establishing a Phare multi-beneficiary programme on the Municipal Finance Facility with European Investment Bank in 2005, for Bulgaria, Romania, Croatia and Turkey

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

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

Having regard to Council Regulation (EC) No 2500/2001 of 17 December 2001², concerning pre-accession financial assistance for Turkey,

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, and Regulation No 2500/2001 lays down the rules and conditions for the granting of economic aid to Turkey;

(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 € 13 million to be financed through Budget line 22.02.10 of the 2005 General Budget of the European Union.

Article 3

The programme described in the Annex to the present decision forms an integral part thereof. The monopoly situation of the European Investment Bank is justified in accordance with Article 168(1) (c) of the Implementing Rules, in section 3.2.1. of the programme.

Done in Brussels,

For the Commission

ANNEX - FINANCING PROPOSAL

1. IDENTIFICATION

<table>
<thead>
<tr>
<th>Beneficiary countries</th>
<th>Bulgaria, Romania, Croatia, Turkey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Programme</td>
<td>Municipal Finance Facility with the European Investment Bank</td>
</tr>
<tr>
<td>CRIS-Number</td>
<td>2005/017489</td>
</tr>
<tr>
<td>Year</td>
<td>2005</td>
</tr>
<tr>
<td>Cost</td>
<td>€ 13 Million</td>
</tr>
<tr>
<td>Implementing Authority</td>
<td>European Commission on behalf of the beneficiary countries.</td>
</tr>
<tr>
<td>Expiry Date contracting</td>
<td>31 December 2006¹</td>
</tr>
<tr>
<td>Execution of contracts</td>
<td>31 December 2014</td>
</tr>
<tr>
<td>Group</td>
<td>L</td>
</tr>
<tr>
<td>Sector Code</td>
<td>24030</td>
</tr>
<tr>
<td>Budget Line</td>
<td>22 02 10</td>
</tr>
<tr>
<td>Task Manager for programming and implementation</td>
<td>Nathalie Boutin (DG ELARG, Unit D3, Horizontal Programmes and Contracts)</td>
</tr>
</tbody>
</table>

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 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 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 contributing to 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 two earlier Financing Proposals for a total of € 30 million for the New Member States, Bulgaria and Romania, this Programme makes available a further € 13 million with a focus on deepening financial intermediation in Bulgaria, Romania and rolling out the Facility in Croatia and Turkey for the first time. The EIB will increase its contribution by at least an additional € 65 million to achieve the Programme’s objectives.

3. BACKGROUND AND STRATEGY

3.1 BACKGROUND

3.1.1 BULGARIA

Bulgaria has approximately 260 urban municipalities and approximately 5,000 rural settlements with populations of less than 150,000. They account for approximately 70% of the population in the country. Their expenditures are approximately 5% of the country’s GDP. Currently, however, they represent only a very small proportion of borrowing by local government. Most capital investment by smaller municipalities comes from targeted grants from central government. Total budgets for these smaller municipalities (<150,000) in 2000 were approximately 1.8 billion lev (900 million Euro), with capital expenditures of approximately 100 million lev (50 million Euro).

Bulgaria's municipalities have significant investment needs in water, wastewater, solid waste and urban transport. Estimates of the investment required to meet EU standards in the water and waste water sector approach €1.15 billion or €138 per capita (2003 figures). About 70 per cent of the population have no access to waste water treatment. Water supply assets are in poor condition with an increase in unaccounted for water loss reported at 56 per cent in 2001 compared to 15 per cent in 1980. At the same time the institutional capacity for addressing sector requirements is underdeveloped both at the level of individual water utilities and with respect to appropriate supervisory and regulatory entities. In addition, the lack of reform in central and local government fiscal relations has left secondary cities (outside of Sofia) without stable and predictable sources of revenues. Cities and municipal governments, therefore, have limited creditworthiness. Local banks are reluctant to make long term loans given the current fiscal arrangements.

3.1.2 ROMANIA

Romania has 250 municipalities and towns and 2,688 communes with less than 150,000 inhabitants (2002). There are approximately 400 public service operators, companies and public service units within the structure of local councils. Modernization of existing local utility capacity and further development are expected to require important financial resources. For Romania to reach European standards in drinking water supply, sewerage and wastewater treatment, the need is estimated at EUR 4.3 bln financing in the short-term, and EUR 10.1 bln in the long-term. Such capital expense needs are as follows: water supply - 35%, sewerage - 20%, and wastewater treatment - 45%.

