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Evaluation Study for the Lorraine Region (France)

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Final Report



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Glossary of acronyms

ACB	Cost-benefit analysis
ACSE	National agency for social cohesion and equal opportunities
ADUAN	Urbanism agency of the Nancy urban area
ANAH	Housing national agency
ANRU	Urban renewal national agency
ARSA	ArcelorMittal Research Maizieres
CDC	Caisse des Dépôts et Consignations (deposit and consignments office)
EC	European Commission
CESEL	Economic and Social Council of Lorraine
CESGR	Economic and Social Council of the Great Region
CGLSS	Guarantee fund for social rental housing for social landlords
CIADT	Interministerial Committee for territorial planning and development
COCOF	Coordination Committee of the Funds
CPER	Contrat de Projets Etat-Région (pluriannual contract between national and regional governments)
CRL	Regional Council of Lorraine
CUCS	Urban contract for social cohesion
CUGN	Communauté Urbaine du Grand Nancy (Nancy metropolitan area)
DATAR	Interministerial delegation for territorial planning and regional attractiveness
DDT	Province directorate for territories
DG REGIO	Directorate-General for Regional and Urban Policy (European Commission)
DOG	General orientations document
DREAL	Regional directorate for equipment, planning and housing
DTA	Planning territorial directive
EPA	Public establishment for land planning
EPARECA	Public establishment for planning and restructuring of commercial areas
EPCI	Public establishment for inter-municipality cooperation
EPF(L)	Public establishment for land (of Lorraine)
ERDF	European Regional Development Fund
HF	Holding Fund
UDF	Urban Development Fund
SF	Structural Funds
FI	Financial Instrument
ILP	Participation institute of Lorraine
OIN	Operation of national interest
PADD	Project of land planning and sustainable development
PDU	Urban mobility plan
PIDUD	Sustainable urban development plan
PLH	Housing local plan
PLU	Urbanism local plan
OP	Operational Programme
PPP	Public-private partnership
R&D	Research and development
SAS	Société par Actions Simplifiée (simplified joint-stock company)
SCoT	Territorial coherence scheme
SESGAR	Department of studies of the General secretariat for regional affairs
SEV	Société d'Équipement Vosgienne
SGAR	General secretariat for regional affairs
SOLOREM	Mixed investment company for urban development in Lorraine
SWOT	Strengths, Weaknesses, Opportunities, Threats
EU	European Union
UESL	Social economy union for housing
ZAC	Zone d'aménagement concerté (joint development zone)

Executive summary

Financial Instruments (FI) are expected to play a stronger role in sustainable urban development projects in the 2014-2020 programming period. Besides the advantages of recycling funds over the long term, Financial Instruments related to urban development will help to mobilise additional private co-investments in order to address market failures in line with the Europe 2020 Strategy and Cohesion Policy priorities¹.

This evaluation study consists of an analysis of the potential intervention of an Urban Development Fund-type Financial Instrument in the French region of Lorraine during the 2014-2020 programming period. It aims to determine how FIs can facilitate and amplify investments in the field of sustainable urban development, and to formulate evidence-based recommendations for the implementation of such instruments.

The study initially focuses on the analysis of the regional context of urban development based on macroeconomic analysis and then considers the regulatory and planning documents on urban development. The results of the implementation of the 2007-2013 ERDF Operational Programme are also taken into account in order to learn lessons for the future programming period. It also presents a description of the urban development market through an analysis of the demand for funding (review of potential projects already planned), the detection of market segments and market failures and finally the analysis of the offer with the identification of the existing sources of funding for urban development.

From a pool of urban development projects potentially eligible three case studies are presented to illustrate the intervention approach of Urban Development Fund-type Financial Instruments in Lorraine and provide examples of operational setting-up.

The report proceeds with the conclusions and the recommendations in terms of structure and investment strategies for an FI dedicated to urban development in the Lorraine region and it proposes an action plan for the establishment of such an instrument in the framework of structural funds 2014-2020 programming period.

Regional context of urban development

The overview of the general context of urban development in Lorraine pointed out that the region is facing a fragile demographic and socio-economic situation related to the decline of regional industries over the past years and the increase of social problems in some specific urban territories. The population is mainly concentrated on a north-south metropolitan axis and in urban agglomerations close to the borders with Luxembourg and Germany. In terms of urban development, the region has to deal with several challenges such as the development of suburban areas and the reconversion of many industrial and military brownfields.

The existing strategic and planning documents in Lorraine, even if they are not always strictly consistent in terms of geographic coverage, time scale and/or priorities, are open enough for the definition of an investment strategy facing market needs.

During the period 2007-2013, 20% of the ERDF contribution was related to urban development through a specific axis meant to **support the urban agenda (€ 24 million)** and other actions related to energy efficiency.

Analysis of the urban development market

The analysis of the urban development market in Lorraine was performed using desk research and interviews with the main public and private stakeholders of the region. 166 urban development projects were identified and analysed according to their area of intervention, strategic basis, and

¹ Articles 32-40 of the proposed Common Provisions Regulation on Common Strategic Framework Funds.

consistency with Europe 2020 objectives, partners, budget and maturity. 75 of these, reaching a volume of almost € 2 billion, were deemed to have a sufficient level of maturity to fall in the scope of a potential Financial Instrument operating during the 2014-2020 programming period.

The analysis of this list of projects released five market segments which could be covered by a UDF-type Financial Instrument:

- Urban regeneration;
- Housing and social housing;
- Energy efficiency;
- Transport and mobility;
- Industrial, military and hospital-related brownfields.

According to the assessment of the five market segments, the following market failures and specific investment needs were identified:

- Address the low attractiveness of the regional territory by a signal effect and risk sharing;
- Reduce project capital costs and improve financial returns by the use of equity or long-term debt;
- Improve profitability by better structuring project funding.

The analysis of the supply was carried out by reviewing the role of key players in the regional market and their investment strategies. With respect to public co-financing several national stakeholders are involved in the funding of urban development projects in Lorraine such as the EPARECA (*Établissement Public National d'Aménagement et de Restructuration des Espaces Commerciaux et Artisanaux*) and the ANRU (*Agence Nationale pour la Rénovation Urbaine*). There are also regional institutions such as the EPFL (*Etablissement Public Foncier de Lorraine*) or the regional branch of the CDC (*Caisse des Dépôts et Consignations*) which are closely working with local authorities and other urban planning organisations.

The national and regional public co-financing mechanisms supporting urban development do not appear to substantially reduce the market failures, and even if a number of private investors, promoters and other financiers are active in Lorraine, the region generally suffers from a low attractiveness of investors.

Case studies

Three case studies have been chosen according to their potential eligibility under an Urban Development Fund (UDF) i.e. they incorporate sufficient educational character and adequate maturity to develop a comprehensive and relevant simulation. The case studies aimed to illustrate the operational and financial implications of deploying UDF-type Financial Instruments and thus to assess the appropriateness of their implementation in Lorraine.

The different cases studies mainly helped to illustrate the benefits of using the Financial Instrument paradigm that optimises private funds before eventually consider public grants.

The main findings of each case study are presented below:

- EPA (*Etablissement Public d'Aménagement*) Alzette-Belval:

The project entails the development of more than 206 hectares of commercial premises, housing and public facilities, on the border with Luxembourg including 100 hectares of industrial brownfield.

Through this case study it was possible to demonstrate the advantages of using an in kind contribution of land to mobilise ERDF resources that could be used to enhance project bankability and attract investments.

Moreover, in the specific context of the EPA Alzette-Belval, it has been shown that financing the project through the UDF could help covering a part of the anticipated deficit of the EPA thanks to the capital gain obtained through the sale of the real property at the moment of the UDF liquidation.

- Ecoparc des Grandes Croisettes:

The aim of this project is to create a local centre of excellence for health, integrated with plots intended for commercial companies and energy efficient residences over a total area of 19 hectares located in the city of Saint-Dié des Vosges.

The proposed intervention of the UDF in this case was meant to mitigate the risk profile of potential private investors. By reducing the interest rate, requiring less collateral or extending the repayment period on loans granted by the UDF, the intervention increases the bankability of the project and therefore reduces the need for government subsidies.

- Nancy Grand Cœur:

Launched in 2007 this project aims to continue the development of the urban area of the Nancy train station and plans to develop almost 180,000 m² of land destined for mixed-use.

This specific case study illustrated a further possible type of intervention: the provision of guarantee products. The analysis demonstrated that the availability of guarantees covering the “first loss” can allow a UDF to leverage from the banking sector a much larger loan. The provision of a larger credit reduces the need for public subsidies, while allowing the realisation of a project with a positive socio-economic impact.

Moreover a guaranteed loan could be granted at better conditions than normal loans (such as with smaller interest rates, reduced collateral needs or longer repayment period) leading to an improved performance of the project.

Proposal of structure and investment strategies of the UDFs

Thanks to the analysis of the urban development market and to the simulations carried out on the three case studies, it turned out that there is a potential for the establishment of an FI dedicated to urban development in Lorraine during the 2014-2020 period.

In order to reflect the different challenges of the urban areas of the region, the proposed structure of the FI includes two urban development funds (UDFs):

- A regional UDF focused on one main investment priority in order to provide an attractive and flexible tool for private investors;
- A territorial-focused UDF for which the ERDF funds would be limited and concentrated to trigger the leverage effect on the metropolitan area of the Sillon Lorrain (north-south axis).

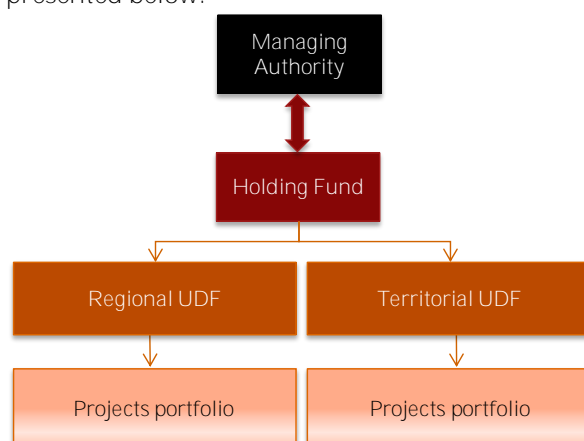
Given the strong coherence with local and European strategies and the presence of projects eligible (for a total funding need of € 443 million), the first UDF should target its investments in the field of energy efficiency across the whole region excluding the north-south metropolitan axis which would benefit from a specific UDF. With a proposed budget of € 110 million including a public contribution of € 55 million², the regional UDF will aim to provide alternative and suitable financing, attractive for private investors.

² Including € 33 million ERDF and € 22 million of matching contribution.

The second UDF should be geographically limited to the metropolitan axis formed by the urban agglomerations of Thionville, Metz, Nancy and Epinal without a thematic concentration. The potential budget for this UDF was estimated at € 80 million with a public contribution reaching € 27 million³.

A holding fund (HF) should also be set up in order to make the management of the whole Financial Instrument easier and to foster the leverage effect in the region. Indeed, the HF can provide the Managing Authority with the adequate infrastructure and human capital, and ensure a better consistency between the investment strategy and the UDFs' operations with a view to increase co-financing by private operators.

The proposed structure is presented below:



In conclusion, according to the estimations based on the market needs and the funds absorption capacity, the two UDFs could benefit from an ERDF allocation of € 49 million and generate investments of € 190 million on urban development projects. In addition, an analysis of the consistency of the UDFs with the Common Strategic Framework has pointed out that both proposed UDFs can be fully implemented according to the thematic concentration requirements⁴.

Keys steps and recommendations for the Managing Authority

The study is closing with the action plan which integrates the setting up of the UDF-type Financial Instrument into the programming process of the 2014-2020 ERDF OP in Lorraine.

The different stages of the action plan include several key recommendations for the ERDF Managing Authority to help the constitution and implementation of the FI:

- Start the discussions with the European Commission (Directorate-General for Regional and Urban Policy) for the integration of an FI in the ERDF Operational Programme on the basis of the conclusions of this study;
- Launch the ex-ante assessment, as referred to in Article 32 of the proposed Common Provisions Regulation. This should include, but not be limited to, updating the identification of market failures that have been carried out as part of this study as well as defining the investment strategy of each UDF starting from the options proposed in this report;
- Provide technical assistance to the project promoters in order for them to redefine the scope of projects combining public and private interventions, taking into account the return on investment and building projects in an integrated, sustainable and bankable way;

³ Including € 16 million ERDF and € 11 million of matching contribution.

⁴ Article 16 of the proposed ERDF Regulation.

- Adopt a long-term perspective when dealing with urban development in order to take into account integrated approaches and payback periods of the investments;
- Get regional stakeholders such as EPFL and CDC on board, in order to foster a close technical support to project promoters and local authorities.

Conclusions on the benefits of implementing a UDF-type Financial Instrument for the Lorraine region

The results of the present evaluation study show that the setting-up of a UDF-type Financial Instrument in the Lorraine region can bring different types of benefits:

- The UDF-type Financial Instrument is consistent with the regional development strategy and will constitute a flexible tool that enables diversification of investments;
- The UDFs will contribute to the reduction of market failures and investment gaps answering to real mature and identified investment needs, as demonstrated in the case studies: reinforcing the attractiveness of the integrated and sustainable urban development projects for private investors, facilitating the access to the financial market by offering risk-sharing products in different configurations;
- The UDF-type Financial Instrument will insure sound management of structural funds and improves their absorption;
- The mechanism will enable the recycling of invested funds over the long term in order for the Managing Authority to re-invest them in future projects.

1 Introduction

This task is entrusted to us at a crucial time for the preparation of the transition to the next programming period (2014-2020). Financial Instruments (FIs) should play a more important role in urban renewal projects and sustainable urban development.

The objective of this evaluation is to analyse in detail the potential for development of FIs supporting urban development in Lorraine and the establishment and implementation of the Urban Development Fund (UDF). It is also to support the design process and selection of Financial Instruments covering the next programming period to meet the needs identified in Lorraine. This should enable management authorities and administrators to better implement FIs, thanks to the definition of an investment strategy and the preparation of documents for the next programming period.

In this context and according to the specifications, this study must meet the following four main objectives:

- **Objective 1: Analysis of the general conditions required for implementing Financial Instruments.** This is to analyse the demand and supply of the market, while conducting a detailed analysis of the current Operational Programme in Lorraine;
- **Objective 2: Analysis of implementation options and case studies.** Objective 2 provides two case studies to highlight the advantages and disadvantages of a Financial Instrument;
- **Objective 3: Definition of investment strategies for Financial Instruments.** We propose a structure for one or more revolving funds, for which the interest of having a fund of funds or not, the role of the fund of funds manager and the UDF will be clarified;
- **Goal 4: Implementation procedures and action plan for the Lorraine region.** It encompasses the development of recommendations to ensure the effective implementation of the agreed strategy associated with an action plan.

For this study, we rely on the results of the similar studies of the Nord-Pas-de-Calais region and the Ile-de-France, as well as the findings of other studies related to assessment of JESSICA and UDF. We also take into consideration the horizontal studies, such as the study on evaluation methodologies of social and economic performance of JESSICA projects. Furthermore, we are closely monitoring any updates on the cohesion policy 2014-2020 on FIs that will guide the definition of the Operational Programme (OP) for the new programming period.

2 Context

The context analysis of urban development in Lorraine was to present the regional macro-economic framework, the existing policy and regulatory documents in terms of urban development, together with operations supported by the ERDF over the period 2007 - 2013. This work has helped to establish the framework for analyzing the supply and demand for financing urban development.

2.1 Overview of Lorraine's urban development

Situated in the North-east of France, Lorraine is a region with **moderate wealth** that has experienced a deindustrialisation of its economy during the past several years. Indeed, the regional territory concentrates many industrial, military and hospital wastelands whose conversion is still incomplete and represents both opportunities and challenges for regional development. The regional economy remains undiversified with industry still significant and tertiary activities still underdeveloped compared to the national average. The detailed presentation of the situation of urban development in Lorraine in Appendix A, list these main elements:

Figure 1: Carte de situation de la Lorraine



The growth of the population is below the national average (negative net migration slightly offset by the natural balance). The population is concentrated in **urban centres located on the north-south axis and in the east of the Moselle**. Changes in population in the last decade show a decline in the number of residents in the periphery of the region, especially on the western half of the Meuse and the Vosges, east of the Meurthe-et-Moselle, and the south of the Moselle.

Lorraine, like other French regions, faces a strong trend of both suburbanisation and peri-urbanisation, thus contributing to the emergence of an urban linear densification from Nancy to Thionville, and near the border with Luxembourg. Beyond its impact on the environment and social diversity, suburbanisation, peri-urbanisation and urban sprawl have implications for the organisation of territories. Major urban centres concentrate a growing share of economic activity, creating dynamic movement around them. The Sillon Lorrain, a network of cities gathering Metz, Nancy, Thionville, and Epinal, faces these issues of territorial development.

Urban centres located in the east such as Sarrebourg, Forbach, and Sarreguemines in Moselle-Est have their own interactions with Alsace or Germany. Small towns close to the Champagne-Ardenne and Franche-Comté are heavily dependent on public sector employment (Meuse, western and southern Vosges), and are experiencing some economic demographic loss compared to the metropolitan growth in the major cities on the Sillon axe.

Lorraine is a major producer and consumer of energy due to its industrial production activities, transportation and housing, and thus contributes significantly to greenhouse gas emissions. Urban areas face significant energy challenges, in particular because of the low energy efficiency of the buildings, and the use of private cars instead of public transport as the means for daily commuting.

The consequences of the current economic climate are already visible on urban development in Lorraine (e.g. sharp decline in home sales compared to a growing supply of housing, increased difficulty in attracting private investors including at Sillon Lorrain). This situation exacerbates the challenges of the Lorraine region, notably the attractiveness of the region, the process of de-industrialisation, sub-regional competition between territories for the creation of economic activities and efforts to attract a growing population. Moreover, estimates of the European Commission regarding the typology of European regions for Cohesion Policy 2014-2020 led to classify the Lorraine in the category of transition regions, confirming the current development challenges in the region¹.

In addition to the current decision-making bodies in the region, the **Lorraine institutional framework** for urban development is characterised by the presence of a public institution for development (EPA Alzette-Belval), one urban community (more than 450 000), a metropolitan centre (the Sillon Lorrain), a particularly active public land institution in view of the steel and industrial past of Lorraine (EPFL), and a European Grouping of Territorial Cooperation (EGTC "Great region"). Tools for urban development are mainly concentrated on the north-south axis, while the medium-sized cities outside this axis are not equipped with instruments of governance. A more detailed description of the institutional framework and governance of urban development in Lorraine is presented in Appendix B.

2.2 Policy and regulatory documents related to urban development in Lorraine

Policy and regulatory documents related to urban development in Lorraine should be considered for the implementation of a Financial Instrument UDF-type, including the following:

- Assessing their relevance to the definition of the investment strategy of a Financial Instrument such as the UDF;
- Recognise the level of integration of urban development projects in Lorraine.

In Lorraine, like in other French regions, the regulatory and policy framework of urban planning is characterised by a superposition of interrelated documents, corresponding to various geographical areas. An analysis of these documents was conducted as part of this study and is presented in detail in Appendix C of this report.

In the absence of a regional planning and land development scheme (SRADT), Lorraine does not have a document that defines a regional policy on integrated urban development. However, existing policy and urban planning documents, although not aligned (geographic scope, priorities ...), are a **useful basis for identifying the main urban development trends in Lorraine**.

Common themes have been identified from these documents and should be considered in the definition of investment strategies for UDFs and/or holding funds. These common themes are:

- The challenge of dealing with suburbanisation and general urban sprawl;
- Urban development driven by mobility concerns and centred around transportation corridors;
- Converting neglected military and industrial brownfields as a driver of economic development;
- The growing importance of the relative attractiveness of property in Lorraine, especially along the Luxembourg border;
- A commitment to ensure balanced regional development between areas of high concentration (Sillon Lorraine and Moselle East) and the rest of the Lorraine region.

¹ Transition regions are NUTS 2 regions whose GDP per capita is between 75% and 90% of the average GDP of the EU at 27.

Moreover, **preparatory works for the 2014-2020 programming on policy cohesion** are an opportunity for a joint reflection between public actors in Lorraine. In this context, diagnostic elements confirming this analysis were presented to DATAR by the Prefecture of the Region and the Regional Council of Lorraine. These elements should be considered in the definition of an investment strategy of a dedicated Financial Instrument for urban development in Lorraine.

The available strategic documents are broad enough to allow for the definition of an investment strategy that meets the needs of the market.

2.3 Review of the ERDF Operational Programme 2007-2013

The European Commission approved an Operational Programme (hereinafter OP) for the Lorraine region for the period 2007 to 2013, on 7 August 2007. This OP has a total budget of approximately € 1.1 billion, including a total of € 329,406,415 from the European Regional Development Fund (ERDF). It is divided into six areas, five of which refer to issues and challenges related to urban development.

