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# Multi-Region Assistance Project-Revolving Investment for Cities in Europe (MRA-RICE)

## Case Study – The Hague

Case study

August 2018

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# 1 The Energiefonds Den Haag (ED)

## 1.1 Context

"*Energiefonds Den Haag*" (ED) Fund is a city fund set up in 2013 in The Hague, under the Holding Fund "*Holdingfonds Economische Investeringen Den Haag*" (HEID). The fund was launched as part of the JESSICA initiative[1], in cooperation with the operational programme "*Opportunities for West*"[2] and under the guidance of the EIB. The HEID was launched to manage the ED fund, as well as a second Urban Development Fund (UDF) "*Fonds Ruimte en Economie Den Haag*" (FRED), focusing on the development of small scale business premises and retail. The city funds and the HEID went operational in October 2013.[3] The aim of the ED Fund is to co-finance energy projects integrated in sustainable urban development plans with loans, guarantees and equity investments. Financed from national and European financing sources, its current size amounts to EUR 18.4 m. The main characteristics of the ED Fund are provided in the table below.

**Table 1: Main characteristics of the ED Fund**

| | |
|---|---|
| **Type of FI** | Debt, equity, guarantees |
| **Financial size** | Total size: approx. EUR 18 m<br>• EUR 11.5 m public funds (ERDF through "Opportunities for West II")<br>• EUR 2.5 m National Co-financing fund<br>• EUR 4 m City of The Hague |
| **EU leverage*** | 1.51x (leverage effect of ERDF funds) |
| **Public resources leverage*** | 0.9x (leverage effect of ERDF funds together with national city funding) |
| **Thematic focus** | Energy projects integrated in sustainable urban development plans |
| **Final beneficiary** | Public and private entities |
| **Partners involved** | City of The Hague, Central government |
| **Life of the Fund** | Unlimited (but aiming at 25 years) |

** At fund level* *Source: SVn, Fund Manger*

## 1.2 What is interesting about the ED Fund

In order to address the financing needs of urban development projects in energy as well as to reflect the objectives formulated in the strategy of the city regarding sustainable development, the city of The Hague has established a dedicated financial instrument to support investments in sustainable energy. The ED Fund was set-up as a **sectoral city fund,** which has become a **part of the multisector Holding Fund HEID**. This organisation set up that was implemented by The Hague, and falls under the fund-of-funds, defines an interesting structure for those cities, which identified

[1] The Joint European Support for Sustainable Investment in City Areas (JESSICA) initiative was developed by the European Commission and the EIB in collaboration with the Council of Europe Development Bank to implement Urban Development Funds in cities. These funds aimed to use the EU's Structural Funds to provide financing to sustainable urban development projects, i.e. through equity, loans and/or guarantees.

[2] 'Opportunities for West' (Kansen voor West) is the operational programme of West Netherlands, which comprises four provinces (North and South Holland, Utrecht and Flevoland) financed by the ERDF: https://www.kansenvoorwest2.nl/nl/

[3] CitYnvest project Energy Fund Den Haag: http://citynvest.eu/content/energy-fund-den-haag

investment needs across different sectors and are planning to carry out multi-sectorial investments.