Financing of necessary investments for the municipal service providers currently come from the local budgets or through subsidies from the State Budget. Municipal credit markets are still in a nascent stage with almost only the large municipalities having access to loan funding and bonds. Small and medium-sized municipalities finance their

---

2 Source EBRD
3 Source EBRD
investments either from short term (3-5 years) loans or from their annual budgets. This results in financing over periods much shorter than the economic life of the assets financed, as well as limiting the overall investment programme as large investments have to be carried out one at a time rather than in parallel. The revenue of local authorities has risen as their responsibilities have widened, with the increase financed by both local authorities’ locally-raised revenue and government transfers.

The current revenue of local authorities rose from approximately EUR 1 bln. in 1998 to EUR 2.6 bln. in 2002. As a reflection of a gradual decentralisation of power starting in 1999, the level of local authorities’ expenditure has increased from circa 4% of GDP in 1999 to around 5% in 2002 and as a ratio of total public expenditure from 11.4% (1999) to 18.7% (2002). Local public debt in Romania amounted to EUR 8.7bn (figures at end-June 2003). In the period 1999–2002, local public debt increased from 35% to 38% of total public debt and stabilised at about 11% of GDP at the end of 2003.

3.1.3 CROATIA

There are approximately 540 cities and municipalities with population less than 100,000 in Croatia, representing approximately 70% of the population. (Cities are generally those having >10,000 population.) Total expenditure of cities municipalities of all sizes represents about 6 per cent of GDP or a little more than EUR 1 billion. Capital grants constitute about 6% of their budgets, with additional expenditures coming from budget surpluses. Croatia has a good legal base for financial activities of municipalities, with suitable borrowing limits established by law. The regulatory structure for the water sector is quite advanced, as there is a national water authority in place, making Croatia the country with the highest score on the transition indicator for water and waste water.

While many municipalities operate at a deficit, many of them also generate large surpluses which could potentially be used to support lending programmes. Loans are available, but generally short-term, although banks are beginning to lend up to 10 years. Borrowing has to be approved by the Ministry of Finance and there is a limit on debt service to 20% of annual revenues.

3.1.4 TURKEY

Municipalities

Among the local administrative units, municipalities are the most important. According to the recent statistical information, there are 3225 municipalities throughout Turkey by 2004. 16 out of this number are metropolitan municipalities (büyüksehir belediyesi), while 89 are metropolitan sub-provincial municipalities (büyüksehir ilçe belediyesi) and first degree municipalities (Ilk kademe belediyesi: A municipality formed within the borders of a metropolitan city without establishing a municipality. They have the same powers, privileges and responsibilities with metropolitan sub-provincial municipalities), 65 to ordinary provincial municipalities, 792 to sub-provincial and 2263 to district municipalities. 80% of the population inhabits in municipal regions. With the growth in urbanization, this percentage will further increase.

---

4 Source : EBRD
5 Source : İller Bankası APK
Financial Structure and Problems of Local Administrations in Turkey

Local administrations have numerous problems the most significant ones of which are related to scales, scarce financial resources, organization, human resources, fast urbanization, increasing number of shanty towns, infrastructure and environment, residential buildings, urban transport etc. While these problems do not appear in the short term, their solutions are not obtainable in the short term either.

Local administrations have the authority to acquire loans not only from public resources, but also from private resources. In practice, we see that until 1980s, local administrations had been using public resources in this sense; however, as of 1986, we see that they started to get loans from international resources in addition to domestic private finance institutions. In terms of public resources, the main lending institution for the local administrations is the Bank of Provinces (Iller Bankası).

Despite the rapid urbanisation, lack of infrastructure and increasing demand for services, it was not possible to increase the revenues of the municipalities which compelled some of the municipalities to borrow money.

