the Commission.

(6) **Management Fee and Auditing Costs**
A management fee shall be paid to the EIB as 1.20 % of each tranche transferred to the Special Account and corresponding to a maximum amount of €180,000. The annual cost for auditing the Special Account will be paid separately from the management fee.

The Commission shall not provide any additional amount to support the ordinary EIB 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 EIB 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 EIB.

4.4. **Financial Support Ratios**

1. The **overall ratio** between the EIB resources and the Phare allocation for this Programme shall be equal to or higher than 5/1. The EIB will provide at least €75 million in the form of loans and the EC will provide a maximum of €15 million.

2. The ratio between the EIB 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 EIB 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 for Romania and Bulgaria where this limit will be €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 EIB considers to fulfil these requirements based on an ongoing relationship with EIB, 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, upgrading 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 EIB exclusion list.

4.5.5. Eligible Investment Costs

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

5. BUDGET

The European Commission will support the Municipal Finance Facility with €15 million.

<table>
<thead>
<tr>
<th>Phare Funding in million €</th>
<th>EIB</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institution Building (IB)</td>
<td>INV</td>
<td>Phare Total I+IB</td>
</tr>
<tr>
<td>15</td>
<td>-</td>
<td>15</td>
</tr>
</tbody>
</table>

(The figures in the budget table are indicative only)
Co-financing for Institution Building projects is provided by the beneficiary bearing certain infrastructure and operational implementation costs, through financing the human and other resources, required for effective and efficient absorption of PHARE assistance.

6. IMPLEMENTATION ARRANGEMENTS

6.1. Financial and Project Management

This Programme will be implemented on a centralised basis by the Commission in accordance with Council Regulation 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the General Budget of the European Communities. To this end, the Commission will conclude a grant agreement with the EIB.

The provisions of Part 2, Title 4, Chapter 3 of Council Regulation 1605/2002 apply to EIB procurement of works, services and supplies financed by Community funds.

6.2. Deadline for contracting and execution of contracts between EIB and Participating Banks

All contracts between EIB and the Participating Banks must be concluded by 30/11/2006. Execution of these contracts must end by 30/05/2011.

The contract of execution period exceeds the average length allowed for the execution of contracts. The length of the execution period is justified due to a number of steps involving the Municipal Finance Facility mechanism. The length is required to allow the Programme to develop its full impact.

As from the signature of the Contribution Agreement EIB has to carry out due diligence on local financial intermediaries and sign a Project Agreement with them.

The deadline for signing these Project Agreements has been set at 30/11/2006 (3 years). For each Project selected, EIB provides credit lines to local financial intermediaries with a duration of several years (normally 4 years or more). The execution of contract period has been set to allow an implementation period of the last Project of 5 years.

Should EIB manage to sign Project Agreement well before 30/11/2006, e.g. by end of 2005, an early termination of the Facility is possible.

6.3. Recovery of Funds

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

Fund 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 30/11/06 (the contracting expiry date between EIB and the PBs), will be de-committed by the Commission.
The Phare Contribution allocated to a Project and not disbursed from the Special Account of the EIB by 30/11/2011 (overall end of the contract execution period will be recovered by the Commission.

6.4. Interest earned on the Special Account

The EIB will continue to manage a separate interest bearing Special Account for this Programme. Interest will be reported to the European Commission and used for the purpose of the Programme as set out in section 4.3.2. and after approval of the competent Commission services in accordance with section 6.5.

The modalities for managing the Special Account will be set in the Contribution Agreement.

6.5. Process of Project Approval

The EIB 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 EIB will provide all relevant information to assess the Project proposals including information on the selected bank, amounts from EIB 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;
- the justification of the need of the particular Participating Bank;
- the additionality and sustainability of the Project;
- the expected quantitative and qualitative results of the Project;
- the Project’s impact on SME development in the beneficiary countries;

By their approval of the Project, the Commission authorises the mobilisation of the Phare Contribution from the Special Account set up at the EIB. The Commission also ensures the confidentiality of the Projects proposed by the EIB.

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

The Contribution Agreement 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 EIB 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.
6.6. 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.

6.7. Secretariat

The Commission (DG ECFIN/L) provides the Secretariat of the Facility. The Secretariat co-ordinates the flow of information between the Commission and all the Sponsors for matters related to Projects, Steering Committee and technical meeting organisation and the administration of the Special Account.

7. Monitoring and Evaluation

7.1. Monitoring

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

After an initial advance payment, the payment of instalments will be conditioned to the presentation to the Commission of a semi-annual or annual operational progress report and a financial report and their subsequent approval indicating the progress of operations and of expenditure of the Special Account.

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

7.2. Evaluation

The Commission may also carry out, from time to time, assessments of activities under the Agreement. To this purpose Commission’s agents or duly authorised representatives may pay monitoring visits down to the Sub-Project level. The Commission also exercises its responsibilities through reviewing the audited accounts and reports produced by the EIB and through its own independent assessments and audits.

The Commission may carry out interim evaluations and shall ensure that ex-post evaluation is carried out after completion of the Municipal Finance Facility.

8. Audit and Anti-fraud Measures

The Financing Decision for this Programme as well as the utilisation 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, concerning on-the-spot checks and inspections 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 the EIB 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 appropriate levels for a period of at least five years after closure of the Project and the Sub-Project.

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

9. Visibility/Publicity

The EIB 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

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3 OJ L 292; 15.11.1996; p. 2-5
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 EIB, 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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