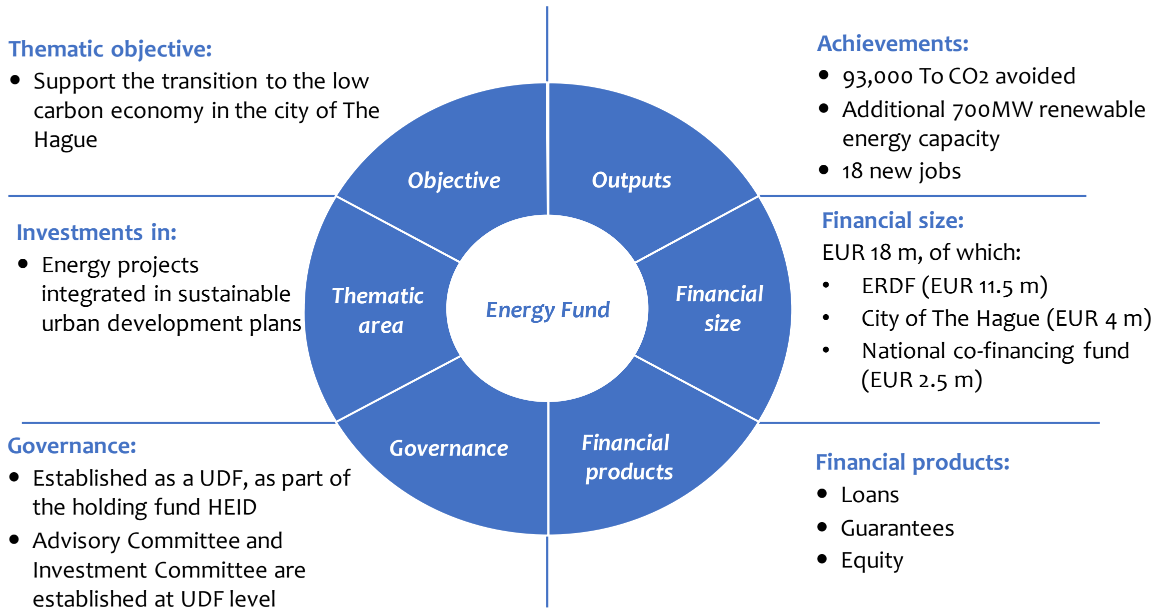
The fund's **investment strategy**, which was designed to provide a diversified offer of financial products for energy projects, was recently revised to align it with the city's investment priorities. Thus, the fund scope will be enlarged from The Hague to the entire Province of South Holland. To improve synergies with the other funds in the Province, the ED fund will focus on financing heat production projects related to renewable energy and waste heat.

In terms of **governance**, the fund operates under a Limited Partnership agreement, as part of a holding fund which is set up as a foundation. This set-up brings a flexible scheme, which enables investors to enter and exit the fund, according to their preferences. The holding fund deploys funds to the ED, the key characteristics of which are presented in Figure 1.

The ED fund **initiated the fund as a pilot**, with a limited initial fund size. Other city funds could build on this experience and start on a small scale to test the model with moderate financial commitments.

Furthermore, the ED Fund has participated in **Public Private Partnership (PPP) investments** for geothermal projects, which could be potentially relevant for other city funds financing PPPs.

Figure 1: Summary of the ED Fund in The Hague



# 2 Project pipeline

## 2.1 Financial products

The development of the project pipeline is the responsibility of the Fund Manager. The project pipeline detailed underneath showcases eight projects, which were all financed through debt products. Of these, one had also access to an equity participation. This list shows that the terms applied can vary strongly across transactions:

- The loan size varies from EUR 72 k to EUR 4.5 m;
- The loan duration spans between 2 to 16 years;
- Interest rates ranges from 3.4% to 8.5%.

**Table 2: List of the financial products disbursed**

| Loans | | | | | |
|---|---|---|---|---|---|
| **Project (*)** | **Project type** | **Loan size [€]** | **Term of loan [years]** | **Interest rate %** | **Grace period [years]** |
| Project 1 | Solar PV energy | 72 k | 12 | 4.6 | 0 |
| Project 2 | Geothermal energy | 800 k | 8 | 6.5 | 5 |
| Project 3 | Cooling installation | 844 k | 10 | 4.5 | 0 |
| Project 4 | Solar PV energy | 2.8 m | 16 | 3.4 | 0 |
| Project 5 | Geothermal energy | 1.3 m | 12 | 6.5 | 10 |
| Project 6 | Geothermal energy | 800 k | 10 | 7.5 | 3 |
| Project 7 | Wind energy (RDI) | 1 m | 2 | 8.5 | 2 |
| Project 8 | Geothermal energy | 4.45 m | 16 | 4.5 | 4 |
| **Equity** | | | | | |
| **Project (*)** | **Project type** | **Investment size [€]** | | | |
| Project 8 | Geothermal energy | 100k | | | |

(*) *The project name was anonymised for confidentiality purposes.*

The ED Fund provided mostly debt financing and no standardised conditions were applied across the projects. The amount and type of financing was adapted to market failures identified at project level. To be eligible for the financing from the fund, the candidate projects need to prove that they have not been successful in securing financing from commercial banks.