Table 1: Operational Programme Budget - 2007-2013

Axis of the Operational Programme	EU intervention rate	Budget €	Committed €*
A - Develop innovation, research, competitiveness and information technology and communication	32.5%	156,750,000	90,555,279
B - Promote sustainable development and the fight against the greenhouse effect	40.0%	70,100,000	46,066,339
C – Support urban policy	45.0%	24,000,000	10,486,341
<i>C.1 - Improve the quality of life in deprived neighbourhoods</i>		<i>18,500,000</i>	<i>10,486,341</i>
<i>C.2 - Develop an urban planning strategy for the treatment of urban wasteland</i>		<i>5,500,00</i>	<i>0</i>
D - Support of the major challenges for the development of Lorraine	45.5%	55,996,415	45,390,112
E - Interregional Programme Vosges	38.5%	10,870,000	6,770,784
F – Technical Assistance	50.0%	11,690,000	12,673,400**
Total ERDF	37.2%	329,406,415	211,942,255

Source: Préfecture of Lorraine * As at 01/09/2012 ** As at 31/12/2011

The data presented above reflect the revision of the OP, which took place at the beginning of programming.

Axis C – Supporting urban policy

Axis C aims to "support the policy developed by the city administration" (equivalent to 4.5% of the total investment which equates to € 24 million).

The overall objective of Axis C is to develop the economy, reduce social exclusion and address environmental issues in order to contribute to sustainable urban development. The goal is not to finance heavy urban rehabilitation operations, but to improve living conditions in poor neighbourhoods and develop a strategy for regional development on brownfield sites. It usually aims at the development of economic activities, the efficient management of energy, the development of services for the population and environmental rehabilitation.

Other areas related to urban development

Other axes of OP (A, B, D and E) are also linked to urban challenges particularly in the following areas: innovation, development of public transport and promoting sustainable development.

Axis A, "Developing innovation, research, competitiveness, and information technology and communication" is aimed at developing clusters and new areas of research and development (R & D), and includes ways to improve technology transfer and diffusion of innovation. All of these goals involve the development and management of urban areas.

Axis B, "Promoting sustainable development and the fight against the greenhouse effect" also discusses urban development, particularly in the action sheets B-11 (Energy Efficiency and Renewable Energy) and B-32 (Development of urban public transport).

Urban development projects are also included in Axis D "Supporting a major challenge for the development of Lorraine." Indeed, this theme aims to support the development of border areas. The Lorraine region, the only French region that borders with three countries, is part of the Greater Region (border initiative between the Lorraine region, the Grand Duchy of Luxembourg, the Walloon Region of Belgium and the states of Saarland and Rhineland-Palatinate, Germany). As a result, **Lorraine's** urban areas are strongly interconnected with the neighbouring towns of the bordering countries.

The Inter-ministerial Planning and Development Planning Committee (CIADT) has approved two projects for the creation and development of border towns in Lorraine:

- Alzette-Belval in 2015 (covered by Action fiche D-31);
- Saarbrücken-Moselle-Est (covered by Action fiche D-32).

These measures complement the assistance of the "Greater Region" border programme (INTERREG IV A) for 2007-2013, in which € 27 million in ERDF were attributed for Axis 2, "*Espace*". This includes the measure 2.1 "Support the land development policy" for which € 5,532,218 have already been scheduled for this measure².

In northern Lorraine the former coalfields district has experienced a profound upheaval due to the after-effects of mining and the decline of this industry. The former textile-based Vosges valleys face similar problems of reconversion. The action fiche D-12 "pursue the treatment of urbanised zones of l'Après-Mines and former Vosges valleys textile areas" and D-13 "pursue the reduction of constraints linked to the discontinuation of mining, steel and textile activities" outline a development and redevelopment policy that embrace all aspects of the **conversion of industrial areas**: urban renewal, sanitation, protection of degraded aquatic habitats, land management, and treatment of wasteland.

Finally, the axis E "*Interregional Programme for the Vosges*" involves the development of tourist accommodation capacity (measure E.1), improving the operation of land (measure E.4) and optimisation of public transport (measure E.5) in the Massif des Vosges.

It should be noted that the managing authority³ of the ERDF OP is not related to any European programmes related to urban development (such as the URBAN initiative for the period 2000-2006) and that examples projects co-financed by the ERDF under the OP 2007-2013 are detailed in Appendix D.

² <http://www.interreg-4agr.eu/fr/projet-tableau.php>

³ The managing authority is responsible for the efficiency and the regularity of the management together with the implementation of operations financed by the ERDF. In the Lorraine region, the Préfet of the region is the managing authority of the Operational Program ERDF 2007-2013.

CONCLUSION

The Lorraine region, with moderate wealth and a negative net migration, was marked by a strong de-industrialisation of the economy in recent years (industrial and military sites), resulting in the economic weakening of certain cities, social problems concentrated in certain territories (USOC) and a potential urbanisation marked by brownfields, or military hospital. This has generated many conversion projects that are in progress or planned.

A considerable disparity between population densities is found between rural and urban areas: a strong north-south axis, an orientation towards Luxembourg (growing) and also a more limited shift towards the German border.

In terms of urban development, Lorraine must address the issues related to suburbanisation and mobility, and consider the conversion of military and industrial wasteland as the engine of economic development. This will ensure a balanced territorial development between areas of high concentration (Sillon Lorraine and Moselle East) and the rest of the Lorraine region.

In Lorraine, about **20% of ERDF funds** (totalling **€ 329 million**) are dedicated to urban development (overall budget = **€ 57 million**, of which **€ 37 million** has been committed, **€ 14 million** has been disbursed)⁴ with no experience in dedicated urban development Financial Instruments. To date, the payout is limited to 25% of the model. Projects on urban development are mainly recorded in the axis C "Supporting urban policy", which focused on the CUGN and Metz Métropole. However, other measures supported under the axes A, B, D and E are related to urban development, such as B11-Energy Efficiency and Renewable Energy and Energy Efficiency-B14.

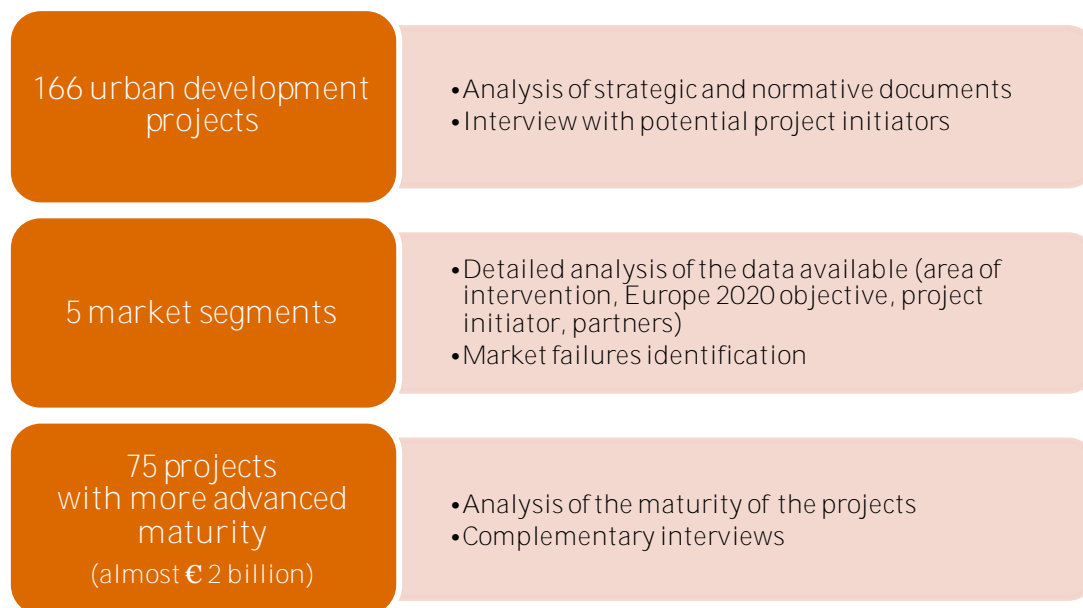
⁴ The urban development is principally covered by Axis C « Supporting urban policy» and deux measures of Axis B « Promote the **development of fight against greenhouse gas**” (B11-Energy efficiency and renewable energy, and B14-Energy efficiency).

3 *Analysis of the current situation of financing urban development in Lorraine*

3.1 *Demand analysis for financing urban development in Lorraine: identification of projects and market segments*

The main steps of the demand analysis and the main results are presented in the figure below:

Figure 2: Main steps and principal results of the demand analysis



To analyse the type, size and characteristics of urban development projects underway or planned on the Lorraine area, we collected a first set of information on the basis of strategic and urban planning documents.

The identification of urban development projects was then completed through a series of interviews with: local authorities, public bodies and private investors in major cities and inter-communal urban area, decentralised state services, semi-public companies, urban planning agencies, public and private financial institutions and private investors. The list of key stakeholders is presented in Appendix F.

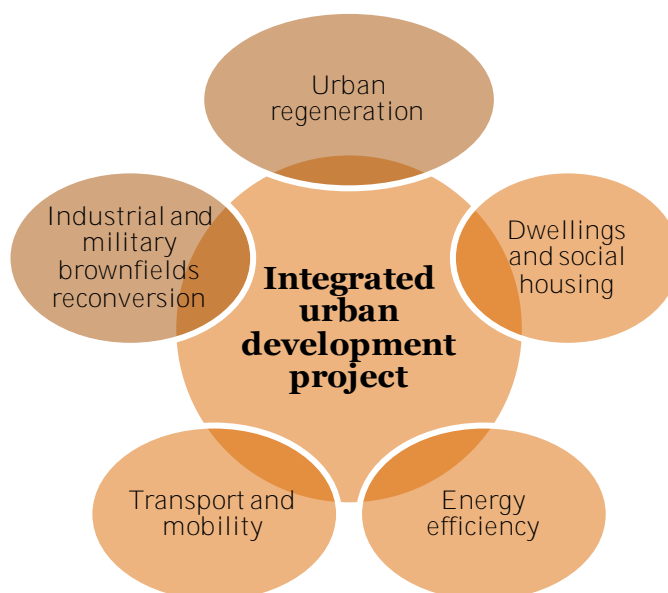
The table in Appendix H (list of urban development projects) details characteristics for the **166 identified urban development projects**: area of intervention, strategic and urban planning documents, the Europe 2020 objectives, project manager, partners, budget and maturity. These last two features were not available or were extremely unreliable for approximately half of them. Telephone contacts were made with the project leaders to clarify, if possible, the missing or inaccurate information.

The 166 projects that were identified and considered relevant for integrated urban development were then classified into five different market segments corresponding to five potential areas of intervention of a dedicated integrated urban development Financial Instrument (see following figure and tables). The integrated urban development projects take into account the economic, physical, social and environmental dimension of a city or neighbourhood. Indeed, considering all these dimensions together is likely to generate synergies that would not have been obtained if each dimension were taken in isolation.

For the remainder of the study (including developing proposals for FIs, cf. Part 6. Recommendations on investment strategies for a dedicated FI for urban development in Lorraine), we chose projects with certain level of maturity for which a first financial estimate was available, which account for 75 projects approximately.

Market segments identified are presented below:

Figure 3: Definition of the market segments related to urban development



The analysis takes into consideration the following items: description (based on the identified projects), strategic coherence, geographic concentration, and the quantity and examples of projects.

URBAN REGENERATION

Market sector description

The projects included in this segment are revitalisation projects of urban neighbourhoods, in the city centre and in the peripheral urban areas:

- Creation of local business;
- Construction of office buildings;
- Business incubators;
- Economic revitalisation through urban renewal operations;
- Eco-neighbourhoods.

50 projects have been identified in this segment in Lorraine, including the following examples:

- Renovation of industrial island Ilot Island of Corsica – Tapis Vert (Street) - 21th Aviation Regiment (Boulevard), Nancy;
- ZUS Plateau Justice, Epinal;
- ZAC Amphitheatre/Centre Pompidou Metz.

Geographic Concentration

There are urban regeneration projects across the Lorraine territory. They may be situated in varied locations such as run-down parts of city centres, public spaces, commercial railway tracks, wasteland, and degraded areas on the outskirts of the city.

Strategic cohesion

- | | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <input checked="" type="checkbox"/> Lorraine 2020 <input checked="" type="checkbox"/> Territorial coherence schemes (SCOT) <input checked="" type="checkbox"/> Local Urbanism Plan (PLU) <input checked="" type="checkbox"/> Territorial Planning Directive (DTA) | <ul style="list-style-type: none"> <input checked="" type="checkbox"/> EU2020: create a resilient and inclusive economy <input checked="" type="checkbox"/> EU2020: towards a more holistic model of sustainable city development |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

HABITAT AND SOCIAL HOUSING*

Market sector description

The projects included in this segment are housing renovation or construction, particularly social housing:

- Housing construction within the development operations of lands;
- Mixed use housing projects.

41 projects have been identified in this segment in Lorraine, including the following examples:

- Improvement of individual housing (estates) and apartment blocks on the site Kaninchenberg, Forbach;
- Operations to improve housings, west of the train station, Nancy;
- Operation Verdun Avenir, Verdun.

* This market segment would in principle be eligible for ERDF (2014-2020) only on the energy efficiency aspect.

Geographic concentration

There are social housing projects throughout the Lorraine territory, either in a dedicated development zone, or in multiple development zones from an integrated urban development project.

Strategic Cohesion

- | | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <input checked="" type="checkbox"/> Lorraine 2020 <input checked="" type="checkbox"/> Territorial coherence schemes (SCOT) <input checked="" type="checkbox"/> Local Urbanism Plan (PLU) <input checked="" type="checkbox"/> Territorial Planning Directive (DTA) | <ul style="list-style-type: none"> <input checked="" type="checkbox"/> EU 2020: the plural city, attractive location and social cohesion |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------|

ENERGY EFFICIENCY

Market sector description

The projects included in this segment are infrastructure or construction projects⁵ introducing energy saving technologies:

- Energy efficiency improvement of housing;
- Energy efficiency improvement of public buildings;
- Large scale cogeneration (industrial installation, electro thermal facilities, etc.), and small scale (in residential homes, micro-cogeneration can be a source of heat and electricity);

⁵ This analysis excludes the projects situated in rural zones

- Energy conversion from biomass (including waste recycling);
- Illumination (energy performance of public lighting, sports lighting, traffic lights, lighting for the festive period, etc.);

41 projects have been identified in this segment in Lorraine, including the following examples:

- Energy Renovation of 200,000 units, Region Lorraine;
- Network biomass heat and CHP Epinal;
- Installation of a fuel cell based cogeneration technology for 56 public housing units, Sarreguemines.

Geographic concentration

There are energy efficiency projects throughout the Lorraine territory mainly involving retro-fitting housing and public buildings. These projects are often located where there is residential development.

Strategic coherence

- Lorraine 2020
- Territorial coherence schemes (SCOT)
- Local Urbanism Plan (PLU)
- Territorial Planning Directive (DTA)

- EU2020: a green city, a better place to live

TRANSPORT AND MOBILITY

Market sector description

The projects included in this segment are transport and urban mobility projects, or integrated urban development including a component of transport and mobility projects:

- Intercity connections, urban bypass;
- Urban Roads;
- Infrastructures for soft mobility, transport;
- Improvement of urban spaces in proximity to train stations.

51 projects have been identified in this segment in Lorraine, including the following examples:

- Transformation of the Louvigny train for the development of high-speed rail freight;
- METTIS project, Metz;
- Infrastructure development for electric vehicles, Region Lorraine.

Geographic concentration

There are transport and mobility projects related to urban development across the Lorraine territory. These projects are located in urban areas, or specifically in the areas in proximity to train stations. The rail and road connection projects between sub-regional urban centres also contribute to the development of urban areas and can sometimes be integrated into broader development projects.

Strategic coherence

- Lorraine 2020
- Territorial coherence schemes (SCOT)
- Local Urbanism Plan (PLU)
- Territorial Planning Directive (DTA)

- EU2020: a green city, a better place to live
- EU2020: a polycentric urban Europe characterised by a balanced territorial development

RECONVERSION OF INDUSTRIAL, HOSPITAL AND MILITARY BROWNFIELDS

Market sector description

Lorraine has an array of land which could be classified as industrial and military wastelands. The characteristics of these wastelands determine the management of the conversion projects: property of the military, demolition and sanitisation, specific regulations, etc. These projects may give rise to real integrated urban development projects according to their geographic location: housing, economic activities, residential economy, sports/culture/recreation, etc.

21 projects have been identified in this segment in Lorraine, including the following examples:

- Air Force Base 128 Metz-Frescaty, Marly and Augny;
- Recreation area on the current location of a settling basin and the central career;
- Reclaiming the former steel site ETILAM (Arcelor Mittal), Thionville.

Geographic concentration

There are conversion projects of military and industrial wasteland across the Lorraine territory, and to a lesser extent in the department of Meuse. The location of these wastelands is directly linked to the history of the region, its industrial decline and to redesign the military map. Brownfields are often located close to city centres and main communication routes, which presents opportunities for the development of new urban areas.

Strategic coherence

- Lorraine 2020
- Territorial coherence schemes (SCOT)
- Local Urbanism Plan (PLU)
- Territorial Planning Directive (DTA)

- Europe 2020: A polycentric urban Europe characterised by a balanced territorial development
- 2020: Towards a holistic model of sustainable city development

3.2 Identification of market failures

Definition

Projects funded by a UDF fall within the definition of market failures (projects with low profitability).

Definition

"Market failures" correspond to projects with low return on investment, insufficient to attract private investors. These projects require additional funding to attract private investment.

- A UDF-type Financial Instrument revolves around the concept of the "recycling" of allocated funds ("revolving" effect) and is an alternative to grants: funds invested in a UDF must be used so that they are self-sustaining, without directly competing with the private market on their investment areas, but rather act in a complementary manner;
- These projects are required to make a profitable position or at least be "viable" (even at a very low level) in their business plan. The UDF is not intended to fund projects which a priori would not generate enough revenues to cover their investments; these projects would instead be funded by grants. The UDF focuses on projects releasing a limited return on investment, which attracts little or no private investors;
- The lack of interest of private investors in the Lorraine or the lack of culture in relation to FIs accentuates the difficulties in financing projects subject to market failures.

Market failures related to urban development in Lorraine

Prior to the presentation of these market failures, it should be noted that it was very difficult to obtain quantitative data on the projects. These projects cover the period 2014-2020 and the lack of quantitative data can be explained by the limited level of maturity of these projects and the difficulty of establishing a business plan to stakeholders. The presentation of the market failures is qualitative.

The difficulties and the specific investment needs of the Lorraine market are the following:

- **Mitigate the low attractiveness of the territories by a signal effect and risk sharing:**
 - Through various interviews conducted as part of this study, it is clear that the main criteria for investment for the private actors are based on the **geographical location of the projects**, regardless of the industry. Indeed, given the macroeconomic data of Lorraine (cf. 2.1 Overview of the situation of urban development in Lorraine), investors are very selective about the geographical location of projects: the situation is most acute outside the main dynamic urban areas in the region, but there are also difficulties within the Sillon Lorrain corridor;
 - In this context, the contribution of a UDF would be a strong signal to the private investors in reassuring the market by risk sharing;
 - Moreover, increasing the attractiveness of regions in Lorraine is linked to transportation projects and mobility. These projects lead to high investments.

- **Reduce project costs and improve financial returns through financial participation in capital or long-term debt**

Two types of projects can be cited as an example in the Lorraine area:

- Energy efficiency:

Projects related to energy efficiency are subject to significant regulatory constraints resulting in an increased cost for the implementation of urban development projects. Thus, real estate developers are faced with higher costs of intervention for all types of buildings (cost of materials and cost of implementation) and must maintain sales prices consistent with the real estate market in Lorraine.

With regards to energy renovation for housing, the need for funding is rather a need for long-term debt, which is not available on the market today.

As stated in the definition of market segments, energy efficiency also covers the areas of transportation (motorised transport), urban infrastructure (e.g. energy performance of public lighting), cogeneration and biomass.

- Brownfields, military and hospital wastelands:

The current and future military and industrial wastelands may generate real integrated urban development projects depending on their geographic location: housing, economic activities, residential economy, sports/culture/recreation, etc. These projects are characterised by high investments including cleanup costs and specific structures (e.g. land piggybacking by EPFL during the pre-planning and cleanup activities), according to many interested parties that were consulted. These projects would require an adapted, specific funding, which can be optimised by using a UDF.

- **Improve financial profitability through better project design**

The projects included in the "urban regeneration" segment (creation of local business, building office buildings, nurseries and incubators, economic revitalisation through urban renewal operations, eco-districts) sometimes require a customised project structuring to attract private investors.