<table>
<thead>
<tr>
<th>Table 1</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Municipalities According to Population</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Category (thousand)</th>
<th>Population (thousand)</th>
<th>No.</th>
<th>%</th>
<th>Residential population (thousand)</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1-2</td>
<td>353</td>
<td>10.9</td>
<td>592.4</td>
<td>1.1</td>
</tr>
<tr>
<td>2</td>
<td>2-5</td>
<td>1,652</td>
<td>51.2</td>
<td>5,127.2</td>
<td>9.6</td>
</tr>
<tr>
<td>3</td>
<td>5-10</td>
<td>559</td>
<td>17.3</td>
<td>3,764.6</td>
<td>7.0</td>
</tr>
<tr>
<td>4</td>
<td>10-20</td>
<td>274</td>
<td>8.5</td>
<td>3,774.2</td>
<td>7.1</td>
</tr>
<tr>
<td>5</td>
<td>20-50</td>
<td>182</td>
<td>5.6</td>
<td>5,732.9</td>
<td>10.7</td>
</tr>
<tr>
<td>6</td>
<td>50-100</td>
<td>83</td>
<td>2.6</td>
<td>5,779.2</td>
<td>10.8</td>
</tr>
<tr>
<td>7</td>
<td>+100</td>
<td>122</td>
<td>3.8</td>
<td>28,636.6</td>
<td>53.6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Table 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The Trend in Investment Expenditures (%) (x)</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>YEARS</th>
<th>Share in overall expenditures</th>
<th>Share in the GNP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>23</td>
<td>0.7</td>
</tr>
<tr>
<td>1995</td>
<td>24</td>
<td>0.7</td>
</tr>
<tr>
<td>1996</td>
<td>30</td>
<td>0.9</td>
</tr>
<tr>
<td>1997</td>
<td>31</td>
<td>1.1</td>
</tr>
<tr>
<td>1998</td>
<td>35</td>
<td>1.2</td>
</tr>
<tr>
<td>1999</td>
<td>26</td>
<td>1.1</td>
</tr>
<tr>
<td>2000</td>
<td>28</td>
<td>1.0</td>
</tr>
<tr>
<td>2001</td>
<td>25</td>
<td>1.1</td>
</tr>
<tr>
<td>2002</td>
<td>25</td>
<td>0.9</td>
</tr>
<tr>
<td>2003 (E)</td>
<td>26</td>
<td>0.9</td>
</tr>
<tr>
<td>Average</td>
<td>27</td>
<td>0.96</td>
</tr>
</tbody>
</table>

(E) Estimate
3.1.5 **OVERALL RESULTS OF THE MUNICIPAL FINANCE FACILITY (MFF)**

By March 2005, 18 projects have been approved under the MFF: 7 in Hungary, 3 in Slovakia, 2 in Poland, **2 in Romania**, 2 in Estonia, **one in Bulgaria** and one covering all of the Baltic States.

The Sponsors are invited to promote this facility in the acceding and candidate countries and at the same time to insure a good regional coverage.

**Overall results of the Municipal Finance Facility with EIB**

So far, the Municipal Finance Facility with EIB has been allocated a total amount of € 30 million under the 2002 and 2003 Phare budgets and with EIB resources of at least € 150 million. In 2004, 11 projects have been approved for a total amount of loans of € 80.80 M and a total amount of EC incentives of € 10.10 M. The country coverage was as follows: 7 projects in Hungary for an amount of € 45.90 M, 1 in Romania for € 18 M, 1 in Poland for € 13.5 M, 1 in Slovakia for € 9 M and 1 in Bulgaria for € 4.5 M.

3.2 **STRATEGY**

3.2.1. **Justification for the monopoly situation of EIB, EBRD and CEB and KfW**

The technical nature and the multi-country approach of the successive Finance Facilities required the involvement of highly-specialised financial institutions, with a long track record in international finance, SME and Municipal sector development. Also the preference was for financial institutions with the status of international public-law bodies, who shared the values of the EU, in particular, in relation to enlargement and had similar public policy objectives, rather than private-sector financial institutions looking for commercial investment terms. Hence discussions started in 1997 with the EBRD and EIB as the only institutions considered able at the time to fulfil these criteria and showing a clear interest to support the Facility’s implementation. Following these discussions, the first SME Finance Facility was launched in 1999 with the EBRD. Discussions also started with the Council of Europe Development Bank in 2000, which through its unique character as an International Financial Institution under the supreme authority of the Council of Europe, made it a suitable partner for the Facility. The first SME Finance Facility with the Council of Europe Development Bank became operational in 2000 involving the Kreditanstalt für Wiederaufbau (KfW) as a partner. Finally, the European Investment Bank (EIB) joined as a partner in 2001. In 2002, the Municipal Finance Facility was included into the Phare programmes with the 3 sponsors of the SME Facilities.

In terms of the Financial Regulation applicable to the general budget (Art.110), and its Implementing Rules (Art.168), the characteristics of these financial institutions as public-law bodies, pursuing European public policy objectives not just for profit, as well as their track-record and specialisation in financing international development, therefore put them in a monopoly situation leaving no other choice as partner for the Commission in these actions.