## 2.2 PPP investments

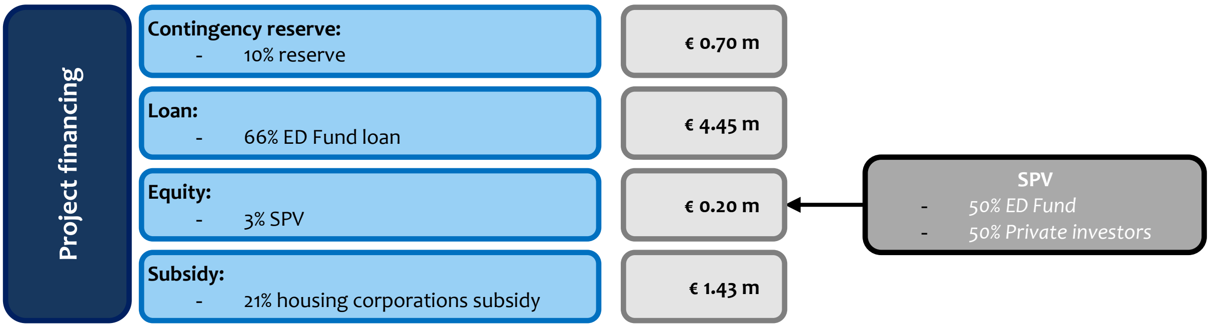
The ED Fund has participated in a PPP investment to finance a geothermal project. As part of this, it intervened with:

- A **loan**, covering 66% of the investment (EUR 4.45 m);
- An **equity share**, covering 50% of the equity tranche that was equal to the 3% of the investment (EUR 100 k).

The other two private companies participating in the Special Purpose Vehicle (SPV) acquired both an equal amount of the investment, corresponding in total to 50% of the equity share (EUR 100 k).

As shown in Figure 2, the ED Fund loan and the equity investment were complemented by a subsidy of EUR 1.43 m and a contingency reserve of EUR 700 k for risk management purposes to offset any exceeding costs incurred by the projects. The contingency reserve has been financed by one of the project's private investors.

Figure 2: Project financing for the PPP investment




The intervention in this particular case was actually triggered by the financial distress of the SPV, which pushed the city to intervene to preserve the public interest. The **equity participation in the SPV ensured voting rights to the ED Fund**, allowing them to have decision power to steer the project and safeguard the **public interest** in the project development. The equity share of the fund was limited to 50% of the equity tranche to ensure the balance of the parties involved and be compliant with State aid rules.

# 3 Investment strategy

The operations of the ED Fund were defined by its investment strategy for 2013-2015. A new investment strategy was validated in the second quarter of 2018, following the approval of the new project plan on 12 March 2018. The analysis in this section focuses on the investment strategy, which is currently implemented.

## 3.1 Area of investment

The fund facilitates investments in energy projects that cannot be supported by conventional commercial financing, due to higher risk profile or lower rate of return compared to conventional energy projects. These projects, however, are still considered to be **economically viable**, since they bring major social, environmental and economic benefits and are integrated into sustainable urban development plans. These projects should be aligned with the policy priorities set at city level, including:

- Priority 1 of the "The Hague Implementing Programme 2007-2013"[4] focused on the knowledge economy, entrepreneurship and innovation;
- The themes set out in the city policy and action programme for 2014-2018, also called the Coalition Agreement;[5]
- The energy policy of The Hague; and
- The Hague ERDF Implementation Programme for the period 2007 – 2013.

The areas of investment targeted are innovative projects in sustainable energy such as wind, solar, biomass, hydropower and energy efficiency (enterprises). Other considered areas are environmental innovation (soil remediation, water management and waste processing), including pilot projects and projects aimed at the development of prototypes.[6]

## 3.2 Financial products

According to the investment strategy, the **ED Fund can provide all financial products authorised as part of the JESSICA initiative, i.e. equity, mezzanine capital, loans and guarantee instruments**. Applicable financing conditions are specified for each individual financing negotiation. The main conditions applying to these transactions are the following:

- **Loans** cover mostly 20-25% of the project investment, typically up to a maximum of 50%; however, the size of the fund's intervention should reflect the market failure. Therefore, exceptions could be considered in specific situations as in the example described in the section above, where the fund's loan represented 60% of the total investment cost.
- For **equity** investments, participations in single projects should not exceed 20% of the total capital investment; no minimum investment size is set; the fund manager should step out of the project as soon as the project becomes self-sustainable, and has access to commercial

[4] Investeringsstrategie van het Energiefonds Den Haag (ED) 2013-2015, SVn, adopted by the Investment Committee February 6, 2015

[5] Coalitie akkoord June 2014; City coalition agreement/programme 2014-2018 June 2014

[6] Investeringsstrategie van het Energiefonds Den Haag (ED), 2013 – 2015, February 2015

financing. Exceptions may occur for specific projects, as described in the example (see Figure 2).