For example, in the same geographical location, allocated areas for handcrafts and SMEs do not appear to attract private investors, who prefer larger commercial areas. Planning for a mix of activities on a site (hypermarkets and supermarkets, franchised stores, crafts and SMEs) permits the reduction of market failure in terms of attractiveness to private investors. Similarly, some equipment for sports, culture, and leisure are not of interest for the private sector (projects funded mainly by government subsidies). However, private participation can be considered if the supply of equipment services can be expanded, a business demonstrating a return on investment is prepared, even a low return.

The implementation of technical assistance in setting up the projects may allow some projects to reach the grey area. This could generate a leverage that can mobilise private investors on integrated urban development projects that are traditionally funded by public funds without generating return on investment for the government.

The market segments identified above are all potentially subject to market failures and the vast majority of the projects identified are located in grey area. Indeed, the current macro-economic situation of the Lorraine causes a general slowdown in private investment in the whole region.

3.3 Analysis of the financial operators proposals for the urban development in Lorraine

The two main financial actors in the field of urban renewal are shown below: public contributors (source of national co-financing) and private actors. This information was collected through a literature search, supplemented by individual interviews with key stakeholders.

3.3.1 Sources of public de co-financing

In Lorraine, **investors of general interest** such as the *Établissement Public National d'Aménagement et de Restructuration des Espaces Commerciaux et Artisanaux* (EPARECA) and the *Caisse des Dépôts et Consignations* (CDC), invest more or less in the long term grey areas in the context of urban renewal policies. Their role is located at the crossover between the public and private sectors.

Caisse des Dépôts et Consignation (CDC)

Regarding the **CDC**, its policy as an investor of general interest has been defined in a doctrine presented to its Supervisory Board. The Regional Directorate of the CDC Lorraine has the following duties:

- **Investor** in projects of public interest in favour of territorial development, in response to public demand, and the benefit of SMEs;
- **Lender** in social housing and local authorities;
- **Escrow**. Trustee activity for the management of funds entrusted by the State: retirement arrangement for civil servants, **notaries' accounts**, major loan, private equity, venture capital, management of European funds (ESF), funds for urban renewal (before the creation of the ANRU who took over this activity);
- **Engineering for public authorities** (support upstream projects, participation in the financing, qualification of a project, structuring loan or investment to get a business plan allowing other investors to intervene).

Its operating conditions are defined in the principles of intervention of the Directorate of Territorial Development and Network (DDTR).

Its actions under 2011 support the four priorities of the Strategic Plan and are detailed in the table below:

- SMEs;
- Housing and the city;
- Tertiary (university) sector and the knowledge based economy;
- Environment and sustainable development.

Table 2: Actions of the CDC Group in Lorraine in 2011

Strategic priority	Key corresponding actions of the Regional Directorate of Lorraine
Housing/City	<ul style="list-style-type: none"> • Loans form savings deposits for the development of social housing (e.g. Behren-lès-Forbach, Haye plateau, Nancy) and medico-social institutions, and financing of major local authority projects (e.g.: Clinic St. Elizabeth): € 350 million per year;

Strategic priority	Key corresponding actions of the Regional Directorate of Lorraine
	<ul style="list-style-type: none"> • Participation in the financing of a new urban shopping centre in Thionville ("La Cour des Capucins"); • Loan for Sustainable Infrastructure (network of public Transport « TCSP Mettis » de Metz, Remiremont Hospital).
SME growth	<ul style="list-style-type: none"> • SME Financing – Midsize Companies: participation in the financing of Schaeffer Building with the Lorraine Fund for Consolidation (FLC)⁶; • Funding for very small businesses (TPE)/support for social and solidarity economy: participation in the NACRE mechanism (New support for the creation and the recovery of business); • Participation in the INORI innovation platform and the structuring of the business cluster Green Valley (wood eco-construction) in Epinal.
University/knowledge economy	<ul style="list-style-type: none"> • Co-financing of the property implementation scheme of the University of Lorraine.
Environment /sustainable development	<ul style="list-style-type: none"> • Investment in the power plant of Metz.

Source: Highlights 2011 of the CDC Group in the Lorraine Region, CDC website

CDC plays a prominent role with local authorities in **project engineering**. Indeed, local authorities need engineering support to help them set goals, organise their projects and formalise business plans. CDC provides this support on numerous occasions without systematically being involved in the projects as an investor.

Etablissement National d'Aménagement et de Restructuration des Espaces Commerciaux et Artisanaux (EPARECA)

EPARECA is a state-controlled entity of an industrial and commercial nature in charge of revitalising the local economy in priority areas where the market "failed", or when there is no buyer or tenant for business premises. It acts as developer and investor for these commercial projects, after referral by the community and confirmation from its Board of Directors. EPARECA sets up the project, achieves the rehabilitation or reconstruction of the mall or the craft centre, runs its operations and then resells it to private investors after 3-5 years of operation. In France since the year 2000, 289 requests for assistance have been issued by authorities. 99 of these resulted in an effective intervention of EPARECA. 6 centres have been sold, 18 are in their operational phase, and 19 in the rehabilitation phase.

Agence Nationale pour la Cohésion Sociale et l'Egalité des chances (Acsé)

With a budget of € 346 million for 2012, Acsé, the national agency for social cohesion and equal opportunities, engages in signing the **Contrats Urbains de Cohesion Sociale** (CUCS) contracts to promote social and territorial cohesion, prevent discrimination and violence, promote diversity and frame the civic service.

⁶ Since 2010, the CDC Enterprise has been associated with the Lorraine region and the **Institut Lorrain de Participation** (ILP) to create the **Fonds Lorrain de Consolidation** (FLC), which aims at strengthening the equity of SMEs in Lorraine, weakened by the crisis

This is the "social" part of the policy of the city that may accompany urban renewal operations. In this regard, Acisé has partnered with ANRU (see below), bound by a framework agreement clarifying the modalities of their cooperation.

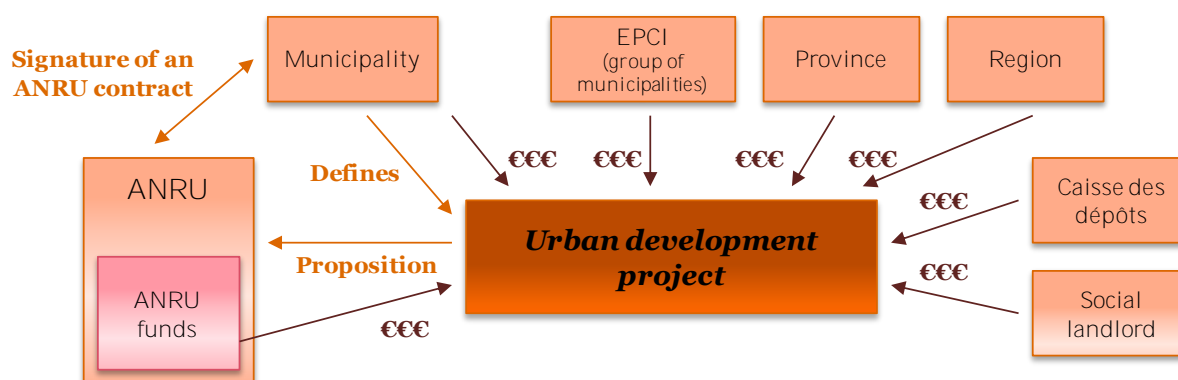
Agence nationale pour la Rénovation Urbaine (ANRU)

The National Agency for Urban Renewal (ANRU) is a public industrial and commercial establishment (EPIC) responsible for monitoring the National Urban Renewal Programme (PNRU – *Programme National de Rénovation Urbaine*). This programme, which targets Sensitive Urban Zones (ZUS – *Zones Urbaines Sensibles*) with a goal of social diversity and sustainable development, "includes urban development operations, rehabilitation, residentialisation, demolition and housing production, creation, rehabilitation and demolition of public or community facilities, reorganisation of economic and commercial spaces, or any other investment contributing to urban renewal activity." (Act No. 2003-710 of 1 August 2003 on guide land planning for cities and urban renewal).

ANRU provides financial support to local governments, public institutions and public or private organisations that conduct urban renewal projects, mainly in the housing sector. ANRU awards **grants to urban renewal projects** under its "central rate", based on the financial situation of each municipality, and defines for each of them the possible subsidy rate. These projects are developed by the mayors - or the presidents of the EPCI when the latter are responsible for urban policy (possibility offered by the Chevènement law), the Prefect of the department, and the territorial delegate of ANRU. These grants are subject to an agreement signed between the agency and different partners.

ANRU has a commitment capacity of 12 billion Euros under the PNRU and plans to renovate 530 districts by 2013. In Lorraine, PNRU projects account for 1 274 million of which 336 million are committed by ANRU⁷. ANRU also mobilises funds from the state, the *Union d'Economie Sociale du Logement* (UESL), the *Caisse des Dépôts et Consignations* (CDC) and the *Caisse de garantie du logement locatif social au titre des bailleurs sociaux* (CGLSS). ANRU has a potential investment capacity of more than € 40 billion, of which nearly 37% of loans from the CDC savings fund. Additional contributions from the region, department, inter-commune authorities, communes and donors can be considered.

Figure 4: Diagram of the ANRU to finance urban renewal projects



Etablissement Public Foncier de Lorraine (EPFL)

The *Etablissement Public Foncier de Lorraine* (EPFL) was preceded by the *Etablissement Public de la Métropole Lorraine* (EPML). The function of the EPML gradually extended from 1973 to 2001: the EPML consisted of land reserves for the expansion of urban Lorraine, and then it became a land tool supporting the projects in the Contract Plan in the Lorraine region.

⁷ State of the PNRU as at 19 February 2013, ANRU

This was before any conversion projects of former industrial sites affected by the crisis (from 1986) and the implementation of the Regional Support for Restructuring Defence Programme (1994). Recently, EPML, which became EPFL in 2001, has integrated sustainable land use in its priority. It always takes an active part in the rehabilitation of brownfield sites, military and urban.

According to the order of September 8, 2011 clarifying the status of EPFs, the EPFL has no authority to intervene in the development phase (now entrusted to the Local Planning and Development Authorities): it is confined to the pre-planning. Its intervention is independent of the existence of a clearly predefined project. For this reason, EPFL is rarely a holder of grants from various programmes (*Contrat de Projet Etat-Région*, ERDF OP, etc.). EPFL finances its activities through collection of the Special Tax on equipment, not exceeding € 20 per year per capita, the sales proceeds, and the grants received under the *Contrat de Projet Etat-Région*.

The preparatory phase (i.e. preparation of land, laying of infrastructure) is the riskiest: EPFL will bear the risk. Throughout the duration of the works (4-7 years), the community should ideally set up a project (e.g., equipment project, housing) so that the land can be purchased directly at the end of the preparatory works period by a developer. Otherwise, the community will buy the land in order to resell it later.

The last multi-annual programme 2007-2013 (PPI 2007-2013) of EPFL has set the following priorities for action: intensifying the conversion of degraded areas (brownfields, military and urban) and conduct a land policy **that's** tailored to support the creation of housing and the creation of land reserves. In 2011, EPFL land activities have reached € 55 million⁸. The activity of the EPFL during 2007-2013 PPI was superior to the forecasts due to strong land activity, and an active participation in the stimulus of the economy (housing off-plan). The funding for the program, initially € 358.5 million, is increased to € 547 million.

3.3.2 Private actors

Third party investors

It should be noted that the third-party investors are generally more attracted to certain economic sectors with guaranteed profitability. It is increasingly difficult to find investors seeking to engage on segment that are in gray areas. Arbitration decisions (invest or sell) are always based on an analysis of the risk/return relationship.

Investment in gray areas is by definition unattractive to private investors who are looking for great return on investment and the stability of assets. In addition, the current situation encourages investors to opt for a strategy to stabilise and optimise the investments already made.

One of the concerns of the private investors in the Lorraine region is related to the multiplicity of the business areas and the socio-economic context of the region. Investors are primarily interested in returns on their existing properties (asset management) before considering new projects, let alone in difficult areas. This concern could be extended to the housing sector in the new period 2014-2020, given the large number of housing projects to come.

Property developers

The role of property developers is to bear the cost (capital and bridging loans) and take a risk on the construction (as well as the ten-year guarantee).

The promoter is not intended to bear the investment; he sells the property to an investor when the work is completed, or as the work progresses in the event of a VEFA sale, sale before completion. The investment horizon of a real estate developer is generally limited to 24 to 36 months.

⁸ <http://www.epfl.fr/Menu%20EPFL/IndexMoyensvert.php>

The developer can also take part in the marketing of a portion of the goods and sometimes even offer a limited guarantee on the marketing of the property and therefore the rents. Their intervention is governed via a property development contract signed with a SCI (*Société Civile d'Investissement*), which bears the investment in the medium or long term.

Banks and other financial institutions

Banks and other financial institutions are typically players who ensure strict compliance with the forecasted profitability of the projects, or at least to the overall profitability of the project portfolio. Their participation may consist of short or long term loans depending on risk profiles and/or equity financing through a stake in the partnership. They provide long-term financing and require funded ratios (share of capital in relation to bank debt), even higher depending on the risk of the project. Banks present in Lorraine in the field of urban development are the usual players such as Caisse d'Epargne, Banque Populaire Lorraine Champagne-Societe Generale, CIC, Credit Cooperative, Credit Agricole, European Investment Bank, Crédit Mutuel, BNP Real Estate. However, very few of these institutions have a heritage policy and/or related to urban development dedicated to the Lorraine region. They operate mainly through the granting of loans by an opportunistic approach and the majority of these establishments have no significant experience in financial engineering dedicated to urban development.

Current funding situation of urban development in Lorraine

Interviews with the actors in Lorraine, complemented by an analysis of policy and regulatory documents on urban development confirm the existence of a significant number of urban development projects. Of these, military and hospital brownfield conversion represent major implications for the urbanisation of Lorraine. Some of these projects will occur over the next twenty years (e.g. EPA Alzette-Belval).

This market is characterised by a limited attractiveness of private investors, resulting in a strong need for government support. The level of maturity of these projects is disparate (to note the difficulty of obtaining business plans for the projects) and, although a number of these projects are set up in an integrated and sustainable way, the funding is not defined in an integrated manner.

Some regional players such as the CDC or EPFL have strong skills in financial engineering dedicated to urban development. However, these skills are only shared by few project leaders, as well as regional financial institutions.

Public funding for urban development was proved effective but remains insufficient to cover the identified market failures.

4 *Case study: illustration of the implementation of a Financial Instrument for urban development in Lorraine*

The purpose of these case studies is to analyse integrated urban development projects to illustrate the implications of the use of Financial Instruments such as UDF in terms of operational and financial structure and thus to evaluate the appropriateness of their implementation in Lorraine.

These projects must be potentially eligible under an urban development fund (UDF) and present a sufficient educational character and maturity to help develop a comprehensive and relevant simulation.

The projects selected and the types of analysis for each project are listed in the table below:

Project	Analysis
EPA Alzette-Belval	Structuring of the Financial Instrument
Ecoparc des Grandes Croisettes	Financial modelling
Nancy Grand Cœur	Operational arrangement and detailed financial modelling

Case studies are presented for illustrative purposes. They were selected by the Steering Committee on the basis of their interesting characteristics; however, this will not necessarily be indicative of the type of project that could be selected for a UDF financing in the future.

In addition, the selected projects are entitled to substantial financing, which is not representative of the rest of the identified portfolio, with smaller amounts of funding.

It should be noted that the eligibility of the selected projects could not be analysed. Indeed, the eligibility criteria of the cohesion policy for 2014-2020 are not yet approved, as well as the eligibility criteria under the future ERDF Operational Programme 2014-2020.

Moreover, the nature of the contribution of EU funds to a UDF is not detailed in the case studies and should be indicated, as well as the implementation or not of a Holding Fund in the project. The national contribution eligible for ERDF co-financing is not specified either. This contribution should take the form of in-kind contributions, grants or other, and should be mobilised at any time during the project in the new regulations.

4.1 *EPA Alzette-Belval*

4.1.1 *Presentation of the case study*

The *Opération d'Intérêt National* Alzette-Belval (hereinafter OIN Alzette-Belval), established as a result of the initiative of the President of the Republic in October 2009, is the French response to the question of industrial reconversion in the North of Lorraine. This concerns a border area, adjacent to Luxembourg and, and is distinguished by the presence of the cross-border conurbation Alzette-Belval. Its scope covers 5,285 hectares and 200 hectares of brownfield, and 526 hectares of urbanised (excluding the heart of the cities).

Figure 5: Localisation of the project in Lorraine



The once prosperous border area Alzette-Belval is now distanced by Luxembourg at several levels: urban planning, of which Belval (advanced stage and mature project related to the reconversion of brownfield in the south of the Grand Duchy), mobility and motorway access, employment opportunities and population growth. The development of Alzette-Belval is an opportunity for northern Lorraine to both restructure and move towards a better balance with the neighbouring territories of the Grand Duchy of Luxembourg, particularly with regard to the Esch-Belval project which is underway.

Trans-boundary aspects of the territory of Alzette-Belval are covered by the two following initiatives:

- A cross-border conurbation was established by the French communes Redange, Russange, Thil, Villerupt, Audun-le-Tiche, Ottange, Aumetz and Boulange, and the towns of Luxembourg Sanem, Esch-sur-Alzette, Mondercange and Schliffange. This cross-border agglomeration shares a common tool for governance between the local authorities of the two countries to harmonise the development of two areas: the convention of European Grouping of Territorial Cooperation (GECT) "Alzette-Belval"⁹. The EGTC "Alzette-Belval" aims to facilitate the implementation of the cooperation convention in favour of a sustainable trans-boundary development around Belval. It ensures, through consultation and dialogue a cross-border consistency across the territory, to develop a prospective vision of the territory, to initiate, to facilitate and support the projects reflecting this strategy and, in this sense, to ensure the management of the project, and enhance the overall image of the territory and its attractiveness;
- The Alzette-Belval project is also within the scope of the INTERREG programme of the European Union, related to Objective 3 European cohesion policy. INTERREG IV A Greater Region 2007-2013 financed by the ERDF aims to strengthen cross-border cooperation through the implementation of local and regional projects between operators from the territories that make up the Greater Region¹⁰.

⁹ GECT: Established by Regulation (EC) No 1082/2006 of the European Parliament and of the Council of 5 July 2006 on an European grouping of territorial cooperation, together with regulations for the operation of the Structural Funds, a GECT is a legal instrument for programs and cross-border and international projects with or without financial assistance from the European Union. A GECT can be considered as a union of transborder and international cities.

¹⁰ <http://www.interreg-4agr.eu>

The OIN Alzette-Belval has a governance tool responsible for the operational delivery of the project: **the Public Establishment of Development Alzette-Belval** (hereinafter EPA Alzette-Belval) created by decree in Council of State on 6 March 2012. This EPCI, under the authority of the State, is responsible for the support of the Regional Council of Lorraine, the Councils of Moselle and Meurthe-et-Moselle, and the Community of Communes of Haut Val d 'Alzette in their development projects, urban renewal and economic development.