---

6 grants included
3.2.2 COOPERATION WITH EIB

The relationship between the European Commission and the EIB in the field of cooperation for pre-accession preparation of the Central and Eastern European Candidate Countries is based on the *Amended Memorandum of Understanding of May 20, 2003*.

This Memorandum underlines the shared desire to foster the reform process in the acceding and candidate countries. In this context the European Commission and EIB 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 to comply with EC law as soon as possible.

The cooperation with EIB allows the Commission, in line with the principle of sound financial management, (1) to pursue important political objectives, (2) to make the beneficiary countries to benefit from a considerable leverage effect of EC grant funding, (3) to implement the Programme with economy of resource by benefiting from EIB’s extensive network of partner banks in South Eastern Europe.

In the context of the Phare Programme, cooperation with the EIB has been extended from the promotion of lending to small and medium-sized enterprises under the SME Finance to the promotion of the municipal lending market under the Municipal Finance Facility. The Commission’s announcement in July 2001 of a Special EIB Programme has added a new area of cooperation involving loans extended to municipalities, namely to accelerate the implementation of small local infrastructure in the candidate countries’ border regions with the EU.

3.2.3 STRATEGY FOR BULGARIA, ROMANIA, CROATIA AND TURKEY

In the context of the Copenhagen economic criteria the Regular Reports 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 strategy paper\(^7\) of the EC on progress in the enlargement process for Bulgaria, Romania and Croatia and the Recommendation\(^8\) of the EU on Turkey’s progress towards accession point out the need to strengthen the enforcement of authorities, notably at regional and local levels, as well as the provision of adequate financial resources for state and private sector investment particularly with regard to the environment.

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

---

\(^7\) Com(2004)657 final

\(^8\) Com(2004)656 final
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 funds 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, hereinafter referred to as the **Promoter**.

*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 acceding and 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 other eligible promoters 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 the Promoter. This Loan Agreement becomes the “Sub-Project”.

4.3.2 Phare Contribution

The Phare Contribution represents €13 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 €156,000. 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.

Upon proposal of the EIB and subject to the approval of the Commission, other appropriate incentives for the benefit of Participating Banks may be granted.

4.4. Financial Support Ratios

1) programme leverage
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 €65 million in the form of loans and the EC will provide a maximum of €13 million.

2) project leverage
For each project, the ratio between the EIB resources and the Phare Contribution shall be equal to or higher than 3/1 if Technical Assistance is financed by the Phare Contribution. The ratio shall be equal to or higher than 6/1 if no Technical Assistance is financed by the Phare Contribution.

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

4) Technical Assistance Amount
For each Project the average amount of Technical Assistance to municipalities shall not be higher than €50,000.

4.5. Eligibility Criteria

4.5.1 Eligible Participating Banks (PBs)
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 fulfilling 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 does not exceed €5 million.

4.5.4. Eligible Sectors

Investments are eligible in the sectors involving municipal infrastructure except for sectors mentioned 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 €13 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>13</td>
<td>-</td>
<td>13</td>
</tr>
<tr>
<td></td>
<td></td>
<td>65</td>
</tr>
<tr>
<td></td>
<td></td>
<td>78</td>
</tr>
</tbody>
</table>

(The figures in the budget table are indicative only)

Cofinancing 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

The programme will be implemented by the European Commission following Article 53.1 (a) of the Council Regulation (EC, Euratom) Nr. 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Commission (the Financial Regulation: FR) as further detailed in the rules for the implementation of Council Regulation on the Financial Regulation applicable to the general budget of the EC (Implementing Rules: IR). To this end, the Commission will conclude a Contribution Agreement with the EIB.

DG Enlargement will be sub-delegating the execution of payments and recoveries to DG Economic and Financial Affairs.

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. contracting and execution deadline between EIB and Participating Banks (PBs)

All contracts between EIB and PBs must be concluded by 30/06/2009. Execution of these contracts must end by 30/06/2014.

For each Project selected, EIB provides credit lines to local financial intermediaries with duration of several years (normally 4 years or more).

The execution period of contract exceeds the average length normally allowed. The length of the execution period is justified due to a number of steps involving the Municipal Finance Facility mechanism and required to allow the Programme to develop its full impact. The execution period of contract has been set to allow an implementation period of the last Project of 5 years.

6.3. Recovery of Funds

In the case of default on Projects, the Commission will initiate recovery from EIB. EIB will undertake recovery proceedings in a manner consistent with the care and diligence applied in EIB projects financed out of its ordinary resources for final recovery to the Commission. 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 30/06/2009 (the contracting expiring 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 30/06/2014 (overall end of the execution period of contract) 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 (1) and 6.6.