- **Guarantees** can cover a maximum of 75% of the project's investment.

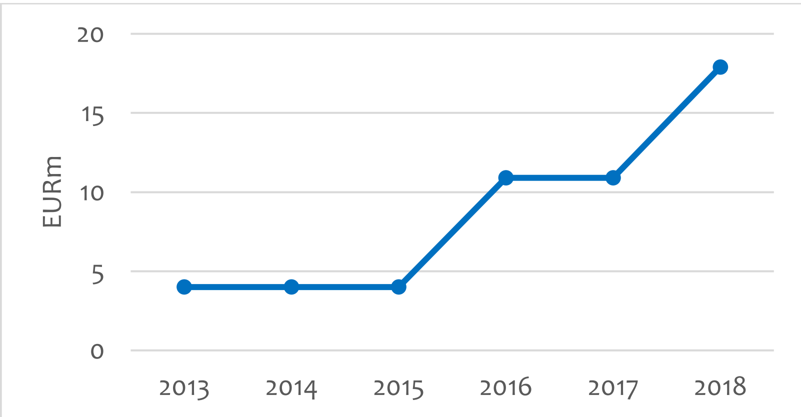
## 3.3 Target recipients

The target recipients of the ED Fund are project developers, housing corporations, businesses, foundations, non-governmental organisations and public entities, e.g. municipalities and local authorities.[7]

## 3.4 Fund size

As of March 2018, the total volume of the ED Fund amounts to EUR 18.4 m. The most substantial contribution comes from the ERDF (EUR 12.2 m), followed by the City of The Hague (EUR 4.5 m) and the national co-financing of the Ministry of Economic Affairs (EUR 1.7 m). The fund has experienced a rapid growth in the past years; it started with EUR 4 m in 2013, subsequently reaching EUR 11 m within the first three years, to finally attain EUR 18 m in 2018, as depicted in the Figure 3.

**Figure 3: Evolution of the funds under management, ED Fund**




*Source: PwC 2018, based on data from the municipality of The Hague*

## 3.5 Revolving effect

Since 2017, there have been payment reflows on three projects. The Fund Manager aims to have the amount invested into the ED Fund revolve once within a period of maximum 25 years.[8] The revolving amount is expected to be of EUR 17 m in the period 2018 – 2032.[9]

## 3.6 Remuneration scheme

The HEID charges 1% management fee to the ED Fund. SVn's fund management fees amount to 2.9% per annum of the capital contributed to ED.

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7 CitYnvest, Energy Fund Den Haag, ED, The Hague territory: http://www.citynvest.eu/sites/default/files/library-documents/Model%2010_Energy%20Fund%20Den%20Haag_ED_final.pdf

8 The reference date refers to when the funds were disbursed from the HEID Fund into the ED Fund

9 Expected results according to memo from the fund manager to the investment committee, September 2017

# 4 State aid

## 4.1 State aid at the ED Fund level

The fund was designed in compliance with State aid rules:

- The need for the set-up of a financial instrument leveraging on ERDF was outlined as part of an ex-ante assessment[10] in 2012.[11]
- The Fund Manager was selected in 2013 by means of a public tender procedure.

## 4.2 State aid at the end beneficiary level

State aid rules at the end beneficiary level were applied based on a process referred to as "Cascade approach". Various specific verification steps are taken at the level of each project to assess whether the financing is market conform or, if not, whether any State aid exemptions apply or if State aid notification is required. More specifically, the process followed by the Hague involved the following main steps:

1) First, the project is assessed to verify, whether there is a market failure linked to its financing. The project is eligible for financing from the Fund only if market failure is confirmed.