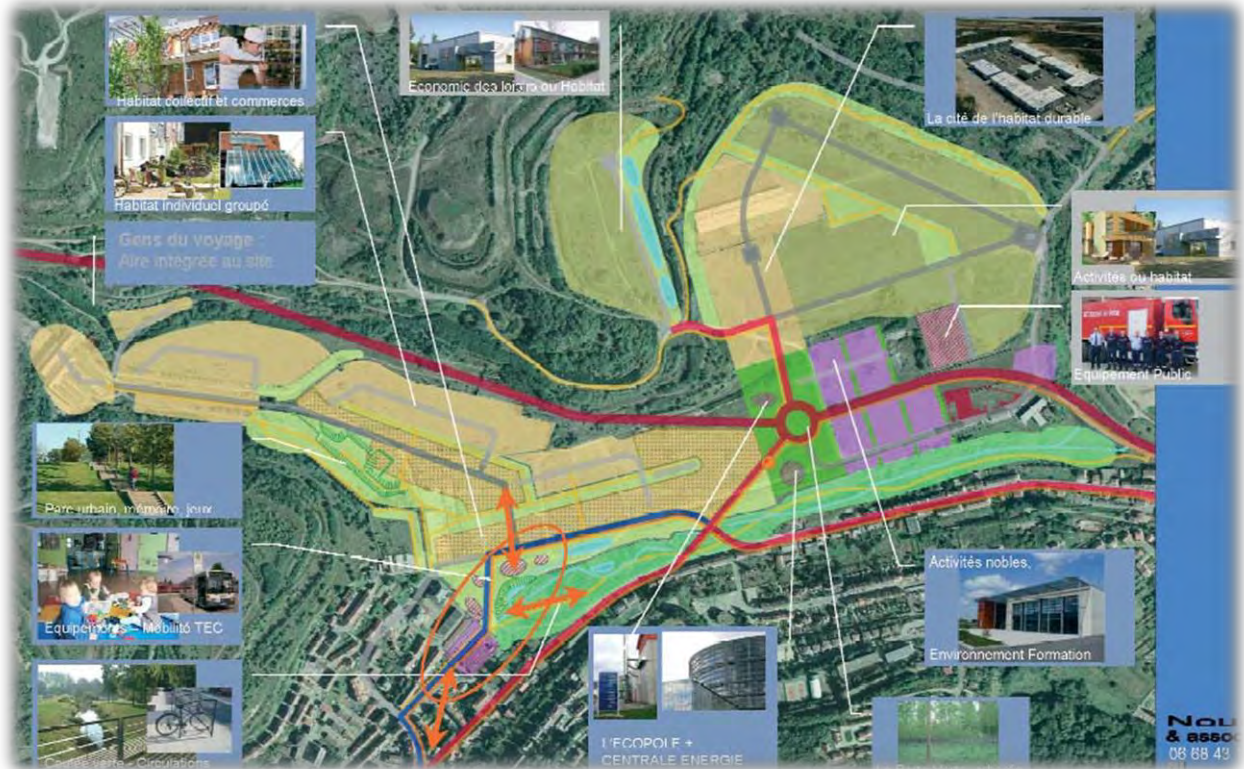
The EPA Alzette-Belval project aims to respond to internal needs of the cities through the development of residential economy projects, but also seeks to achieve external appeal through mobility projects, and economic and sustainable development:

- Organisation and structure of housing supply: rehabilitation of 500 to 800 units, construction of 8,600 housing (including social housing, low-energy housing, and positive energy buildings) horizon 2032;
- Development of the residential economy: new training and cultural areas (projects under discussion: antenna of the *Ecole Nationale des Arts et Metiers*, professional training centre Franco-Luxembourg, border bilingual school), development of sites accessibility;
- Transport and mobility management, beyond the completion of a bypass connecting the Luxembourg motorway to A30;
- Economic development: structuring projects proposed such as data centres (central data storage) and a supercomputer, an eco-business accelerator (eco-technologies and biotechnologies), and new spaces dedicated to service activities (e.g. commercial projects around leisure and multimedia).

The project plans over 20 years the development of more than 206 hectares (activities, housing and public facilities), including 100 hectares of industrial and steel brownfields. These developments will be in accordance with the criteria of eco-city. In 2009, the Alzette-Belval project was selected as an Ecocity. The thirteen labelled cities must become pioneer cities of the sustainable cities of the 21st century. The Ecocity approach, launched in the context of sustainable city plan, had large French urban areas contribute (over 100,000 inhabitants) to offer a highly innovative approach to ambitious growth (over 30%) to accommodate 50,000 inhabitants in one generation. These projects must be exemplary on issues of cohesion and diversity.

The figure below shows some assumptions reflection of the project.

Figure 6: Synthetic chart of the EPA Alzette-Belval



4.1.2 Project analysis

Integrated character

This project has a strong all-inclusive character: it has a dedicated legal structure (EPA) and brings together urban strategies of industrial restructuring, transport and mobility, housing and energy efficiency.

On one hand, the economic development of the data centre project on the brownfield site of Micheville may generate synergies with the residential projects in these new districts, in the framework of eco-city. In this regard, the heat generated by data centres could be collected for district heating (for potentially 20,000 units) and contributes to the power distribution system of heat. The opportunity and the viability of this tool will be explored as part of future studies.

On the other hand, the Alzette-Belval project will integrate the bypass of Audun-le-Tiche (which connects to the Luxembourg motorway A 30). This bypass is intended to improve the accessibility of the region and is likely to strengthen the economic and residential attractiveness of the area.

Strategic consistency

The OIN Alzette-Belval project is mentioned in the forward-looking document of Lorraine 2020, the Territorial Planning Directive and the SCoT of Thionville for its cross-border issues and resulting urban dynamics. Moreover, it contributes in an integrated manner to the objectives of the Europe 2020 strategy, promoting sustainable urban development, the consolidation of a "resilient and inclusive economy", building a cross-border urban centre as part of an "urban polycentric Europe" and the creation of a "green city".

Maturity of the project planning of the implementation

The operational strategic plan of the EPA is being prepared and will be finalised by March 2014. Specific information with regard to the planning is not available at this time. However, a first round of **funding of € 95 million is planned for the period 2012-2017**. This first phase is the period covered by the new 2014-2020 financial programming and should include environmental cleanup, pre-planning, public infrastructure (roads, relocation of the fire station on the site planned for Micheville 2016), as well as some housing operations (retirement homes and housing for students in 2015) and economic development projects.

Expected Social and economic benefits expected

There are multiple and varied transactions that constitute the EPA Alzette-Belval project, which it is hoped will generate many diverse social and economic benefits. The strategic operational project EPA will clarify the directions and key objectives covering the following areas that have an impact on the socio-economic benefits: taxes, jobs, residential economy, economy, culture and recreation, demographics, housing, history and heritage, landscape, biodiversity, transportation, mobility, pathways and networks, etc.

An illustration in two dimensions is proposed hereafter:

- Environment:

The development of an Ecocity will, in particular, preserve and enhance the environmental aspect of new spaces. Urban design of the 206 acres of activities, housing and public facilities will be designed to preserve and enhance the natural heritage. The conversion of industrial and steel brownfield will be conducted with special attention to preserve the historical heritage of housing estates. The most energy inefficient buildings will be renovated to help the transition to a sustainable economy.

Some indicators that illustrate the socio-economic benefits associated with environmental aspects could be energy savings (MWh) and the net impact on greenhouse gas emissions (tonnes of CO₂ equivalent).

- Social diversity:

Strengthening the social mix is an expected result of the EPA Alzette-Belval project. This social diversity is partially and indirectly provided by the creation of economic activities such as the IT hub or the acceleration of innovative company in the field of eco-technologies and spaces dedicated to integrated training plan for residential development. Moreover, the quality of life of residents will be improved through social cohesion, enhanced by the interrelation of professionals, students and residents. Indicators related to the concept of territorial enrichment could be used to measure this new urban dynamics: impact of a euro invested in planning compared to the increase in household consumption and local tax revenue.

4.1.3 Description of the business plan

EPA Alzette-Belval has established a provisional business plan. All development expenditure over the period 2012-2032 is estimated at € 300 million and the estimated loss is forecasted at about € 70 million. These development projects have a very low profitability; for this reason, they receive public support, through grants from EPA¹¹ members, and proceeds from the sale of serviced land, major revenue for an EPA.

One of the assumptions is that the business plan will comprise a three-phase planning approach:

1. The *Etablissement Public Foncier de Lorraine* (EPFL) supports the pre-development of land, including, where applicable, its pollution;
2. EPA Alzette-Belval buys the land and is responsible for the development of public space (roads and utilities);
3. The land is sold to promoters or developers who are responsible for the construction and the sale of the estate.

This last phase of implementation, construction and sales, is the most profitable phase and represents a source of income. The construction is generally carried out by private companies, in the case of the Alzette-Belval area, the later should support the development of approximately 8,600 new housing, rehabilitation of 500 housing units, creation of data centres, eco business accelerator, and creation of new spaces dedicated to tertiary activities.

The amounts and sources of funding for these projects are not identified to date. Some public facilities such as the fire station will be funded solely by the public authorities.

4.1.4 Financial analysis

In agreement with the steering committee, it was decided to concentrate the financial analysis on a portion of the site in the programming period 2014-2020. The selected example is *Micheville plateforme basse Est*; this area will host a data centre and housing that meets the criteria for an eco-city.

Due to market failure, this sector has a sale value estimated at € 23.5 million, while the purchase of pre-developed land and development expenditures amounted to € 32 million, or a negative balance of € 8.5 million, which must be supported by the state. The objective of the financial package via an FI is to cover the negative balance of € 8.5 million in cash on a portion of the margin at the time of sale of the properties and activities of the sector. This is possible by sharing the risk of development with the promoter.

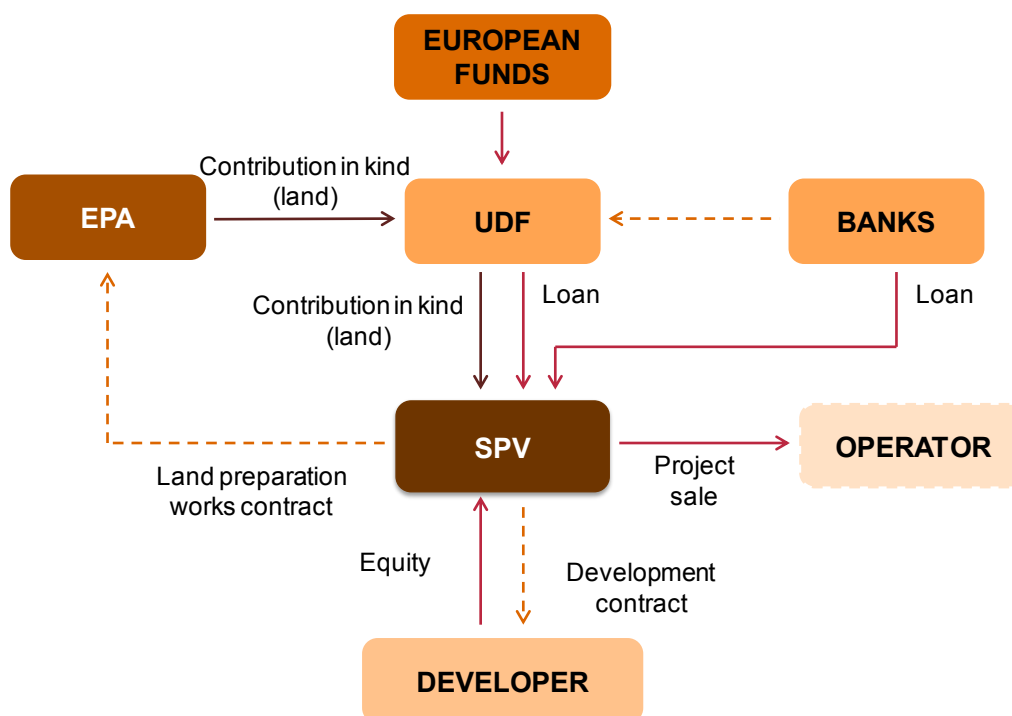
The expected revenues for the developer are exclusively the proceeds from the sale of buildings. The operating revenues for the building managers (data centre business, residential areas etc) are out of the scope of this analysis.

Structuring of the operation

We simulated the intervention of a UDF-type Financial Instrument in the case of this project. The proposed structure set out below is essentially characterised by a contribution in kind to the EPA project via the UDF.

¹¹ State, Conseil Régional de Lorraine, Conseils Généraux de Moselle et de Meurthe-et-Moselle, Communauté de Communes du Pays Haut Val d'Alzette

Figure 7: Proposed structure of the operation



The proposed UDF can catalyse public investment (ERDF, EPA ...) and potentially private (possible contribution from banks). The advantage of this investment via a UDF is to mobilise more resources than direct participation. This can be done through the creation of a partnership project between the UDF and the developer (see Chapter 5 and Appendix J for details on the possible forms of the project company).

The contribution in kind of land, and the structuring of an FI to reduce the development and financing costs for the project company can increase the performance of the project. Indeed, thanks to the FI, the developer concedes a portion of its margin to the UDF, and in return:

- Benefits a risk sharing;
- Has a reduced need in cash for the land to be bought;
- Has access to cheaper sources of funding (lower interest rates), or with longer maturity. Thanks to the important assets size of the project company and the mobilisation of ERDF resources.

It should be noted that the contribution in kind could be done directly for the benefit of the project company; but the contribution to the UDF, depending on the details of the new regulations yet to be validated, could mobilise the ERDF resources. These could be used to generate additional loans. The loan by the UDF, unlike those granted by the local banks may have more favourable conditions with less collateral or longer repayment period.

Brief overview of financial modelling

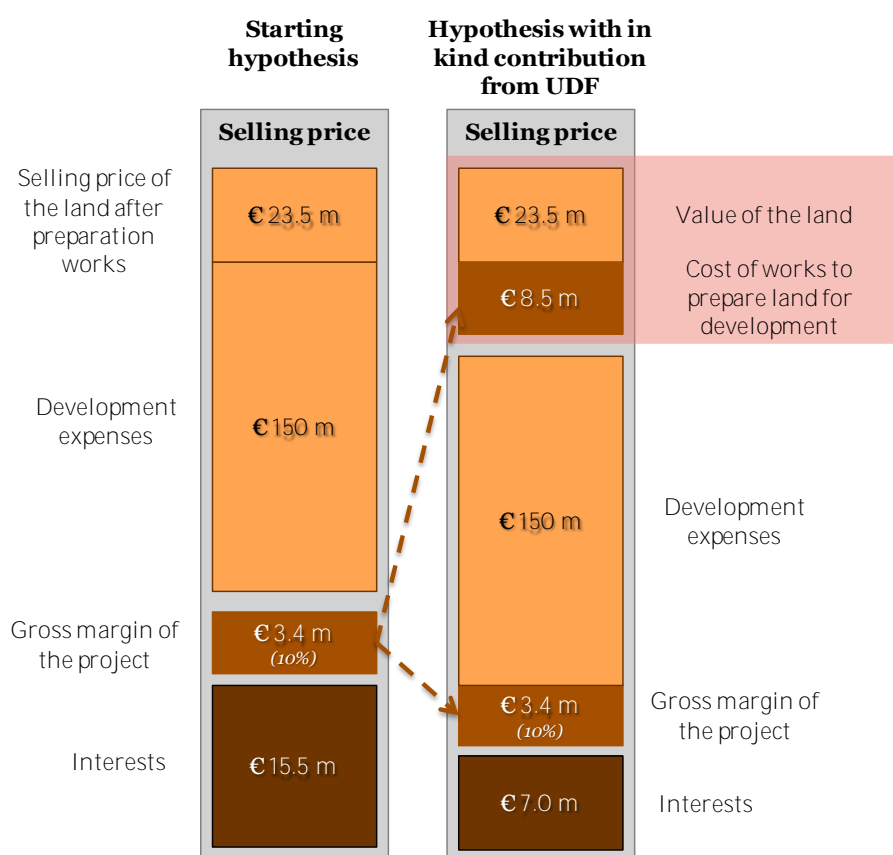
From the above proposed structure (UDF project company), we simulated the main elements of the project funding. The proposed scenario with the UDF and the project company intervention aims at covering the development costs (a total of **€ 8.5 million** negative balance) in exchange for a reduction in charges for the developer.

For this model, we make the following assumptions:

- The estimated cost of building energy class B in the eastern sector *Micheville plateforme basse Est* are € 150 million;
- With the same selling price to the ultimate purchaser, the developer could forego the additional **gross margin and accept a stable return of € 3.4 million for the reasons mentioned above. The remaining profit will be transferred to the developer (EPA) via the UDF. This is to pay the capital provided by the UDF and the part of the risk assumed. In the optimal case, the return given in exchange for the advantages of the intervention of UDF cover the negative balance of € 8.5 million, corresponding to the development costs.**

From these assumptions and the available data, the financial modelling can be represented by the following scheme:

Figure 8: Main elements of the model



An important advantage of this approach is to prevent municipalities to sell land to developers at prices below those of pre-developed land and development expenditures. The FI allows the development of an urban area without requiring or limiting state subsidies.

In our model, a decrease in the need for and better financing conditions reduces the overall volume of interest on loans from € 15.5 million to € 7 million. The strategic vision needed to launch this type of operation also reduces the risk of giving developers excessive direct and indirect subsidies and provides an opportunity for local planners to better identify the key success factors of the project (e.g. through a more detailed analysis of the application).

In addition, in its role as a participant, the UDF can direct the choice of the project company beyond the eligibility criteria and push for a best-practice standard of project performance, for instance in terms of energy efficiency. For example, the UDF and the EPA could accept a return of **€ 7 million just** to convince the developer to make an extra effort and spend in energy class A. With a stable return of **€ 3.4 million for the developer, the project would be able to generate additional socio-economic** benefits.

4.1.5 Conclusion

The main financial and non-financial advantages of a funding through a UDF-type Financial Instrument intervening in this type of project are listed below:

- The contribution of land by the EPA in the UDF capital mobilises ERDF resources;
- The "catalytic" effect of ERDF resources injected into the project as a subordinated loan enhances the prospects of the project in terms of access to bank credit and attracting investment;
- All or part of the deficit of the development operation could be covered by the gain on the sale of the property at the time of the liquidation of the UDF and thus would not be at the expense of the EPA;
- The financial benefits of the intervention can be used by the UDF to guide private investment into socially desirable outcomes, such as more environmentally friendly buildings.

4.2 *Saint-Dié-des-Vosges, Ecoparc des Grandes Croisettes*

4.2.1 *Presentation of the case study*

The development zone (ZAC) EcoParc des Grandes Croisettes in Saint-Dié des Vosges is an environmental activities park built by the *Société d'Équipement Vosgienne* (SEV) on an undeveloped site, mostly wooded, St. Die-des-Vosges. The development task has been entrusted by the Municipality of Saint-Die-des-Vosges to the SEV in December 2007 as part of a management concession.

Figure 8: Localisation of project in Lorraine



The aim is to make the Ecoparc des Grandes Croisettes a health centre of excellence that is the grouping of structures in relation to accommodation of dependent persons, and health care facilities. Other plots are intended for commercial high-tech companies and ecological habitat. This project site covers 19 hectares with four main areas:

- A **medical-social centre of excellence** with a specialised foster home and a public retirement home:
 - The specialised care facility (MAS), called "Mosaic House" is an extension of the current House of XXI Century maintained by the association Turbulence. Mosaic House is a medico-social institution capable of hosting 57 people patients suffering from serious diseases such as Alzheimer's, autism and other mentally illness. This type of specialised care facility is the latest generation of medical and social structures with optimal care for patients (two employees per resident). Moreover, the building of the Mosaic House responds to the High Environmental Quality (HQE ®);
 - The nursing home EHPAD La Chaumiere (*Établissement d'hébergement pour personnes âgées dépendantes*) will be relocated on the Ecoparc site and become the public retirement home CCAS.
- A **tertiary area** designed to accommodate high-tech companies;
- A space dedicated to **craftsmanship**;
- A **private residential area** in the form of pavilion or communal living.

The project is divided into three instalments (see figure below). The first instalment consists of the development of the medico-social area which includes specialised home care, nursing home and the implantation of an ambulance service. The second instalment is mixed and consists of the construction and the development of housing, offices and locals dedicated to crafts.

Figure 9: Site map



The whole operation meets the principles of the Urban Environmental Approach (AEU)¹ developed by the Agency for Environment and Energy Management (ADEME). This is the first AEU made in Lorraine for an activity park. The buildings must also meet the High Environmental Quality (HQE) environmental standards and residential buildings must comply with the standard BBC - 20%.

4.2.2 Project analysis

Consistency with the strategic and regulatory documents

The urban regulation of the ZAC EcoParc des Grandes Croisettes was directly included in the Local Development Plan of the city of Saint-Die-des-Vosges. In addition, this project contributes to the objectives of the Europe 2020 strategy by promoting a "sustainable urban development and environmentally," the consolidation of a "resilient and inclusive economy" and creating a "green city".

¹ The environmental approach to urban planning (AEU) is developed by ADEME to integrate environmental considerations into development projects and planning tool. EPS is a tool that takes into account the main factors affecting the quality of the relationship between the built and the environment: energy, water, waste, transport, noise, landscape, biodiversity and climate.

Integrated nature of the project

The ZAC EcoParc des Grandes Croisettes is part of an integrated approach designed for mixed-use: medico-social, technological centres, craft workshops, and residential housing. The project also combines intervention in the domains of economic development, energy efficiency, sustainable development and housing. In particular, the strategy of energy efficiency and environmental quality is complimenting the strategies for economic development and housing through sustainable building practices.

However, the funding for this development is divided by project, as managed by the SEV, the construction of the Mosaic House by “**Association Turbulences**” (a **social** organisation assisting the disabled).

Maturity of the project and planning of the implementation

In 2005, a commissioned study was initiated by the town of Saint-Die-des-Vosges in this area which was an “infill²” near the city centre. In 2007, an agreement was signed between the city and the *Société d'Équipement Vosgienne* (SEV). Concurrent with the acquisition of plots (still in progress as of today), the SEV has launched a phase of study and consultation; and an AEU study which was conducted from January 2009 to January 2010. In 2009, the group Arcadis-Environment Council-Digital Landscape was selected for the management of the EcoParc.