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

6.5. Implementation Principles

(1) No Phare funds will be used for the purposes of a Project without prior approval of that Project by the Commission and the EIB.

(2) The specific procedures relating to the implementation of the Project will be set down in Project Agreements with the Participating Banks. Project Agreements will specify the terms and conditions applicable to the use of EIB resources and the Phare Contribution and will ensure that relevant provisions will be incorporated in the corresponding agreements between the Participating Banks on the one hand and the Promoters on the other.
6.6. Project Selection and Approval

Project proposals shall be assessed as to their compliance with the following criteria:

(1) the compliance with the Contribution Agreement in particular with eligibility criteria;
(2) the need of a particular PB;
(3) the specific objectives of the Project and their relation to specific needs of the PB;
(4) the additionality and likely sustainability of the Project, including the Project’s impact on the financial sector;
(5) the expected quantitative and qualitative results of the Project;
(6) indicators of achievement which allow measuring project progress;

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.

By its approval of the Project, the Commission authorises the mobilisation of the Phare Contribution held in the Special Account with EIB.

6.7. Environmental Impact Assessment and Nature Conservation

The procedure for environmental impact assessment as set down in the EIA-directive is 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.

If a project is likely to affect sites of nature conservation importance, an appropriate assessment according to Art. 6 of the Habitats Directive must be documented.

6.8. Secretariat

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

7. Monitoring and Evaluation

7.1. Monitoring

The Commission will monitor the implementation of the Programme on the basis of reports from the selected contractors and independent assessments.

At operational level, the implementation of this Programme will be monitored through:

1. financial statements, semi-annual and annual reports to be submitted by EIB,
2. the Steering Committee:

the necessary coordination between the different Sponsors is ensured by a Steering Committee composed of representatives of the Commission and each Sponsor. The Steering Committee convenes at the request of any of its members, but meets at least twice per year under the chairmanship of a representative of the Commission in order to
- monitor financial and operational progress of the Facility;
- review, as appropriate, publications reporting on the Facility;
- review the experiences of the Facility overall with a view to proposing improvements;
- coordinate activities of the Facility, where necessary;

the decisions of the Steering Committee are taken by unanimity, and

3. monitoring visits.

Moreover, the accounts and operations of all activities carried out under the Programme may be checked at regular intervals by an external 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 by the Phare Contribution under this Programme, 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 Services shall ensure that this programme will be subject to interim and/or ex-post evaluations.

8. AUDIT AND ANTI-FRAUD MEASURES

The accounts and operations in relation to the utilization of the Phare Contribution under this Programme are subject to supervision and financial control by the 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 Commission can conduct check-ups and inspections on site, in accordance with the procedures foreseen in Council Regulation (Euratom, EC) No 2185/96\(^\text{10}\), 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 controls and audits described above are applicable to all contractors and subcontractors who have received Community Funds. Project Agreements to be

\(^{10}\text{OJ L 292; 15. 11. 1996; p. 2-5}\)
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 all 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 minimize any potential disruption to activities.

EIB shall inform the Commission services without delay of any element of information indicating the possible existence of irregularities or fraud.

Irregularity shall mean any infringement of the Financing Proposal, resulting contracts or Community legislation resulting from an act or omission by an economic operator, which has, or would have, the effect of prejudicing the general budget of the Communities or budgets managed by them, either by reducing or losing revenue accruing from own resources collected directly on behalf of the Communities, or by an unjustified item of expenditure.

Fraud shall mean any intentional act or omission relating to:

(i) The use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds from the general budget of the European Communities or budgets managed by, or on behalf of, the European Communities,
(ii) Non-disclosure of information in violation of a specific obligation, with the same effect;
(iii) The misapplication of such funds for purposes other than those for which they are originally granted.

The procedures foreseen in Commission Regulation N°1681/1994 of 11 July 1994 on the communication in case of irregularities and the putting in place of a system to administrate the information in this field shall apply.

9. **VISIBILITY AND PUBLICITY**

All Projects financed under the Facility involving Community funds shall reflect explicitly the input of the Commission through: (i) announcements in the national press of the country concerned; and (ii) inclusion of specific clauses promoting visibility in the Sub-Projects supported at the FI level. Phare visibility measures are based on the provisions of the regulations and decisions applicable to the Structural Funds.\(^{11}\)

In addition, EIB will report on the activities under the Municipal Finance Facility in its Annual Report at the same visibility level granted to other special funds.

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.

---