2) If market failure is confirmed and the potential financing contribution is under assessment, the next step consists in reviewing the credit rating of the debtor and their collateral position. This information is analysed to understand if there is a possibility of State aid. Other aspects, i.e. the impact of investments on the market to avoid market distortions, are also assessed.

3) Based on the credit rating and the collateral of the borrower, the fund verifies if the financing terms (i.e. loan interest rate) are in line with EC guidelines. Based on the credit check and on the analysis of potential market distortions, the assessment shows if there are elements of State aid and if any State aid exemptions are applicable.

4) Where the project does not qualify for State aid exemptions, the fund files State aid notification. Projects with an element of State aid can be approved if they stay within the maximum limit of EUR 13.61 m as set out in the State aid notification[12] of the JESSICA funds;[13] if this amount is exceeded, the Fund Manager is obliged to report to the Managing Authority, which acts as the responsible authority for State aid issues.

Of the projects financed so far, two of them had an element of State aid; thus they were notified to and approved by the programme authority *"Opportunities for West"*.

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[10] Evaluation study carried out to estimate the potential impacts of specific future interventions; it is used in particular to design financial instruments to be financed through EU Structural Funds

[11] JESSICA Architecture in the West-Netherlands Region, March 2012

[12] The control procedure of the European Commission for the presence of State aid is based on the principle of the notification. The Commission needs to be notified about any aid measures and give clearance to their implementation: http://ec.europa.eu/competition/state_aid/studies_reports/sa_manproc_en.pdf

[13] Aid to the final beneficiary is part of the approved state aid notification SA.34660 (2012/N)

# 5 Fund set-up and Governance

## 5.1 Structure of fund

The fund is a revolving fund established by the Municipality of The Hague in 2013, as a Limited Partnership under Dutch law ("Commanditaire Vennootschap"). The ED Fund is owned by the Holding Fund HEID. The Limited Partnership scheme allows for a flexible entry and exit scheme for the fund's investors. The scheme allows for changes in the composition of the partners based on informal agreements.[14]

The **Fund Manager is appointed by the Holding Fund HEID**, **as part of an Operational Agreement**. The Fund Manager has set up a foundation, which serves as the Managing Partner of the Limited Partnership.

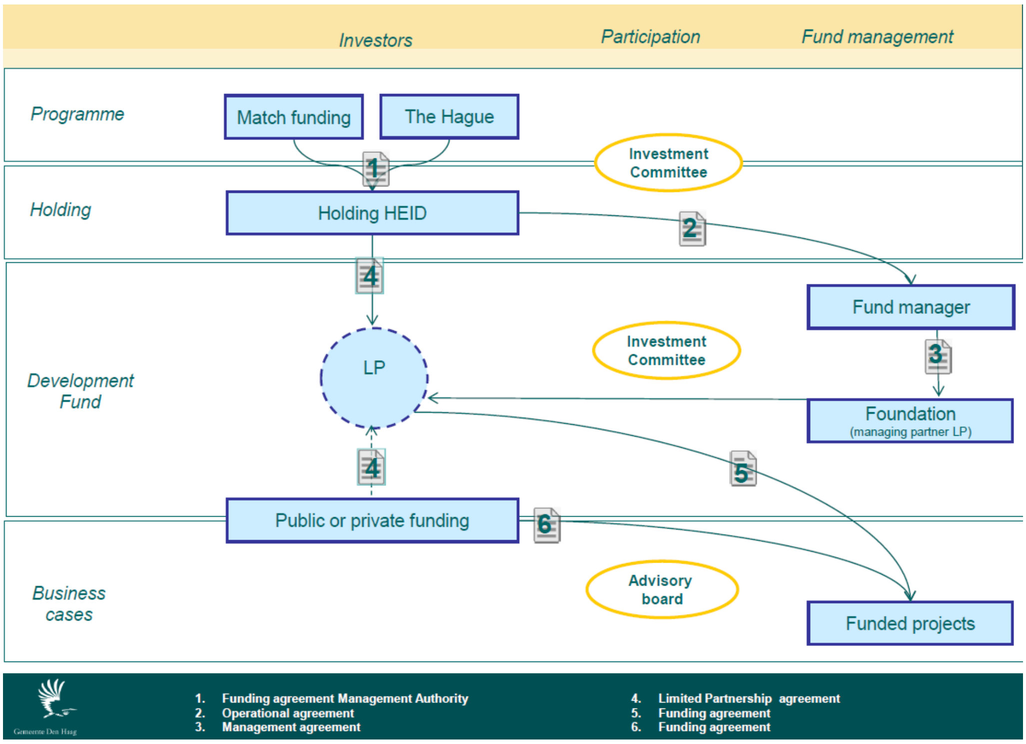
The Fund Manager operates under a Management Agreement set up between the foundation and the ED Fund. In this set-up, the responsibilities of managing the Fund are assigned to more than one entity. As a Managing Director, the foundation is responsible exclusively for the management of the Limited Partnership, whereas the Fund Manager is in charge of a day-to-day management of the fund. As a consequence, the Fund Manager can take investment decisions independently.