The development of the first instalment of the EcoParc began in April 2011. In October 2012, the specialised foster home Mosaic was inaugurated and the proposed retirement home was launched (public contracts awarded in November 2012). The construction of the second instalment of EcoParc began early in 2013. Phase 3, which is due later (about 2015-2016), will be a mixed residential area.

Expected Social and economic benefits

All the operations that are undertaken and planned on EcoParc ZAC des Grandes Croisettes generate several social and economic benefits for the local community. Some of the socio-economic benefits are listed below.

The social diversity of the project is reflected by the different types of activities hosted by the ZAC and by the various economic sectors represented (housing, medical, commercial activities, retirement homes). Indicators such as the number of people or households affected by the project could be tracked.

The creation of commercial and service activities will have a positive impact on the local economic dynamics by promoting regional development and the creation of new links with other urban areas, thanks to the presence of specialised ambulatory care in Saint-Die-des-Vosges. Typical indicators on employment would be useful to highlight the economic benefits (e.g. full-time equivalent corresponding to the implementation of the project, number of jobs created).

The socio-medical centre will provide specific services to better meet the needs of the population. The care facility Mosaic offers an innovative therapeutic approach for people with disabilities; the nursing home should provide, in addition to the traditional services of a retirement home, customised services, such as care of the elderly for very short periods (e.g. 2 hours, an afternoon) to relieve those who are in charge of the patient.

In addition, the project helps preserve and enhance the environmental quality of the area of Saint-Die-des-Vosges in respect of the principles of the Urban Environmental Approach (limited deforestation, respect the topology of places, efficient structures in terms of energy, etc.).

² In urban planning, an infill is an unbuilt area surrounded by built plots.

Indicators related to environmental aspects could be the energy savings (MWh) and the net impact on greenhouse gas emissions (tonnes of CO₂ equivalent).

4.2.3 Business plan description

Our analysis takes into account the first two phases of the ZAC des Grandes EcoParc Croisettes, especially the retirement home, the specialised foster home (MAS) and the area for tertiary activities. It was not possible for us to obtain the business plans (neither for the entire project, nor major projects). To establish a business plan corresponding to the chosen study and relevant to a UDF scope, the following assumptions or/and factors were taken into account:

- In EcoParc, the area of land designated exclusively for tertiary activities is 18,000 m² (excluding housing and crafts), which leads us to estimate a usable space of 6,000 m². Unit prices for the construction, offices for lease, and premises for commercial activities in energy class B are derived from the BKI-Kostenplanner V15 software. The revenue stream for this component of the project entails the risk because the level of effective occupation is currently only an estimate. The existence of this risk will induce relatively higher interest rates;
- The two medico-social centres have/will have a total capacity of 127 beds: the specialised foster home "Mosaic" has a capacity of 57 beds while the nursing home 70 beds on a surface of 5,775 m²:
 - Construction
On the basis of unit price and in comparison with similar projects³, the investment costs are **estimated at a total of € 20.6 million for the extension of the "Mosaic" care facility⁴, € 8.5 million for the nursing home and € 12.7 million for the tertiary sector. The total construction cost with the development works equates to € 4.4 million and expenses amount to € 42.2 million.**
 - Operation
The activities of the medico-social nursing home and the specialised care facility are very **expensive services. The total operating cost is estimated at € 17,000 per year for the first and € 87,500 per annum for the second**, and this cost is not entirely affected to the patients. The National Health Service (health insurance covering **the "Mosaic" care facility**) has an agreement to rent beds at a price including operating expenses and financial depreciation of the two structures. The fees charged to the end user will probably not cover the total costs but the national health service is considered a reliable payer. Since the insolvency risk perceived by the market is rather limited, medico-social structures are in the position to negotiate a relatively lower interest rate on a bank loan.

To facilitate the understanding of the case study, we will consider these three components together, assuming they are managed jointly by a single management company. This working hypothesis does not prejudge in any way the possibility of a UDF-type Financial Instrument to fund one component of this project independently.

According to the available information, the project would not have been launched without public subsidies. The nursing home is a wholly public investment, and the care facility was over 85% financed by the State. Funding for the project has followed the conventional assembly: maximise the grant application, and look for a commercial loan to cover the remaining financial needs. The proposed model emphasises the involvement of private funds before eventually using public aid.

³ Source : **Fédération des établissements hospitaliers et d'aide à la personne (FEAP)** – Repères de gestion et de comparaisons pour les structures sociales et médico-sociales (2011), Logiciel BKI-Kostenplanner V15

⁴ This estimate **is much higher than the actual cost of investment of around € 8 million for the Mosaic House** due to the strategic choices made in terms of construction and therapeutic approach.

4.2.4 Financial analysis

Financial modelling

In the financial modelling exercise, the revenues generated by the project, the buildings and the other structures are handled by a joint management. Such an entity is responsible for the daily running of the nursing home and the care facility. Net income generated by the lease of sites dedicated to tertiary activities is partially used to reimburse the loan over 8 years (the time horizon considered). The remaining part of the loan is reimbursed at the end of the 8 years with the selling of the economic activity.

Parameters

Time horizon	8 years
Tax rate	15%
Loan interest rate	4.50%
Weighted Average Cost of Capital	5.61%
Depreciation	30 years

The utilisation rates are modelled to achieve the full saturation of the supply after 7 years of operations. The project is expected to be sold soon after, that is following year 8.

Starting from these assumptions and relying on the data collected, we have assessed the residual value of the buildings and the economic activity.

The financing deal amounts to € 42.2 million and relies on a commercial loan covering 60% of the funding needs, which is € 25.3m. An injection of € 12.7 million of equity is expected while € 4.2 m of grants are needed to close the residual financing gap.

Figure 10: Simulation of the financial planning of the project

Loan	Grant	Equity	30%	Return on equity	-0.8%
60% (€25.3 m)	10% (€4.2 m)	30% (€12.7 m)	60%	Loan (interest rate)	4.5%
€42.2 m			10%	Public grant	-
Internal Rate of Return of the project (IRR)					2.4%
Debt Service Cover Ratio (DSCR)					1.5

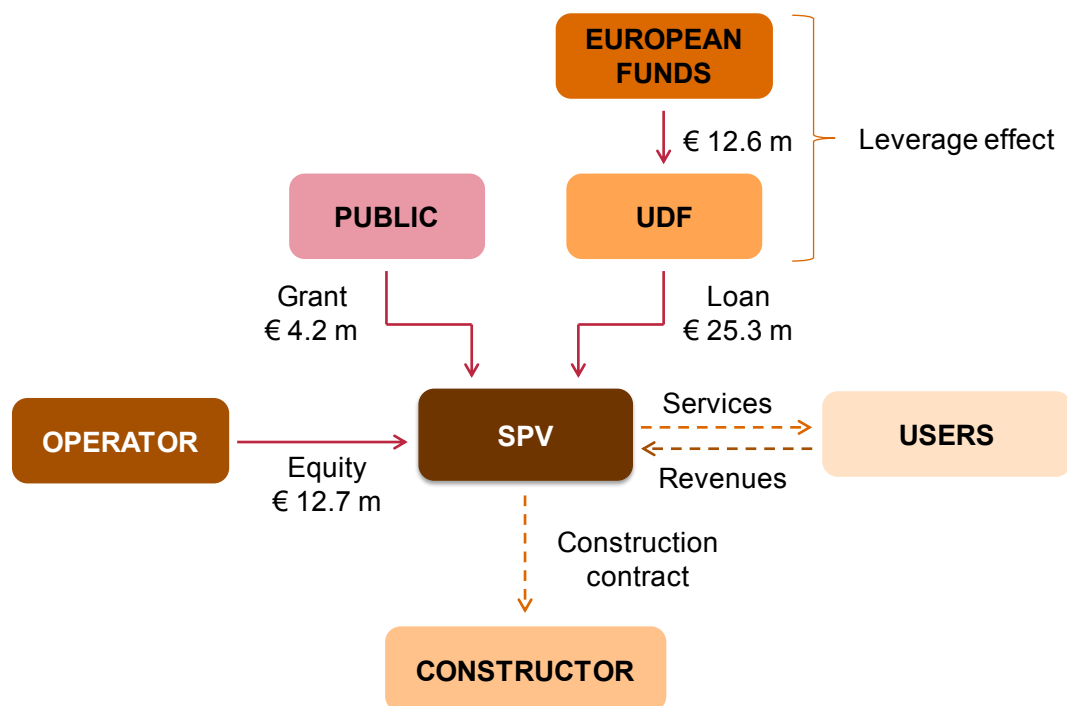
The financial terms of this structure of the deal highlight the viability limits of the project. In particular the loan interest rate set at 4.5% appears to be the maximal feasible lending costs. With this value, the internal rate of return of the project (IRR) is 2.4% and the debt service coverage ratio (DSCR) reaches 1.5. The latter, measuring the ratio between net operating incomes and the annual debt service, shows that the project generates sufficient operational margins to safely cover the annual loan instalments.

Suggested intervention approach

In our simulation, the UDF is mostly involved in the land development phase of the project rather than in the operational phase. The strategy of the FI in this scenario is to foster the economic activity with advantageous loans during its initial years of the project but it will not participate in further phases (i.e. after the selling of the activity).

A proposed structure for the operation is presented below:

Figure 11: Proposed structure of the operation



In this simple operational structure, the use of the Financial Instrument does not lead to any increase of complexity to either the project or its governance. The UDF provides a financing source but does not participate in the governance of the project.

Capital drawn for European Funds enables the UDF to grant the project a loan at favourable conditions. Such positive financial conditions transferred to the project by the UDF improve the financial performance of the project (in the form of a higher internal rate of return) and reduce the need for public grants.

The € 12.6 m granted to the UDF will mobilise a € 25.3 m commercial loan in favour of the project. The leverage effect achieved is of € 2 for every € 1 invested (i.e. 1: 2). Nevertheless, it should be verified if the conditions required to achieve such leverage effect fall or not within the definition of State aid⁵.

Financial analysis

The table below examines the impact of two variables on the deal structuring: the interest rate of the loan granted by the UDF and the share of public grant in the total finance of the project. The body of the table presents the yield of the Internal Rate of Return of the project (IRR) according to the value of these two variables. It should be noted that other variables such as the tenor of the UDF financing or the amount of collateral required could have been modified to improve the structuring of the deal. The initial case, corresponding to the simulated scenario (previous paragraph) is framed in red.

⁵ Reference rates calculated by the Commission for France have fallen in 2012 from 2.07% to 0.67% - applicable since January 2013. To these base rates the appropriate top-ups need to be added. Such rates are regularly updated and can be found on the Commission website: http://ec.europa.eu/competition/state_aid/legislation/reference_rates.html

Figure 12: Sensitivity analysis of the project IRR

		Loan interest rate (by mean of HF intervention)				
		5.5%	4.5%	3.5%	3.0%	2.0%
Grant	0.0%	-2.6%	-1.2%	0.3%	1.0%	2.4%
	2.5%	-1.7%	-0.3%	1.1%	1.8%	3.3%
	5.0%	-0.8%	0.6%	2.0%	2.7%	4.1%
	7.5%	0.1%	1.5%	2.9%	3.6%	5.0%
	10.0%	1.1%	2.4%	3.8%	4.4%	5.8%
<i>State aid issues</i>						

This sensitivity analysis of the IRR demonstrates that the intervention of the Financial Instrument enables a reduction of public grant. A strong commitment of the UDF reducing the interest rate down to 2% would allow to eliminate public grants without entailing the financial viability of the project (the rate of return is stable).

On the other hand, the provision of better financing terms must consider the issue of State aid. In particular, an interest rate of 3% is often seen as the value below which the issue of State aid must be analysed.⁶

4.2.5 Conclusions

This case study is useful to show the advantages of preparing projects with the intervention logic of an UDF-type Financial Instrument compared to the standard approach:

- Standard logic: maximise the level of grant and look for commercial loans to cover any residual funding need;
- Financial Instrument logic: optimise the intervention of private investors before eventually seeking public support.

The benefits of a UDF-type Financial Instrument intervention in this kind of projects are summarised below:

- By modifying the structure of risk of potential private investors, the UDF Financial Instrument leads to a leverage effect of 1: 2;
- Lower interest rates, smaller collaterals and a longer repayment period of the loans granted by the UDF increase the investment performance of the project and positively impact its bankability;
- The availability of funds through this public instrument triggers the initiation of the project while reducing the need for grants and producing a positive socio-economic impact for the city.

⁶ Reference rates calculated by the Commission for France have fallen in 2012 from 2.07% to 0.67% - applicable since January 2013. To these base rates the appropriate top-ups need to be added. Such rates are regularly updated and can be found on the Commission website:
http://ec.europa.eu/competition/state_aid/legislation/reference_rates.html

4.3 Nancy Grand-Cœur

4.3.1 Presentation of the case study

The "Nancy Grand Cœur" project was launched in 2007 by the *Communauté Urbaine du Grand Nancy*. It aims to further the urban development of the train station area. Because it is located in the centre of the city, it is one of the most important centres of attraction in Nancy, and is important as a place of housing, communication, and economic/commercial activity.



The development of the project was entrusted to SOLOREM, la *Société Lorraine d'Economie Mixte d'aménagement urbain*.

The different axes of the project consist of upgrading the public space and make the Nancy Grand Cœur area a neighbourhood promoting urban diversity, eco-mobility and respect for the natural and built environment. Nancy Grand Cœur has been labelled "*EcoQuartier*" by the Ministry of Ecology, Energy, Sustainable Development and the Sea in 2009. The project also aims to strengthen the strategic importance of the area Nancy Grand Cœur, strengthening its economic appeal and its status as the city's "front door."

The parcels of land included in the project were gradually acquired by the *Etablissement Public Foncier de Lorraine* (EPFL) and SOLOREM from SNCF and RFF. Among these areas, six distinct work projects can be distinguished, situated in different locations:

- Re-development of the Place Charles III and its surroundings as an urban centrepiece;
- Reorganisation of the **station forecourt's** functions, the future Place Thiers;
- Construction of the Prouvé Convention Centre and its parking lot;
- Extension of the Rue Mazagran pedestrian-only zone;
- Re-development of the site of the Synagogue, including the installation of water features;
- Development of landscaped areas along the Quai Vert.

Figure 13: Site map



Diverse urban spaces with mixed-uses will be developed within these parcels of land, comprising a total of about 180,000 m² *Surface Hors Oeuvre Nette* (SHON). Such uses include:

- The Prouvé Congress Centre
- A hotel;
- The relocation of the fire station;
- Offices and areas for activities;
- Shops and services;
- Between 600 and 700 homes.

4.3.2 Project analysis

Consistency with the strategic and regulatory documents

Because of the strategic stakes surrounding Nancy Grand Coeur, this project has been the subject of extensive prior consultation which is still in progress as of today. The project Nancy Grand Coeur is mentioned in the prospective document *Lorraine in 2020, the urban social cohesion contract of Grand Nancy, the PDU of Grand Nancy 2006-2015, the PLU of Nancy, and the local Habitat Programme of Grand Nancy*.

In particular, it contributes to the objectives of the Europe 2020 strategy promoting sustainable urban development, consolidating a "resilient and inclusive economy" and applying the concept of "green city".

Integrated nature of the project

The integrated nature of **Nancy Grand Coeur** stems from the variety of strategies that the project aims to serve, with particular importance placed on economic regeneration, liveability, increased mobility and energy efficiency.

The station district in Nancy is one of the main centres of attraction of the Greater Nancy region. Through the implementation of programmes to enhance the economic influence of the sector, the project will strengthen the strategic positioning and function of the area.

This perspective is accompanied by the ambition to create a sustainable development project that integrates all urban components, and urban mixing, essential in this strategic area.

The energy efficiency and environmental quality strategy join the economic development and habitat through the construction of energy efficient buildings, using materials with low environmental impact, advanced management of household waste and noise pollution and the organisation of "green projects" with limited pollution.

The construction of **Nancy Grand Cœur** is integrated into a wider urban outreach program for soft modes of transport. The area will benefit from two nodes mobility such as the railway station and the Place de la République. The traffic will be limited with a new traffic plan and the creation of a ring of service in the heart of the city.

Maturity of the project and implementation planning

The concession agreement to Solorem on the opening of the urbanisation process and the implementation of the development program was signed in May 2004 for a period of 10 years. The development program of the ZAC Nancy Grand Cœur includes the public infrastructure program and the methods for financing the development project. It was adopted by the Council of Urban Community in June 2009.

The master plan of the urban project, established by the AREP, has defined the structure of the impact study carried-out by ADUAN. This study was integrated in the development program of the ZAC approved in June 2009.

The EcoQuartier application was deposited with the Ministry of Ecology, Energy, Sustainable Development and Spatial Planning in March 2009. The station **Nancy Grand Cœur** was listed in the EcoQuartier prize winners in November of the same year. All parcels of land included in the project owned by SNCF and RFF will be acquired by mid-2013 by Solorem and EPFL.

Constructions of the Congress Centre and the parking are the only project in progress: the Prouvé center will host its first event in 2014. Other sectors of the ZAC are still in the planning phase. The most advanced in terms of planning sector focuses on the extension of the "**Maison des soeurs**" (Lot L - see below).

Expected Social and economic benefits

The project ZAC **Nancy Grand Cœur** meets the objective of reclaiming the spaces along the rail beam by ensuring the connection between historic and modern neighbourhoods and limiting urban sprawl. It aims to achieve three objectives: increasing the ability of the city to evolve, and its social and generational diversity.

The neighbourhood, better connected to adjacent cities, will gather in the heart of the city public facilities, housing, offices and shops and become more attractive to residents and visitors. This gathering on the same site of these activities will ensure social mix of residents, workers and visitors. On this dimension, the monitoring indicators could be the jobs created during the construction phase and operation, and the number of households/population affected by the new facilities.

The project has several socio-economic benefits linked to the increased energy efficiency of the buildings, the use of materials with low environmental impact, waste management and reduction of pollution of the sites and during the operational phase of the project. In addition, many green areas will be included in the neighbourhood: a green platform will be created along the railway line and a pond will be installed near the convention centre. The label EcoQuartier therefore ensures the creation of a framework for high-quality living and growing mobility, while ensuring high environmental quality. Some indicators that illustrate the socio-economic benefits associated with environmental aspects could be energy savings (MWh) and the net impact on greenhouse gas emissions (tonnes of CO2 equivalent).

4.3.3 Business plan description

Current structure of the project

Several actors have an active role in the business plan Nancy Grand-Cœur. CUGN and EPFL are responsible to acquire ownership of the land on the ZAC mainly belonging to the SNCF and RFF. Clean-up costs, mainly hydrocarbons, are not significant and do not represent a threat or significant risk to the overall financial operation. The management and preparation of land within the scope of the ZAC are mainly assigned to the EPFL.

CUGN and/or EPFL remain medium-term owners of the land until it is gradually transferred to the Solorem for the development of the various parcels. Solorem will buy the lands when construction projects developers have reached a sufficient level of maturity, allowing for a quick sale after development work. This reduces the cash requirements for Solorem which has among other a guarantee of CUGN for its short-term loans.

Financial Highlights of the project

The table below summarises the main data on the project (sources: CUGN and Solorem)

Surface m ²	Net floor area m ²	Land price €	Construction cost €	Total amount €
45,330	177,651	51,345,022	463,364,486	514,709,508

The project plans to build 177,651 m² of total net floor area on 13 parcels of land with mixed-use. The construction cost is **€ 463 million**.

For the majority of planned construction on the various plots, the tender documents have not yet been submitted to potential developers, therefore, the details of the net floor areas and construction costs are not final values but current estimates.

Land price in the table above is an estimate of the sales value of the developed land by Solorem. In addition to the proceeds from the land, the development company also receives a contribution from the CUGN (not included in the price) at the time of delivery of urban infrastructure on the ZAC for their revaluation or development (such as roads or district heating).

Additional key assumptions for the business plan

The following assumptions were necessary to complete the business plan:

- **Construction costs are estimated at € 463 million (see table above) and the estimated total scope of analysis is € 410.2 million;**
- The costs and operating revenues were estimated based on average values for the centre of Nancy;
- The average monthly rent for a residential house is **10 €/m²**. With an increase of 10% compared to the average market price for the added value of integrating the EcoQuartier and a new building, we **estimate an income of € 132/m² per year;**
- For tertiary activities, the average annual rental price in the centre of Nancy has been corrected with the observed market price for new recently lease offices on the Republic Square. With a 5% increase to integrate the value added of EcoQuartier, **we get € 189/m² per year (without tax) or € 226/m² per year (with tax);**

- Operating costs for the management of commercial and residential space for lease are estimated at 10% of revenues.