A Funding Agreement allocates the ERDF funding and national co-financing from the Managing Authority "Opportunities for West" to the foundation of the Holding Fund HEID, managed by the Municipality of The Hague. It is then used to finance urban development projects, which are set up as part of Financing Agreements with the ED Fund. Private investors can invest in the Holding Fund HEID, the Energy Fund and at project level.

The graph below illustrates the legal set-up of the ED Fund.

[14] JESSICA Architecture in the West-Netherlands region, Evaluation study, March 2012

Figure 4: Legal set-up of the ED Fund




*Source: City of The Hague*

## 5.2 Governance

The ED Fund is managed by an external **Fund Manager**, an independent non-profit foundation, "*Stichting Stimuleringsfonds Volkshuisvesting Nedelandse gemeenten*" (SVn). The **external Fund Manager was selected through a public tendering procedure**[15] **and is appointed by HEID**. The Fund Manager is responsible for the development of the project pipeline and undertaking investment decisions based on the investment criteria defined in the investment strategy.

The **Investment Committee**[16] supervises the performance and functioning of the ED Fund. It advises on, approves and validates any amendments to the investment strategy. The Investment Committee is composed of one independent member, a maximum of two members nominated by the Holding Fund HEID, and one for each shareholder holding at least 25% of the shares in the ED Fund.

[15] The initial tender was published in 2012, as an open European call for expression of interest with three separate lots for the management of the city fund. The candidate companies were invited to a meeting to receive relevant information and received tendering notes. Finally, two companies applied, but none of them was selected, as they did not meet the selection criteria. As a consequence, a new call for expression of interest was launched, organised as a closed call to three suppliers which showed interest in the first public call. SVn was selected from this call. When the initial contract period finished, no new procurement procedure took place. Instead the fund manager (the Managing Foundation) applied directly for the ERDF subsidy, in close cooperation with the HEID foundation, using the mechanism of "quasi-in house" contracting. Quasi-in-house contracting refers to the direct appointment of an organisation to a specific position, without having to participate in a public or restricted tendering procedure and is defined by the regulation 2014/24, article 12, regarding public contracts between entities within the public sector.

[16] Regulations concerning the composition and working method of the Investment Committee

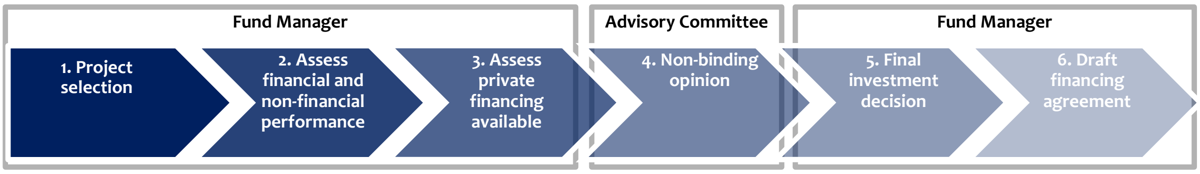
The **Advisory Committee** advises the Fund Manager on the allocation of funds and on the investment strategy. The Committee reviews the proposed investment decisions and verifies their compliance with the applicable investment strategy. Furthermore, the Committee reviews the amendments proposed to the investment strategy. Based on this analysis, it provides a written non-binding opinion to the Fund Manager. The Advisory Committee consists of a representative of the ED Fund, two representatives of the HEID, and one representative for each of the ED Fund's shareholders which detain a minimum share of 25%.[17]

## 5.3 Investment process

The investment process of the ED Fund follows the main steps outlined below and illustrated in Figure 5:

1. The **Fund Manager selects projects** which are in line with the investment strategy of the ED Fund.
2. The Fund Manager **assesses each financing request**, to verify the project's financial feasibility, as well as its non-financial social and environmental benefits.
3. The Fund Manager **assesses** whether the beneficiary has taken sufficient measures to obtain financing from private financing sources, i.e. testing the **evidence for market failure**.
4. The **Advisory Committee** provides a **non-binding opinion** on the submitted financing request.
5. The **Fund Manager decides** on the request for financing based on the information acquired and on the opinion of the Advisory Committee.
6. In case of a positive outcome, the fund manager **drafts the financing agreement.**[18]

Figure 5: Structure of the investment process, the ED Fund




Source: PwC, 2018

[17] Regulations concerning the composition and working method of the Advisory Committee (no date)
[18] Regulations concerning the composition and working method of the Investment Committee (no date)

# 6 Conclusions

## 6.1 Achievements

The total amount of the funds committed in 2014 were invested before July 2016. The financial results of the ED Fund in the first years have been negative, since there was no reflow on the principal and interest payment. In 2017, an annual gross result achieved by the fund amounted to 5.5% less the management fees (of 2.9% and maximum 1 % for the management of the ED and the HEID fund, respectively) resulting in **a net profit of 1.6%.**[19] The leverage effect of the ERDF funds amounted to 1.51, however additional financing attracted came from the public sources. The investments achieved following non-financial objectives:

- **Greenhouse gas emission reduction of approx. 93,000 tons $CO_2$eq;**
- Additional **700 MW of renewable energy capacity financed;**
- **A total of 18 new jobs created.**

## 6.2 What can be replicable from this model for the set-up of a city fund and how?

### 6.2.1 Investment strategy

The principles used to define the investment strategy of the ED Fund could potentially be replicable for the set-up of other city funds in Europe.

The design of investment strategy allows for flexibility in terms of **financial products and sectors targeted**, as well as to test different financing solutions depending on the market failure identified at project level. While **loan financing** covers **more than 90% of the investments** analysed, there seem to be **no standard terms** applicable to the single deals. The loan amount, duration, and the availability of a grace period vary among projects. This model can be replicable for funds targeting projects with heterogeneous financing needs, risk and profitability profiles.

The model of **PPP financing** presented in this case study intervened in a specific context under a re-financing of the project SPV that experienced some financial distress. However, this could be a common situation to many PPP deals and it could be an example for other city funds on how the public interest can be safeguarded.

This case study could also be a source of inspiration for direct investment in PPP by other city funds although it is well known that any PPP transaction is a specific and unique.

The decision to start off the fund as a **pilot**, with an initial limited **fund size**, could be a replicable experience for other funds as well. Other city funds could build on this experience and start off in small scale, testing the model with moderate financial commitments.

***The investment strategy defined for the city fund in the initial stage should remain sufficiently flexible in terms of financial products and sectors targeted, to test how different financial products address the market failures identified.***

[19] Calculated based on an annual gross result of 5.5%, a management fee of 2.9% for the ED Fund and of 1% for the HEID

### 6.2.2 Set-up of the city fund

The **set-up** of the ED Fund, as a **sectoral city fund,** which is a part of the **multisector** Holding Fund HEID, could also be replicated in other urban contexts. The **fund-of-funds** structure with **thematic city funds** could be relevant for those cities which identified investment needs across different sectors and are planning to carry out multi-sectorial investments, however still require Fund Managers with sectorial expertise, as well as the definition of tailored investment strategies for each of sector.

The appointment of an **independent Fund Manager** ensures that the taken investment decisions follow an independent appraisal, based on the defined investment strategy. This is crucial to attract new sources of financing, and in particular **private sector investors**.

With the establishment of **Limited Partnerships** for the Fund-of-Funds and each city fund, the cities can attract potential future investors at different levels (fund-of-funds, city fund and/or projects). The set-up of Limited Partnerships might depend on the regulatory framework applicable to each country.

***To invest across multiple sectors with well-defined sectoral strategies, the set-up of a Fund-of-Funds encompassing sectoral city funds should be considered. The appointment of an independent Fund Manager is crucial to make the fund attractive to private investors.***