Regarding the planned infrastructure (conference centre, hotel and fire station), a specific analysis was made for each component:

- In the "Prouvé" congress centre, anticipated revenues exactly cover operating costs (approximately **€ 2 million per year**). On the same plot, financial flows from operating the parking lot are based on estimates from Solorem giving approximately **€ 1.26 million in annual revenue and € 0.5 million of annual costs**, not including major repairs;
- The operating cost of the fire station is estimated at **€ 0.5 million per year**, with a corresponding zero revenue;
- Based on an occupancy rate of **70% of its 120 rooms at a estimated price of € 80 per night**, the hotel should achieve a **revenue of € 2.4 million per year with operating costs totalling 1.7 million € per year**.

4.3.4 Financial analysis

Financial modelling

In order to streamline the financial analysis, we assume that all the construction works will be carried out simultaneously. The revenues and the costs generated by the project, the buildings and the other structures are analysed as a whole as in the case of a joint management.

Gross operational benefits are partially used to pay the interests of the 8 years loan. On the basis of similar experiences such a timeframe has been considered suitable but it will need to be validated according to the future regulation in the field. The loan is largely reimbursed at the end of the period of analysis by the selling of the economic activity.

The utilisation and occupation rates have been modelled to reach their maximum value as of the fifth year of the project. The hypothesis used is an occupation of 85% of the houses and commercial surfaces available. After year 8 the project will be sold and a new loan will be negotiated by the buyer.

To better shape the case study with potential eligibility criteria for UDF-type Financial Instruments, the plots fully dedicated to housing (i.e. plots E, H, J, L and M) have been excluded from the analysis. The same applied to public infrastructures – such as the fire station – which do not generate income since costs are not covered by any revenue.⁷

Starting from these hypotheses and using the data available we have calculated the residual value of the buildings and the economic activities.

The simulated financing plan for the € 410.2 million includes the granting of a loan for € 305.6 million, i.e. 74.4% of the funding needs. Solorem is expected to inject € 40.7 million of equity in the form of contribution in kind of the land.⁸

⁷ Public services that do not generate revenues are not supported by financial instruments but are rather the recipient of public grants.

⁸ This amount corresponds to the value of the equipped lots falling within the scope of the case study (after the exclusion of the lots fully dedicated to housing and the fire station).

Parameters

Time horizon	8 years
Tax rate	15%
Loan interest rate	3%
Weighted Average Cost of Capital	5.61%
Depreciation	30 years

Figure 14: Simulation of the financial planning of the project

Loan	Grant	Equity	9.9%	Return on equity	6.4%
74.4% (€ 305.6 m)	15.6% (€ 64.0 m)	9.9% (€ 40.7 m)	74.4%	Loan (interest rate)	3%
€ 410.2 m			15.6%	Public grant	-
Internal Rate of Return of the project (IRR)					1.7%
Debt Service Cover Ratio (DSCR)					1.02

The estimated interest rate for commercial loans is 3%.

The average debt service coverage ratio (DSCR) is 1.02. This ratio, which expresses the relationship between the net operating income and the annual debt service, shows that the project generates sufficient income to cover the loan instalments but the anticipated margins are low.

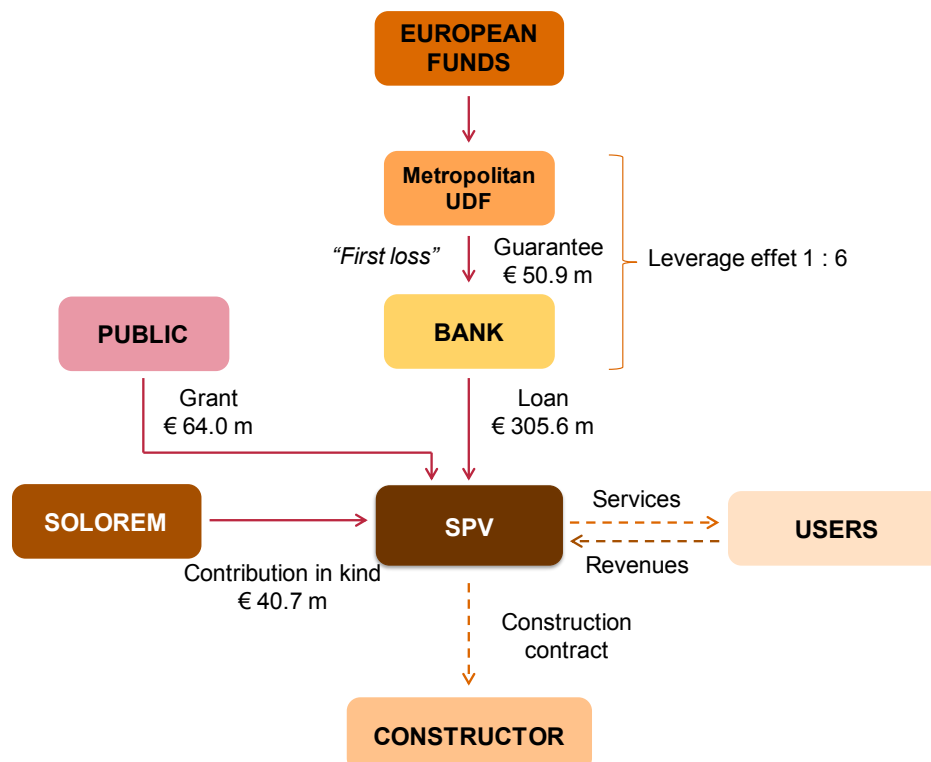
The overall internal rate of return of the project (IRR) attains 1.7%. However, thanks to a limited equity contribution compared to the total investment volume – 9.9% – the internal rate of return of the equity reaches a higher value – 6.4%.

Suggested intervention approach

In the simulation presented below, the UDF has a role in the preliminary phases of the project by optimising the financial terms required to cover the entire funding needs of **€ 410.2 million**. In this scenario, the strategy of the FI is to provide guarantees allowing the stipulation of the large loan required but it does not directly invest in the project.

A proposed structure for the operation is illustrated below:

Figure 15: Proposed structure of the transaction



The guarantee underwritten by the UDF allows the banking sector to grant a larger loan to the project. The guarantee will follow the principle of "first loss" **which doesn't insure** the beneficiary bank for the entire amount but only part of the loan.

Based on practical experience of a well-capitalised public financial institution, a financial structuring with a "first loss" guarantee based on cash facilities can achieve a leverage **effect of € 6 (or more) per euro** invested (i.e. 1: 6) even in high-risk industries. **Therefore, € 50.9 million** granted by the UDF should be sufficient to mobilise **in favour of the project a commercial loan of € 305.6 million**. The contribution of Solorem to the capital of the special purpose vehicle corresponds to the property value of the rehabilitated and prepared (i.e. ready to build upon) land included in the ZAC area. This was worth an **estimated € 40.7 million**.

Financial analysis

The intervention logic of an FI is to optimise the involvement of private finance and seek public finance only for residual needs.

Analysis of equity and public grant

The table below shows that the financing structure, framed in red, could hardly have involved more private capital. Indeed, increases in equity (columns on the right) have a limited capacity to generate a sufficient margin to reduce grant intervention.

Figure 16: Sensitivity analysis of the project IRR: government subsidies and capital

		Equity				
		5.0%	9.9%	15.0%	20.0%	25.0%
Grant	11.5%	-9.5%	-3.5%	-1.5%	-0.5%	0.2%
	12.5%	-6.2%	-2.1%	-0.6%	0.2%	0.7%
	13.5%	-3.4%	-0.8%	0.3%	0.9%	1.2%
	14.5%	-1.2%	0.5%	1.1%	1.5%	1.7%
	15.6%	1.0%	1.7%	2.0%	2.1%	2.2%

A third source of financing is implicitly included in the table. This is the amount of debt which arises due to loans used to finance the remainder of the project (after equity and grants have been contributed). This means that values on the top-left of the table imply a larger share of debt (up to 83.5% of the investment: 5% of equity and 11.5% of grants) and those on bottom-right corner a smaller debt (down to 59.4%: 25% equity and 15.6% grant).

Because of the growing costs for interests, scenarios with more debt (up left of the cell framed in red) have a lower return.

Analysis of the interest rate and public grant

The table below shows how the internal rate of return of the project (IRR) reacts to changes in the interest rate of the loan and demonstrates that improved financial conditions of the loan can reduce the need for public grants. Other terms such as the tenor of the UDF financing or the amount of collateral required could have been modified as well to improve the structuring of the deal.

Figure 17: Sensitivity analysis of the project IRR: government subsidies and interest rate

		Loan interest rate (by mean of guarantees)				
		3.25%	3.00%	2.75%	2.50%	2.25%
Grant	12.0%	-4.4%	-2.8%	-1.2%	0.5%	2.1%
	13.0%	-2.9%	-1.4%	0.1%	1.7%	3.2%
	14.0%	-1.6%	-0.1%	1.3%	2.8%	4.3%
	15.0%	-0.3%	1.0%	2.4%	3.8%	5.2%
	15.6%	0.4%	1.7%	3.0%	4.4%	5.8%

State aid issues

The table above illustrates the effect on the IRR of the project of different combinations of public grants and interest rates. The current rate of return – framed in red – corresponds to 1.7%. With an interest rate of 2.5% it would be possible to reduce the public grant to 13%. Indeed, the rate of return would remain the same. Such reduction of 2.6 percentage points of public grant might appear minor **but in practice it corresponds to a capacity of the deal structuring to cope with € 10.7 million of additional commercial loan.**

Similarly to the previous case study, a loan granted with an interest rate lower than 3% requires to check whether the specific conditions are to be considered as state aid.⁹

Analysis of the occupation rate and public grant

The financial analysis should rely on a very detailed demand analysis in order to optimise the financing structure of the project cash flows. Indeed, the return of the project is strongly related to the actual rate of occupation of the buildings developed. In our modelling exercise the relationship is linear: a reduction of 5 percentage points in the occupation (from 85% to 80%) needs an increase of 5 points of grants (from 15.6% to 20.6%) to guarantee a similar rate or return.

Figure 18: Sensitivity analysis of the project IRR to the occupation rate of the buildings

		Occupation rate of the buildings built				
		80.0%	82.5%	85.0%	87.5%	90.0%
Grant	10.5%	-13.8%	-10.2%	-5.1%	-1.5%	1.5%
	13.0%	-10.1%	-5.1%	-1.4%	1.5%	4.0%
	15.6%	-4.9%	-1.2%	1.7%	4.2%	6.3%
	18.0%	-1.3%	1.6%	4.1%	6.3%	8.2%
	20.5%	1.7%	4.1%	6.3%	8.2%	9.9%

4.3.5 Conclusions

The benefits of using UDF-type Financial Instruments in this kind of project are summarised below:

- Guarantees underwritten by the UDF positively impact the risk exposure of lending banks and therefore generate a leverage effect of 1:6 and improve the bankability of the € 305.6 m of loan;
- The granted loan will likely have a lower interest rate, lower need for collaterals and a longer repayment period in comparison with standard market conditions. The performance of the investment is therefore improved;
- The land contribution of Solorem to the capital of the SPV allows mobilising ERDF funds at the UDF level;
- The availability of funds through an FI would have allowed the granting of a larger loan and reduced the need for public grants while fostering the implementation of a project with positive socio-economic impact for the Grand Nancy;
- The financing of accommodation (not eligible to ERDF co-financing) shall be considered in a wider context of integrated and sustainable urban development where housing is financed by co-investors.

⁹ Reference rates calculated by the Commission for France have fallen in 2012 from 2.07% to 0.67% - applicable since January 2013. To these base rates the appropriate top-ups need to be added. Such rates are regularly updated and can be found on the Commission website:

http://ec.europa.eu/competition/state_aid/legislation/reference_rates.html

5 Conditions for structuring a Financial Instrument dedicated to urban development

Community law affords Member States and their local authorities a large degree of flexibility in the organisation of FIs for urban development. However French law does not provide a legal framework or specific legal regime governing the structuring of such instruments in France.

Any UDF-type structure must simply be part of the existing legal and administrative framework at national and regional level and must comply with Community rules governing the use of funds under the Common Strategic Framework for 2014-2020.

With regard to the possible establishment of an investment fund, for illustrative purposes, its management may be entrusted to the EIB, the CDC or any public or private financial institution.

Any structure, public or private, can participate in an FI dedicated to urban development, namely an urban development fund (UDF). With regard to public or semi-public structures, the CDC could be a candidate in the formation and management of urban development funds, this hypothesis is to be confirmed depending on the strategy of the CDC under review.

Many legal forms can be identified for projects receiving UDF: construction project, partnership agreement, public works concession, development concession agreement, co-investment in a semi-public company (SEM), local public company (SPL) and co-investment in an ad hoc *Société Civile Immobilière* (SCI) or a simplified joint stock company (SAS) kind.

These arrangements will be reviewed in the light of future regulations applicable to EU structural funds for the period 2014-2020.

A detailed description of how to structure a dedicated urban development FI is presented in Appendix J, which incorporates the main elements of the 2010 study for the Nord-Pas de Calais region.

6 Recommendations on investment strategies for a dedicated Financial Instrument for urban development in Lorraine

The analysis of demand and supply of financing related to urban development and the case studies have allowed us to identify the potential for the establishment of a dedicated Financial Instrument for urban development in Lorraine.

Indeed, the analysis of the urban development market Lorraine for the period 2014-2020 reveals active market segments. However, urban development projects are very unattractive to private investors for many reasons: the current difficult economic environment, the general macro-economic context of the Lorraine is unfavourable, mature projects may be limited (non availability of business plan, the difficulty of calculating the return on investment, limited availability of data, or limited knowledge of FIs).

In this context, the establishment of a UDF-type Financial Instrument has some advantages such as the leverage for private investors. The case studies have confirmed the relevance of financing a project through a UDF type of Financial Instrument.

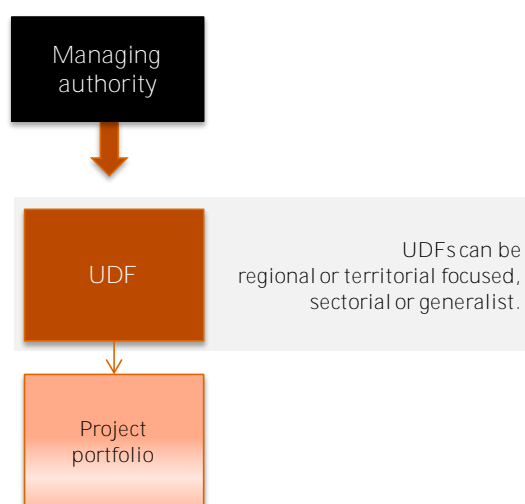
6.1 Options for structuring a Financial Instrument

A dedicated FI for urban development can be realised through two types of structuring under the next programming period 2014-2020, subject to additional requirements from future regulations.

Option 1: Structuring of a Financial Instrument without Holding Fund

When a single urban development fund is established, it is appropriate to adopt a simple financial structure in which the Managing Authority directly feeds the UDF.

Figure 19: Functional diagram of a Financial Instrument without Holding Fund



If the managing authority does not possess the internal expertise in FIs, or the management of EU and public-private partnerships funds; it is recommended that initially the authority seeks technical assistance for the management of UDF.

Option 2: Structuring of a Financial Instrument with Holding Fund

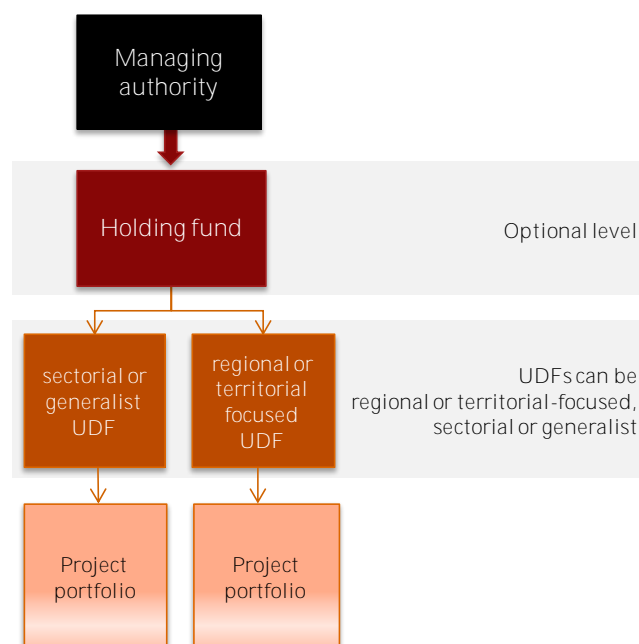
When several Urban Development Funds (UDF) are set up, it is usually best to create an investment fund (Holding Fund) which will be a beneficiary of the ERDF and regional co-financing.

The Holding Fund is intended to supply regional or territorialised urban development funds, thematic or general. Under current regulations, there are several options for the management of this fund. As explained above (see "5. Conditions for structuring a dedicated Financial Instrument for urban development" and Appendix J), the draft Regulation on common provisions for the period 2014-2020 would maintain the possibility of entrusting the management of the European Investment Bank and other organisations¹⁰.

Future regulations also allow a pre-selected manager to take over the management of the Holding Fund and to transfer the management to a regional entity after a period of adjustment for the launch and implementation of the instrument.

A UDF would then be established as an independent legal entity, governed by agreements between investors or shareholders.

Figure 20: Functional diagram of a Financial Instrument with Holding Fund



¹⁰ Subject to confirmation by EU regulation for the period 2014-2020

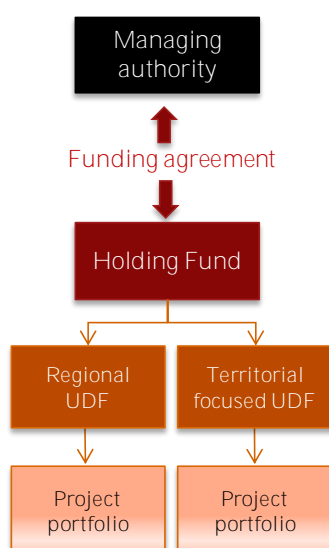
6.2 Proposal for structuring a Financial Instrument dedicated to urban development in Lorraine

In view of the analysed factors, the establishment of a Holding Fund seems to be a strong potential course of action for Lorraine. This would take into account the varied challenges inherent in the urban region and should promote the leverage of funding sources. At first, the use of a simplified Holding Fund (role played by the EIB for example) could be considered, whose contributions would be limited to being an independent agent and a technical assistant before transferring the management to a regional entity. It is indeed important not to neglect the adaptation phase of the different actors, and the period of implementation of such instrument.

In this context, it is possible to set up a structure including one Holding Fund and two urban development funds. The option presented below puts forward two UDF to meet the challenges of urban development in Lorraine:

- A regional UDF with priority thematic to provide a suitable and attractive financing for private investors;
- A territorialised UDF for which the ERDF funds used would be limited and focused on leverage.

Figure 21: Proposed structuring



The different characteristics of the proposed investment strategies are presented below for the thematic and territorialised funds. These characteristics must be thoroughly analysed when validating the creation of these funds.

6.2.1 Regional thematic Fund

The request for funding for urban development in Lorraine is focused on five thematic segments (see 3.1 Analysis of the solicitation for financing urban development in Lorraine: identification of projects and market segments):

- Urban Regeneration;
- Habitat and social housing;
- Energy Efficiency;
- Transport and mobility;
- Conversion of military and industrial brownfield.

The regional fund could have a priority theme. An analysis of the funding application and market failures on urban development revealed that the segment of energy efficiency corresponds to a substantial demand as identified in many projects in the Lorraine region. This segment covers not only the energy performance of buildings, but also the fields of transport (soft mobility), urban infrastructure (e.g. energy performance of public lighting), cogeneration and biomass.

Most of the projects related to energy efficiency, such as energy retrofits or urban infrastructure, can be set up relatively quickly and reduce the projects time-to-market to generate a faster return on investment.

As explained above (see 3.2 Identification of market failures) projects related to energy efficiency are subject to significant regulatory constraints which lead to an increase in costs of implementation of the urban development projects. For example, developers are faced with higher costs for all types of buildings but have to maintain sales prices consistent with real estate market in Lorraine. Concerning energy renovation for housing, the need for funding is rather a need for long-term debt, which is not available on the market today.

A regional UDF with a thematic priority on energy efficiency could respond to a large application for funding of many projects of varying size **that's** present all over the territory.

Indeed, thanks to the analysis of the application for funding for urban development (see Appendix H: List of 166 urban development projects), it is estimated that the urban development operations in Lorraine related to energy efficiency represent a total cost of € 443 million over the period 2014-2020.

In addition, energy efficiency will be a central challenge for the Lorraine region over the coming years. Lorraine is indeed a great producer and consumer of energy due to industrial production, transport and housing activities. In this context, the Lorraine Regional Council has set ambitious goals for energy reduction in the Grenelle Environment¹¹: in order to achieve a 75% reduction in energy consumption in the building in 2050, more than 50% of homes in Lorraine will undergo renovations in the coming years.

The investment strategy may well be targeted on energy efficiency in Lorraine, while maintaining flexibility in order to:

- Cover many urban projects planned for the period 2014-2020 (see definition of the market segment in § 3.1);
- Facilitate the implementation including finding investors interested in this particular segment;
- Amend, if necessary, the investment strategy going forward.

The proposed investment strategy of a UDF dedicated to energy efficiency Lorraine presented below is derived from the results of the market analysis.

¹¹ The Grenelle Environment Forum is a series of political meetings held in France in September and October 2007, which brought together government and civil society. These meetings helped to make long-term decisions on the environment and sustainable development, in particular to restore biodiversity through the establishment of a greenway and blueway and regional patterns of ecological coherence, while decreasing emissions of greenhouse gas emissions and improving energy efficiency (www.legrenelle-environnement.fr). Some commitments were translated into laws called "Grenelle Laws" between 2008 and 2010.

Characteristics of the investment strategy proposed for a regional UDF with "Energy Efficiency" as a priority theme	
Potential budget	<p>€ 110 million</p> <p>The potential budget of the UDF giving priority to energy efficiency was estimated on the basis of the analysis of the demand for financing urban development (€ 443 million). To ensure a "realistic" absorption capacity to the proposed FI, it is suggested to provide a financial capacity covering 25% of this need.</p>
Potential leverage	1:2
Public financing	<p>€ 55 million</p> <ul style="list-style-type: none"> • ERDF co-financing with € 33 million (60%¹² of public funding); • National counterpart of € 22 million. The national counterpart may consist of in-kind contributions, government grants, resources from the leverage generated equity. Subject to confirmation by the regulations, the national counterpart will be materialised in the different phases of the project.
Private investment generated by the leverage	€ 55 million
Types of intervention	<p>This UDF is intended to finance various types of project: energy retrofitting for public buildings, large scale co-generation (industrial, electro plants ...), and small-scale energy production from biomass (including waste recycling), energy efficient lighting (energy performance of public lighting, the sports lighting, traffic lights bright festive illuminations ...), etc..</p> <p>Types of intervention may differ according to the needs of the projects:</p> <ul style="list-style-type: none"> • Equity participation for projects related to energy production; • Long-term debt for other projects¹³.
Scope of intervention	The Regional UDF with thematic priority "energy efficiency" is intended to cover the whole region with the exception of the metropolitan core (the assumption is that the centre would be covered by a specific UDF).
Investment period	Minimum 8 years depending on the payback period of the cost of investment
Socio-economic benefits	<ul style="list-style-type: none"> • Development of more favourable energy structures; • Improved quality of life; • Preservation of the environment and resources.

¹² Lorraine is part of the category of transition regions for the 2014-2020 programming and has a 60% co-financing rate (Article 111 of the RPDC).

¹³ JESSICA – UDF Typologies and Governance Structures in the context of JESSICA implementation, EIB-DG Regio, novembre 2010.

Characteristics of the investment strategy proposed for a regional UDF with "Energy Efficiency" as a priority theme

Possible indicators among the common indicators proposed by the European Commission (ERDF 2014-2020) ¹⁴
Additional production capacity of renewable energy
Number of households whose ranking in terms of energy consumption has improved
Decrease in primary energy consumption of public buildings
Population living in areas with integrated urban development strategies

Absorption capacity of similar projects during the period 2007-2013

The absorption capacity of ERDF funds for energy efficiency is demonstrated with respect to the usage rates of funds from the ERDF programming 2007-2013.

Thus, as at 31/12/2011, measures of the ERDF OP Lorraine 2007-2013 related to energy efficiency¹⁵ present a greater amount of resources than those used for urban development measures.

2007-2013 ERDF OP measures related to energy efficiency and urban development		% budgeted	% disbursed
Axis B. Promote sustainable development and the fight against the greenhouse effect	B 11. Energy efficiency and renewable energy	69%	267%
	B 14. Energy efficiency of social housing	100%	42%
Axe C. Support urban Policy		44%	51%

Source: Annual report on the implementation of the ERDF OP as at 31/12/2011.

Consistency with the Common Strategic Framework¹⁶

The UDF is consistent with the following thematic objectives (non-exhaustive list for the thematic apart from energy efficiency):

- TO4. Support the transition to a low-carbon emissions in all sectors
- TO7. Promote sustainable transport and remove bottlenecks in key network infrastructures

Potential partners

- Possible managers: CDC, private financial institution;
- Possible contributors: EPFL, EPCI, private financial institutions, institutional investors;
- Possible members of the Investment Committee: EPCI, EPFL, CDC, private financial institution, external experts.

¹⁴ Document d'orientation - Suivi et évaluation de la politique européenne de cohésion : Concepts et recommandations (ERDF et FC), DG Regio, novembre 2012.

¹⁵ The main achievements of the ERDF OP 2007-2013 related to energy efficiency are: 9 territorial plans climates developed out of the projected 15-20, 55 operations in renewable energies carried out of the 100-150 projected; 31 operations on the energy efficiency in buildings out of the 10-15 projected.

¹⁶ The thematic objectives of the Common Strategic Framework for the period 2014-2020 and the corresponding investment priorities for the ERDF are respectively defined in Article 9 of the draft Regulation with common provisions, and Article 5 of the draft ERDF Regulation .

6.2.2 North-South Corridor Territorial Fund

In terms of urban development in Lorraine, the majority of projects identified - including projects financed under the ERDF OP 2007-2013 - lie on a north-south corridor connecting the cities of Nancy to Thionville. The regional macro-economic analysis and the analysis of the demand for financing urban development carried out at the beginning of this study also identified a strong dynamic of urban development along this corridor.

Additionally, the metropolitan corridor in Lorraine - along the cities of Thionville, Metz, Nancy and Epinal – benefit from a long tradition of cooperation and has common institutional tools and governance capable of carrying out an integrated and sustainable urban development strategy¹⁷.

These elements allow considering a level of leverage of 1:3 on the basis of similar experiences. In addition, a catalyst should be derived from the presence of UDF for the viability and/or feasibility of certain projects.

The investment strategy of a UDF dedicated to this axis could target integrated urban projects of the metropolitan areas in Lorraine, responding to a specific territorial demand. It would then reflect the strategy of the perimeter. This scope will be defined by the concerned local and regional actors and may be flexible if they wish. The UDF would be an FI supporting urban development strategy and facilitate greater cooperation between the different actors. The proposed investment strategy of a dedicated UDF to the Metropolitan Lorraine corridor shown below is driven by the results of the market analysis and case studies, including that of the Nancy Grand Coeur operation supported by the urban Community of Grand Nancy.

Characteristics of the investment strategy proposed for a territorial UDF "Metropolitan Corridor"	
Potential budget	<p>€ 80 million</p> <p>The potential budget of a territorial UDF for the Metropolitan corridor was estimated on the basis of the analysis of the demand for financing urban development, which is estimated between € 1,200 million and € 1,700 million. The endowment fund would cover a portion of those needs. In addition, the ERDF co-financing would be slightly lower than the allocation for C axis of the 2007-2013 programs.</p>
Potential leverage	1:3
Public co-finance contribution	<p>€ 27 million</p> <ul style="list-style-type: none"> • ERDF co-financing with € 16 million (60%¹⁸ of public funding); • National counterpart of € 11 million. <p>The national counterpart may consist of in-kind contributions, government grants, resources from the generated leverage, equity. Subject to confirmation by the regulation, the national counterpart may be made at different levels of implementation of the FI.</p>
Private investment generated by the leverage	€ 53 million

¹⁷ The main existing tools are the Pôle métropolitain of the Sillon Lorrain and the EPCI of Thionville, Nancy, Metz and Epinal which feature regional projects (agglomeration projects of Metz and Epinal are in progress).

¹⁸ Lorraine is part of the transition regions for the 2014-2020 programming and has a 60% co-financing rate (Article 111 of the RPDC).

Characteristics of the investment strategy proposed for a territorial UDF "Metropolitan Corridor"

Types of intervention Projects funded under this UDF can be of various kinds and types of intervention may vary according to project needs: loans, equity, guarantees, long-term debt for other projects.

Scope of intervention The territorial UDF is intended to fund the metropolitan north-south axis of Lorraine, which has a high and peri-urban concentration around the areas of Thionville, Metz, Nancy and Epinal. The exact scope of this axis will be determined by the various stakeholders and may be flexible.

Investment period Minimum 8 years depending on the payback period of the cost of investment

Socio-economic benefits Projects funded under this UDF can be diverse in nature and therefore could generate a variety of socio-economic benefits:

- Enhancing the attractiveness of urban areas (equipment, services, housing, transportation);
- Improved social and generational diversity;
- Development of economic activities;
- Reduction of the environmental and energy impact of urban spaces.

Possible indicators among the common indicators proposed by the European Commission (ERDF 2014-2020) ¹⁹
Population living in areas benefiting from integrated urban development strategies
New green spaces in urban areas
New public and commercial buildings in urban areas
New housing in urban areas
Indicators related to energy efficiency (see 6.2.1 Regional Thematic Fund)

Absorption capacity of similar projects during the period 2007-2013 The geographic scope of the proposed fund (larger than the C axis of the current ERDF Operational Programme), an appropriate investment strategy, and the new national co-financing rules are expected to improve the capacity of absorption of ERDF funds compared to the Operational Programme 2007-2013.

Consistency with the Common Strategic Framework²⁰ The thematic scope of action of the territorial UDF is broad and flexible. In view of the existing urban development projects and the identified demand for the period 2014-2020, it is estimated that the thematic objectives covered by the UDF are:

- TO1. Strengthen research, technological development and innovation;
- TO2. Improve the access to information technology and communication, their use and their quality;

¹⁹ Document d'orientation - Suivi et évaluation de la politique européenne de cohésion : Concepts et recommandations (ERDF et FC), DG Regio, novembre 2012.

²⁰ The thematic objectives of the Common Strategic Framework for the period 2014-2020 and the corresponding investment priorities for the ERDF are respectively defined in Article 9 of the draft Regulation with common provisions, and Article 5 of the draft ERDF Regulation.

Characteristics of the investment strategy proposed for a territorial UDF "Metropolitan Corridor"

- TO3. Strengthen the competitiveness of small and medium enterprises;
- OT4. Support the transition to a low-carbon emissions in all sectors;
- OT5. Promote adaptation to climate change and the prevention of risk management;
- OT6. Protect the environment and promote the rational use of resources;
- OT7. Promote sustainable transport and remove bottlenecks in key network infrastructures;
- OT9. Promote social inclusion and fight against poverty;
- OT10. Invest in education, skills and training throughout life.

Potential partners

- Possible managers: CDC, private financial institution;
- Possible contributors: EPFL, EPCI, private financial institution;
- Possible members of the Investment Committee: EPCI, EPFL, CDC, private financial institution, external experts.

Possible evolution towards an Integrated Territorial Investment (ITI) as an option for the implementation of the Financial Instrument

The territorial UDF could eventually and depending on the evolution of the Community rules become an Integrated Territorial Investment (ITI)²¹. According to the information available to date, the ITI is a tool available to state members under the Cohesion Policy 2014-2020 which could also be a possible option for the implementation of Financial Instruments.

- The ITI should be based on an integrated and cross-sectorial strategy for a defined territory;
- It will allow the combination of ERDF and FSE in the form of grants or through FIs to fund projects within the integrated territorial strategy;
- It will provide opportunities for management authorities to delegate the management of funds to sub-regional actors (local, urban) who become "intermediate bodies".

Moreover, the relevance of the use of the approach of "Local Development led by local actors"²² (Community-led development) can be analysed for the implementation of the FI.

6.2.3 Proposed UDFs contribution to the requirements of « thematic concentration » of Regulation 2014-2020

The Managing Authority of Operational Programme ERDF 2014-2020 is constrained by regulations (Articles 4 and 7 of the draft ERDF Regulation) to focus a large portion of the funds on a limited number of themes. Thus, for developed and transition regions such as Lorraine, the ERDF funds should be subject to the "thematic concentration" as follows:

- At least 80% of the total ERDF resources at national level shall be allocated to one or more of the thematic objectives 1, 2, 3 and 4 of the Common Strategic Framework;

²¹ Article 99 of the Regulation with common provisions.

²² Articles 28, 29, 30, 31 of the Regulation with common provisions.

- At least 20% of the total ERDF resources at national level shall be allocated to the thematic objective 4 of the Common Strategic Framework;
- At least 5% of ERDF resources at national level shall be allocated to integrated sustainable urban development actions.

The table below shows how the two UDFs previously proposed could contribute to meeting the requirements of thematic focus of regulation 2014 to 2020. These estimates are based on the types of projects eligible for funding through UDFs and the investment priorities set for each thematic objective in the draft ERDF Regulation.

Table 3: Estimates of ERDF contributions to UDFs

		Territorial UDF North-South Axis	Regional UDF with a priority on energy efficiency	TOTAL
Estimates of ERDF contributions to UDFs (€ million)		16.00	33.00	49.00
UDFs projects funded under the thematic concentration (Article 4 ERDF)	OT1. strengthen research, technological development and innovation	10%	0%	
	OT2. improve the access to information technology and communication, their use and their quality	20%	30%	
	OT3. strengthen the competitiveness of small and medium enterprises and the agricultural sector (for the FEADER) and fisheries and aquaculture (for the FEAMP)	20%	20%	
	OT4. support the transition to a low-carbon emissions in all sectors	50%	50%	
	Contribution (%) of eligible ERDF under the thematic concentration: 80% of OT 1, 2, 3, 4	100%	100%	
	<i>of which% eligible ERDF contribution for thematic concentration: 20% 4 OT</i>	<i>50%</i>	<i>50%</i>	
	Amount (M €) eligible ERDF under the thematic concentration: 80% OT 1, 2, 3, 4	16.00	33.00	49.00
	<i>amount (€ M) eligible ERDF under the thematic concentration: 20% 4 OT</i>	<i>8.00</i>	<i>16.50</i>	<i>24.50</i>
Projects funded under the Sustainable Urban Development (ERDF Article 7)	Share contribution (%) of eligible ERDF under integrated actions for sustainable urban development: minimum 5%	100%	100%	
	Amount (M €) eligible ERDF under integrated actions for sustainable urban development: minimum 5%	16.00	33.00	49.00

	Estimations ERDF OP 2014-2020*	80% thematic concentration on OT 1, 2, 3 4	Of which 20% on OT 4
Estimative Budget ERDF OP (M€)*	329.00	263.20	65.80
ERDF contribution to UDFs (M€)	49.00	49.00	24.50
ERDF contribution to UDFs (%)	15%	19%	37%

*Estimation based on the PO ERDF OP 2007-2013 budget.

In conclusion, **the proposed two UDFs could be fully implemented within the framework of the thematic concentration** required by the draft ERDF Regulation. ERDF envelopes dedicated to UDFs represent 19% of the resource focused on thematic objectives 1, 2, 3 and 4, and in particular 37% of the resources are allocated to thematic objective 4 which prioritises energy efficiency.

Conclusions on the proposed structure of the Financial Instrument dedicated to urban development in Lorraine

The creation of two Urban Development Funds would address key market failures identified during the analysis of the demand for financing urban development in Lorraine:

- A regional UDF with a thematic priority dedicated to energy efficiency to provide a suitable and attractive method of financing for private investors;
- A territorial UDF dedicated to the metropolitan north-south corridor of Lorraine²³ for which the ERDF funds used would be limited and focused on leverage.

In this context, it is possible to set up a structure including a holding fund which will be a beneficiary of the ERDF funding and regional co financing.

On the basis of the study, a major risk for these two UDFs can be identified: a demand that is not up to the estimates due to the current economic situation (described in Appendix A for Lorraine). This risk, however, could be controlled by the following two actions: 1/accurately define and share the prioritisation of investments, 2/evaluate in detail the financial plans of the submitted projects. A technical support for potential beneficiaries is also essential to assist them in setting up and managing the projects co-financed via a UDF. For this purpose, it is possible to mobilise some funding for technical assistance from the ERDF Operational Programme.

In anticipation of the ERDF Operational Programme for the period 2014-2020 for Lorraine which is being developed with the proposed Community regulation, it seems reasonable to allocate around 10% of the programme on Financial Instruments. Anticipating a reduction in endowment for the ERDF OP 2014-2020 and taking into account the importance of urban development and FIs in the 2014-2020 programmes, the assumptions made for each of the UDF (€49 million fund ERDF for both UDF) seem plausible.

The Lorraine region is ranked among the transition regions for the period 2014-2020, the corresponding national contribution would amount to € 33 million (if we consider a co-financing rate of 60%²⁴). A **total public budget of € 82 million would be available to invest in a dedicated FI** for urban development in Lorraine²⁵ and would generate a total investment of € 190 million.


²³ The scope should be defined by local and regional actors

²⁴ Lorraine is part of the transition regions for the 2014-2020 programming and has a 60% co-financing rate (Article 111 of the RPDC)

²⁵ According to the draft regulation with common provisions (Article 110, paragraph 5), if the managing authority decides to implement a set of priority through financial instruments, the maximum co-financing rate is increased by ten percentage points. For example, within the next ERDF OP 2014-2020, if a priority dedicated to energy efficiency was fully implemented by means of an instrument of UDF type, the national counterpart would be reduced from 40% to 30% in Lorraine.

The diagram below summarises the key elements from the Operational Programme 2007-2013 and the projection for 2014-2020:

Figure 22: Comparison between the Operational Programme 2007-2013 and the Projections 2014-2020

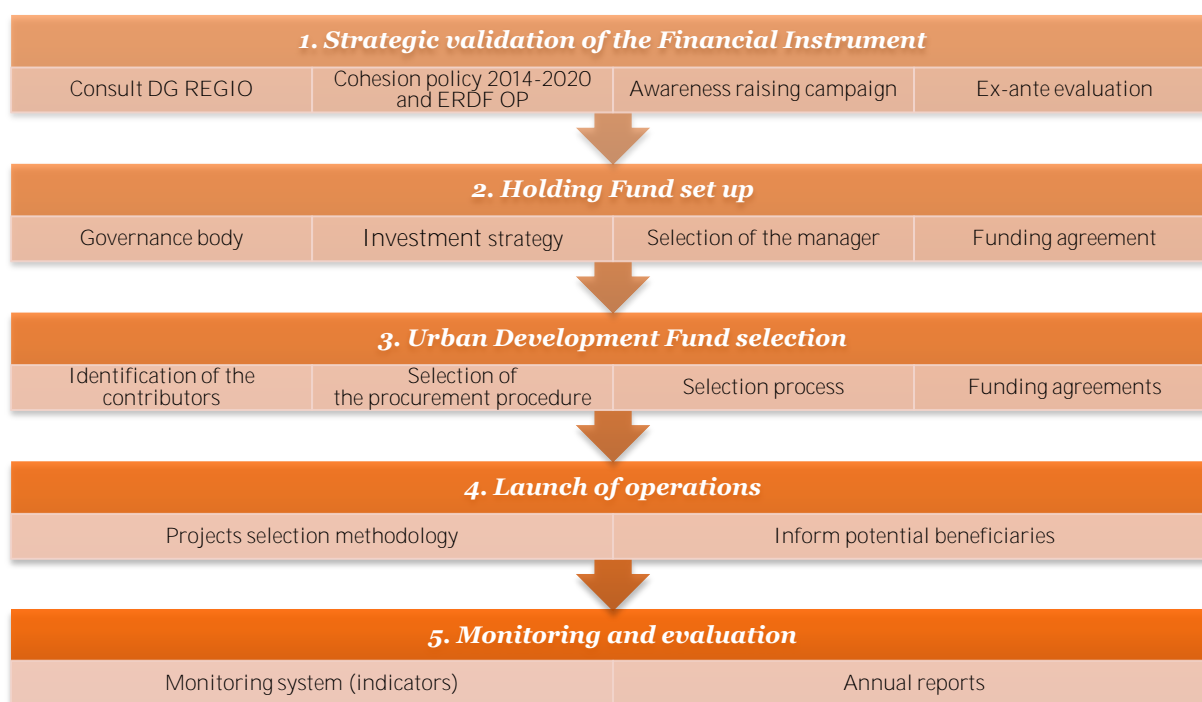
Operational Programme 2007-2013	Projections 2014-2020 allowing a complete regional coverage
ERDF OP Envelope	ERDF OP Envelope
€ 329.4 million	Unknown as of today
ERDF contribution dedicated to urban development²⁶	ERDF contribution via a Financial Instrument dedicated to urban development
<p>€ 56.6 million (or 17% of the OP total envelope):</p> <ul style="list-style-type: none"> - € 19.5 million B11 «Energy efficiency and renewable energy» - € 13.1 million B14 « Energy Efficiency » - € 24 million Axe C where all funded projects are located in the metropolitan axis 	<p>€ 49 million (or 15% of the OP total envelope if similar to the 2007-2013 envelope):</p> <ul style="list-style-type: none"> - € 33 million on the thematic UDF, outside of the metropolitan axis oriented Energy Efficiency - € 16 million on the Territorial UDF dedicated to the metropolitan axis
	
Estimation of the generated investments	
<p>€ 190 million:</p> <ul style="list-style-type: none"> - € 110 million on the regional territory outside of the North-South axis - € 80 million on the metropolitan axis 	

²⁶ Urban development is mainly covered by the C axis "Supporting urban policy" and two measures of axis B "Promoting sustainable development and the fight against the greenhouse effect" (B11-Energy Efficiency and Renewable Energy and energy efficiency-B14).

7 *Action plan for the implementation of a dedicated Financial Instrument for urban development in Lorraine within the 2014-2020 programme*

7.1 *Steps for the implementation of the Financial Instrument*

This section presents the five main steps in the establishment of a dedicated Financial Instrument for urban development in Lorraine.



7.1.1 *Strategic validation of the Financial Instrument*

The implementation of a dedicated Financial Instrument for urban development must be linked to urban development strategies and must be consistent with the regulatory framework for cohesion policy 2014-2020 to receive a portion of the funds allocated through operational programs.

Consistent with the strategy of the 2014-2020 cohesion policy and the ERDF OP of Lorraine

For the Financial Instrument to receive funds under the Common Strategic Framework (CSF), including the ERDF in the field of sustainable urban development, and for the projects it finances to be eligible for these funds, it must be consistent with:

- The Europe 2020 strategy for smart, sustainable and inclusive growth especially on urban development²⁷;
- The Common Strategic Framework and the 11 thematic objectives that it provides. The investment strategy of the FI will contribute to the fulfilment of the "thematic concentration²⁸" which obliges

²⁷ Les villes de demain. Défis, visions et perspectives. DG Regio, octobre 2011.

each Member State to allocate at least 80% of ERDF resources to one or more of the following four thematic objectives:

- TO1. Strengthen research, technological development and innovation;
 - TO2. Improve the access to information technology and communication, their use and their quality;
 - TO3. Strengthen the competitiveness of small and medium enterprises;
 - TO4. Support the transition to low-carbon emissions in all sectors: at least 20% of ERDF resources at national level shall be allocated to the thematic goal.
- The priorities of the ERDF Operational Programme 2014-2020 for Lorraine, which is currently under development.

The investment of the dedicated FI for urban development strategy in Lorraine should be consistent with the elements presented above. This strategy will be defined in several ways:

- In the ERDF Operational Programme;
- In the investment strategy of the Holding Fund;
- In the investment strategies of the urban development fund(s).

Launching an awareness campaign for the different actors

Like other French regions, Lorraine has no experience in using Financial Instruments in the field of spatial planning and territorial development. The use of such a tool requires the ability to analyse the projects, and an understanding of the concept of return on investment and business plan.

That is why it is crucial to launch an awareness campaign early in the process. Local and regional actors who are potentially involved in the implementation of the FI need to be familiar with the integrated approach of the project's structures, the notion of return on investment, and the recycling of funds (their "revolving" nature).

Technical assistance could be at the heart of this campaign, which if coupled with hands-on support to the potential beneficiaries, could lead to the emergence of projects compatible with UDF kind of funding. This would be a first portfolio of potential projects that could eventually guide in the selection of UDF.

Conducting an ex-ante evaluation

The Managing Authority shall initiate an ex ante evaluation ("ex-ante assessment") of the Financial Instruments. Indeed, the draft Regulation on common provisions for the period 2014-2020 (Article 32, paragraph 2) states that FIs should be designed on the "ex ante assessment" basis to identify a market failure, situations of non-optimal investment, the respective investment needs, the possible involvement of the private sector and the added value of the FI that results. This also helps to avoid duplication and inconsistencies between financing tools implemented by different actors at different levels.

During the implementation phase, it will be necessary to deepen the understanding of the legal aspects related to the launch of the operations (see Chapter 5. Conditions for structuring a Financial Instrument dedicated to urban development).

The table below presents the main component of this study which are element of response to the *ex ante assessment*.

²⁸ Article 9 of the ERDF Regulation project

Table 3: Key elements of the ex ante assessment

Component of the ex ante assessment (Article 32, point 2 of the RPDC ²⁹)	Elements of response in this study to document these criteria
<p><i>a. An analysis of market failures, suboptimal investment situations, and investment needs for policy areas and thematic objectives or investment priorities to be addressed with a view to contribute to the strategy and results of the relevant programmes and to be supported through financial instruments.</i></p>	<p>3. Analysis of the current financing situation of urban development in Lorraine 3.1. Solicitation for financing urban development in Lorraine 3.2. Identification of market failures</p>
<p><i>b. An assessment of the value added of the financial instruments considered to be supported by the CSF Funds, consistency with other forms of public intervention addressing the same market, possible state aid implications, the proportionality of the envisaged intervention and measures to minimise market distortion.</i></p>	<p>4. Case studies: illustration of the implementation of a financial instrument for urban development in Lorraine 6. Recommendations on investment strategies for a dedicated financial instrument for urban development in Lorraine</p>
<p><i>c. An estimate of additional public and private resources to be potentially raised by the financial instrument down to the level of the final recipient (expected leverage effect), including as appropriate an assessment of the need for, and level of, preferential remuneration to attract counterpart resources from private investors and/or a description of the mechanisms which will be used to establish the need for, and extent of, such preferential remuneration, such as a competitive or appropriately independent assessment process.</i></p>	<p>4. Case Studies: illustration of the implementation of a financial instrument for urban development in Lorraine 6. Recommendations on investment strategies for a dedicated financial instrument for urban development in Lorraine 6.2. Proposal for structuring a financial instrument dedicated to urban development in Lorraine</p>
<p><i>d. An assessment of lessons learnt from similar instruments and ex ante assessments carried out by the (region) in the past, and how these lessons will be applied going forward.</i></p>	<p>3. Analysis of current financing situation of urban development in Lorraine 3.3. Analysis of the supply of financial actors for urban development in Lorraine</p>
<p><i>e. The proposed investment strategy, including an examination of options for implementation arrangements within the meaning of Article 33, financial products to be offered, final recipients targeted, envisaged combination with grant support as appropriate.</i></p>	<p>6. Recommendations on investment strategies for a dedicated financial instrument for urban development in Lorraine 6.1. Options for structuring a financial instrument 6.2. Proposal for structuring a financial instrument dedicated to urban development in Lorraine</p>
<p><i>f. A specification of the expected results and how the financial instrument concerned is expected to contribute to the achievement of the specific objectives and results of the relevant priority or measure including indicators for this contribution.</i></p>	<p>6. Recommendations on investment strategies for a dedicated financial instrument for urban development in Lorraine 6.2. Proposal for structuring a financial instrument dedicated to urban development in Lorraine</p>

²⁹ The french version of the RPDC is not available as of today.

Component of the ex ante assessment (Article 32, point 2 of the RPDC ²⁹)	Elements of response in this study to document these criteria
<p><i>g. Provisions allowing for the ex ante assessment to be reviewed and updated as required during the implementation of any financial instrument which has been implemented based upon such assessment, where during the implementation phase, the managing authority considers that the ex ante assessment may no longer accurately represent the market conditions existing at the time of implementation.</i></p>	

7.1.2 Creation of the Holding Fund

As explained above (see 6.2 Proposal for structuring a Financial Instrument dedicated to urban development in Lorraine), it is possible that the establishment of a dedicated Financial Instrument for urban development in Lorraine includes a Holding Fund. This will enable a rapid implementation of the FI and may, if necessary, be removed after an initial phase of implementation if regional organisations are able to perform the duties.

Constitution of the governing body of the Financial Instrument

The governance of the FI is provided by an investment committee which is the supervisory body of the management of the Holding Fund. The composition and responsibilities of the Investment Committee are detailed above (see 5. Conditions for structuring a Financial Instrument dedicated to urban development).

The governing body of the FI must have a structure that brings the political, administrative, and financial competence in the region. At least, it must gather the State, the Regional Council of Lorraine, the main partners of urban development such as the EPFL and the Caisse des Dépôts et Consignations, and possibly the main urban local authorities that are concerned.

Development of the investment strategy

The investment strategy of the Holding Fund is to set the policy and the investment targets that are in line with the objectives of the ERDF Operational Programme, and if possible, with existing integrated development strategies. The goal of the strategy is to define the choice of investment for the programming and the implementation of the dedicated Financial Instrument for urban development in Lorraine.

At a minimum, the investment strategy should include³⁰:

- Target sector and territories;
- Types of UDF and preliminary identification of projects;
- Investment products offered;
- Estimates of the amounts to be invested in the UDF;
- Limitations of investments and investment controls;
- General Criteria for the selection and evaluation of UDFs (e.g., types of appropriate structure for managing a UDF);
- Provisions relating to the recycling of funds.

The Holding Fund's investment strategy is usually part of the investment agreement concluded between the managing authority and the manager of the investment fund.

³⁰ JESSICA – Holding Fund Handbook. EIB-DG Regio, novembre 2010.

Selection of the Holding Fund manager

According to Article 33, paragraph 4 b) of the Common Provisions Regulation, the Managing Authority may choose to entrust the implementation tasks to the:

- European Investment Bank;
- International financial institutions of which France is a shareholder, or financial institutions established in France, pursuing public policy objectives under the control of a public authority, selected in accordance with EU rules and national rules;
- A body governed by public or private law selected in accordance with EU rules and national rules.

At present, few Holding Funds have a structure that does not involve the EIB. Indeed, it has the technical and financial expertise to assist management authorities and other stakeholders to launch a dedicated FI for urban development. In addition, the Bank has in place internal structures that are particularly suitable and experienced to assume the management of an investment fund. The EIB could be a temporary partner involved in the launch of the FI and will aim to transfer the administration of the fund to participate in a regional body after an initial phase of implementation.

Establishing a financing agreement with the managing authority

Subject to confirmation by the regulations, once the fund manager is selected, it is necessary to establish a financing agreement between the managing authority and the Holding Fund. If the managing authority is a different entity from the Regional Council of Lorraine (e.g. Prefecture region), this financing agreement can be tripartite in the event that the Regional Council would also contribute to the holding fund. The content of the financing agreement is stated above (see 5. Conditions for structuring a Financial Instrument dedicated to urban development).

The draft Regulation on common provisions (Article 33, paragraph 6) indicates that entities (such as Holding Fund managers) which have been delegated implementation tasks will have to open fiduciary accounts in their name and on behalf of the managing authority. Assets held in the trust accounts will be managed in accordance with the principle of sound financial management, in compliance with the appropriate prudential rules, and must be have sufficient liquidity.

7.1.3 Selection of the urban development funds

As explained above (See 6.2 Proposal for structuring the Financial Instrument dedicated to urban development in Lorraine), we propose the creation of two UDFs in Lorraine for 2014-2020:

- A thematic UDF;
- A territorial UDF.

Identification of the contributors

In order to implement the UDF, public and private actors should be identified to contribute to the co-financing and co-investment in the UDFs, as well as the nature of these contributions (financial or in kind).

The draft Common Provisions Regulation (Article 32, paragraph 3) states that in-kind contributions will only be eligible for Financial Instruments if "in terms of contributions of land or real estate related investments contributing to the objective of urban development or urban renewal, where the land or buildings are part of the investment".

In Lorraine, potential contributors to the proposed UDF could be the *Etablissement Public de Cooperation Intercommunale* (EPCI), the *Etablissement Public Foncier de Lorraine* (EPFL), and public financial institutions such as the *Caisse des Depots et Consignations*, or private.

Choice of methods for selecting UDF

A transparent and non-discriminatory selection process for UDF must be organised. According to Article 33, paragraph 5 of the Regulation on common provisions, the Holding Fund manager may entrust part of the implementation to financial intermediaries³¹. As financial intermediaries, the UDFs should be selected through open, transparent, proportionate and non-discriminatory procedures, and preventing conflicts of interest.

The selection of a UDF should be done through a public procurement procedure. The choice of this procedure depends on the target of the UDF and the level of competition among potential candidates. The most commonly used procedures are the open or restricted procedures. The proposed regulations do not provide further details on the selection of the UDF.

UDF selection process

The Holding Fund launches calls for expressions of interest by publishing the corresponding terms of reference, receives proposals from various candidates and selects the manager. In the case where a prior sensitisation campaign made compatible projects with a dedicated FI for urban development emerge, the selection of UDF can be done on the basis of projects in the pipeline.

Although the selection of UDF is done directly by the Holding Fund manager, the governing body of the FI (Investment Committee) is also involved.

Establishing the financing agreements between each UDF and Holding Fund

Subject to confirmation by the implementing Regulations of the Regulation with common provisions, a financing agreement shall be established between the investment fund and each of the UDFs. It will define the modalities of contribution of the Holding Fund in each of the selected UDF, the investment plans, and modes of operations of the latter.

Once the financing agreement is established, the managing authority can contribute with ERDF to the holding fund, which in turn will invest in the UDFs according to their respective investment plan. The UDFs will then raise additional funds from other public and private contributors. Subject to confirmation by the final regulations for the period 2014-2020, the national public counterpart completing the ERDF may be made at different levels (Holding Fund, Urban Development Funds or projects).

7.1.4 Start of the operations

Procedures for selecting projects

Once created, the UDF will define the eligibility criteria and the procedures for the selection of the projects, while respecting the eligibility rules and the priorities of the ERDF Operational Programme.

³¹Provided they take responsibility to ensure that these financial intermediaries meet the criteria set out in Article 57 and Article 131, paragraph 1, point 1 a) and paragraph 3 of the Financial Regulation.

Informing potential beneficiaries

Communication activities targeting potential beneficiaries of UDF should be organised to inform them correctly of the functioning of the FI and the eligibility criteria of the different UDF. It will be especially necessary to assist them in preparing their project so they can benefit from the mechanism.

Technical support to the recipients will be required for the preparation of the project. Organisations could possibly make this technical support, while making sure to avoid potential conflicts of interest with respect to their role in the FI. Among the agencies that provide this support, the regional branch of the *Caisse des Depots et Consignations* has expressed an interest in providing support to potential beneficiaries for the project engineering phase.

7.1.5 Monitoring and evaluation

Monitoring

The Holding Fund in collaboration with the UDF will create a system of monitoring and evaluation of the Financial Instrument dedicated to urban development. This system should include:

- Procedures to ensure transparency in the operation of the instrument;
- Socio-economic indicators;
- Indicators of physical monitoring;
- Indicators of financial monitoring. In terms of financial monitoring, the proposed Common Provisions Regulation (Article 34, paragraph 1) states that the UDF and Holding Fund managers should produce regular transactions monitoring reports and transmit them to the management and expenditure control organisation at the beginning of the accredited program period.

Annual Reports

Due to the specific procedures and delivery structures of the FIs, the provision of information control on the use of budgetary resources from the CSC funds are crucial for all stakeholders cohesion Policy 2014-2020, as they allow us to draw conclusions about the actual performance of supported instruments and the necessary adjustments to ensure their effectiveness. Therefore, the proposal for a Regulation on common provisions (Article 40) requires the management authorities to forward to the Commission a "special report on the activities related to Financial Instruments" in the form of an annex to the annual implementation report of the Operational Programme.

This special report will contain the following information:

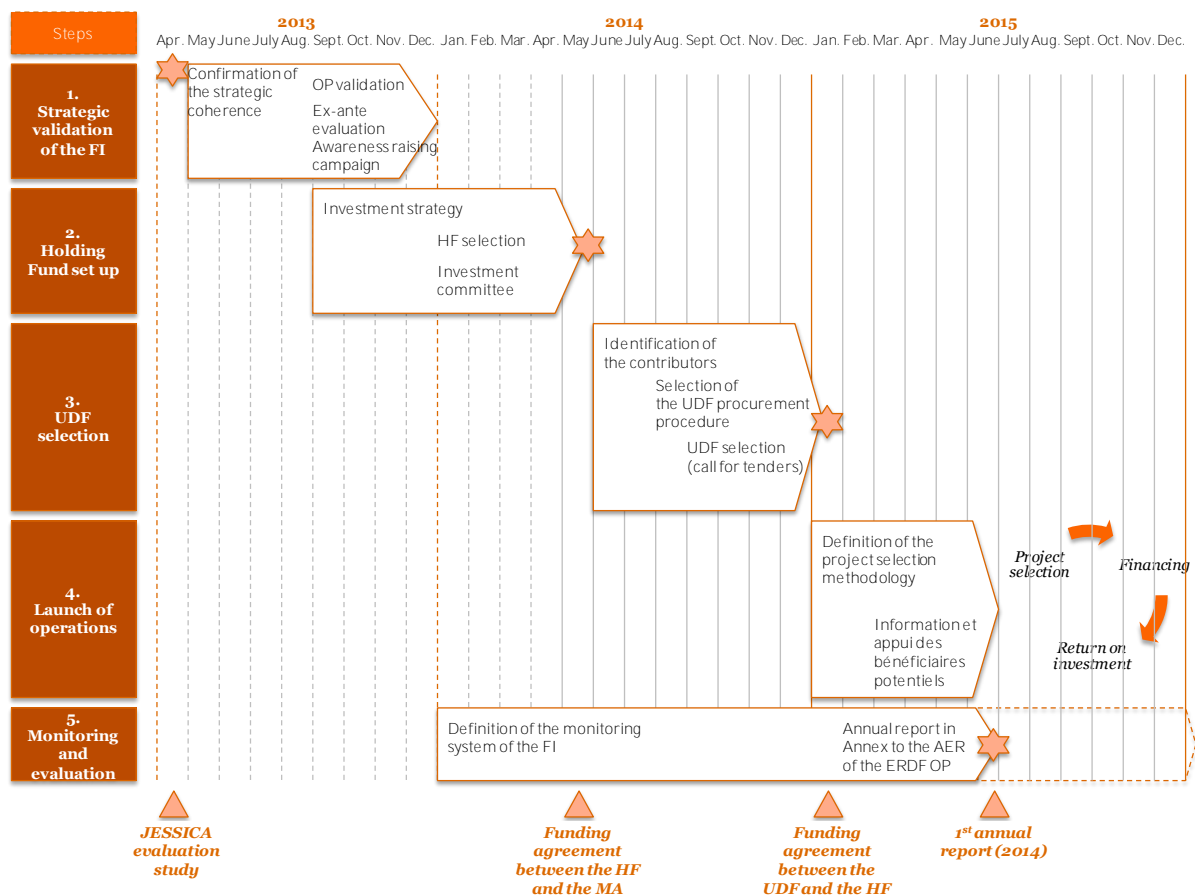
- The name of the program and the priority under which support from the CSF Funds is granted;
- A description of the financial arrangements and the implementation methods;
- Identification of the organisations to which the implementation tasks have been entrusted;
- The total disbursement, by program, priority or measure, of the Financial Instrument mentioned in the claims submitted to the Commission;
- The total amount of assistance disbursed or committed for guarantee contracts by the Financial Instrument to the final recipients, by program and priority or measure, included in the requests for payment submitted to the Commission;
- The income of the Financial Instrument and repayments thereof;

- The multiplier effect of investments made by the Financial Instrument and the value of investments and participations;
- The contribution of the Financial Instrument to the achievement of program indicators and the concerned priority.

7.2 Indicative timetable

The following timetable is indicative and may be modified depending on the future regulation of the Cohesion Policy 2014-2020. The proposed timelines will allow the management authority to highlight the first investment in the first year of implementation of the ERDF Operational Programme report.

Figure 23: Indicative timetable



8 *Conclusion*

If Lorraine opts for the implementation of a Financial Instrument dedicated to integrated and sustainable urban development, it seems essential to pay particular attention to the following key factors for success, beyond the recommendations and action plans set out above:

Provide technical assistance for setting up projects

Use of Financial Instruments requires the development of project evaluation expertise as well as an increased awareness of the concept of return on investment and the forecasted business plan. Technical assistance will be needed to ensure that these tasks of the project preparation are successfully carried out.

Redefine the scope of the projects

It is essential to have the ability to redefine the scope of projects to ensure that they are *integrated, sustainable and bankable*. A Financial Instrument requires involving the public sector together with the private sector on larger scope projects while ensuring the public sector make a financial return. In the long run, this return will be used to help recycle the funds initially invested.

Separating the economic and political time horizons

The logic of Financial Instruments is associated with a multi-year vision; public actors are required to adopt a broader perspective to consider the projects in their entirety in the medium to long term.

Involve regional actors

EPFL and the CDC have key roles to play in the implementation of these Financial Instruments.