

**Local Action Plan CSI Europe
Investment Strategy
Holdingfund Economic Investments The Hague**

Summary
31 March 2015



1 Introduction

Municipality of The Hague founded in 2013 the foundation "Holdingfund Economic Investments The Hague (HEID)" in order to deliver a new financial instrument for economic development. Subsequent the former experience in investing in seed capital funds for starting SMEs the Holding facilitates long term revolving investment in urban development, as well geographically focused as thematic focused. Utilising European funding from the European Regional Development Fund (ERDF) and match funded by local public funding the Holding¹ succeeded in running the first JESSICA²-pilot in the Netherlands.

The pilot concerned a (certainly seen on a European scale) relatively small-scale pilot within the JESSICA philosophy. Nevertheless the pilot has delivered very relevant experience with a new kind of public-private partnership and brings forward a sustainable future- and Europe proof financing vehicle. Moreover investments will recycle because of the way they are structured which means that the funding can be multiplied.

HEID aspires a long term availability of capital to jointly invest with other public and private investors in an integrated and sustainable urban development for The Hague and its economic domain (regional, national and cross-border). To learn from other European "JESSICA"-cities The Hague participated in the URBACT project "CSI Europe". A network of cities that consider how financial instruments can help cities to deliver integrated sustainable urban development. The key themes that het network has explored are governance, state aid, technical assistance and regulation. The network sought to identify new models for investment through financial instruments. Annex 1 of the Investment Strategy presents an overview of the lessons learned.

Resulting from the partner meetings and the gathered experiences each partner city delivers a Local Action Plan. The Local Action Plan The Hague aims to define the new investment strategy for economic urban investment using financial instruments between 2015 and 2020. This way, the original JESSICA investment strategy which was drafted on EIB model, will be elaborated and suited for more different investment purposes within the economic range of The Hague.

The investment strategy addresses the strategic focus, governance and an operational plan.

¹ Objective is to organise the Holding as "light" as possible.

² Joint European Support for Sustainable Investment in City Areas

2 City context and definition of the initial challenge/policy issue

The Hague has a unique profile as city of Peace and Justice with a high-quality working and living environment and a strong knowledge-intensive business sector which makes it an attractive location for headquarters and international organisations. In order to reap the benefits of these assets, the availability of highly skilled workers and an attractive, dynamic urban environment is crucial. Despite these strong assets, the economy of The Hague is facing a number of challenges and a transition is deemed necessary. The number of jobs has decreased by 5% since 2008. At the same time the population has risen, and so did unemployment figures. This job decrease cannot be fully assigned to the economic crisis, for an important share it has to do with the structure of the economy.

Within The Hague there has always been a large number of jobs within the public sector (especially within the central government) and within business services. As a result of structural austerity measures the number of jobs in the government sector is shrinking and this seems to be a structural trend. Also the business services sector is declining as a result of automation and internationalisation. Strengthening the flourishing clusters of the city and at the same time broadening the economic basis is thus of great importance.

In this respect the mismatch on the job market deserves mentioning. In The Hague there is a relatively large number of low skilled people and at the same time a demand for qualified and highly skilled labour from international organisations, innovative SMEs and fast-growing companies. This mismatch threatens to slow the recovery of the economy and can be a serious threat to The Hague's proposition to international headquarters and international organizations. Investing in strong clusters and new economic drivers can be a means to create highly skilled jobs. This investment strategy needs to ensure that the creation of highly-skilled jobs triggers the creation of jobs on other skill-levels. Whilst at the same time people are empowered and encouraged to earn at least a basic qualification.

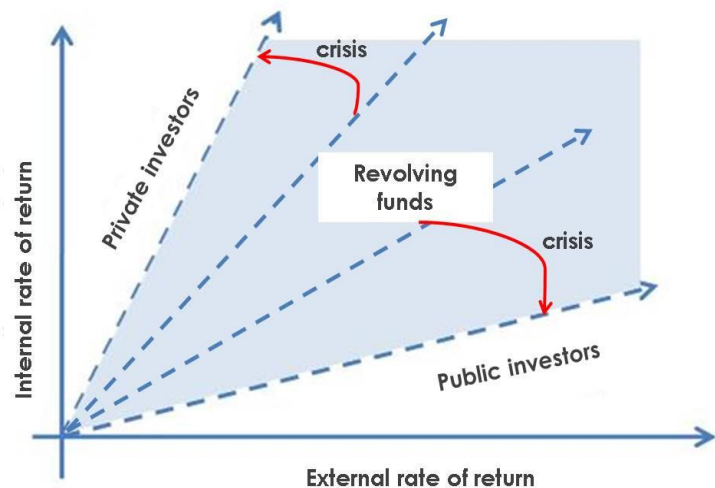
The city is eager to respond and facilitate to its citizens and entrepreneurs in a way that is according to actual problems and chances. This is perfectly in harmony with the JESSICA philosophy to jointly invest in the future of cities and with the coalition agreement 2014-2018.

The **coalition agreement 2014 – 2018** '*Trusting the power of The Hague*' is leading in determining the '*couleur locale*' in the policy goals of the investment strategy. Guiding principles in the agreement are (1) enactment close to entrepreneurial people in the city and (2) providing space and support where necessary. The city aims to broaden its economic basis and create new jobs (at least 10.000) by strengthening the strong economic clusters (Justice and peace, tourism, security, ICT and congresses) and by providing room and support for promising new initiatives of young creative entrepreneurs. Cooperation between the triple helix partners of government, knowledge institutes and entrepreneurs plays an important role in achieving this.

The Hague chooses a future viable urban development. The big challenge will be to attract investment capacity to the city and link the potential to multiply the investment strategy. Any level of funding can be considered, most likely The Hague is aiming at public partners such as European Union, national government, regional institutions. But only to facilitate and match fund private parties to invest in urban business cases.

Due to market failure and financial crisis banks are not financing businesses which can not meet the more strict requirements they face last years although there is proof of a sufficient level of internal return on investment. Government institutions used to meet recession with additional public spending. Specifically by awarding grants to urban development initiatives to prevent further stagnation in private investment. These days also government budgets are declining which leads to more focussed policy goals and a serious decreased subsidy budget. Initiatives with a perspective of self support and for that reason less need for public support therefore are the first to experience funding gaps.

Since the foundation of the Holding Fund “HEID” the city of The Hague has a new and flexible instrument to invest revolving, rather than subsidising. HEID applies for grants and funding capital and will be investing this public money just there were private investors and private capital is lacking. HEID investment must be proven additional and only when business cases show a funding gap and when at least sufficient external return on investment is guaranteed. The targets for external return on investment will be matched to the policy goals set by the supporters of the HEID investment capital.



Supported business cases need to generate at least enough return on investment to be able to pay off. While HEID receives return on investment public investment will be available for re-investment and thus for a relatively longer period compared to the use of subsidy. Smart financial engineering will help spur investments which make a demonstrable contribution to the strengthening of the economic structure of The Hague, employment for everybody, and sustainable development. These investment are to be supported by firms and citizens in the city.

Europe	<ul style="list-style-type: none"> • Juncker Fund • EIB • ERDF (KvW2)
National	<ul style="list-style-type: none"> • Future Fund • National Energy Fund • Fisheries Fund NL
Regional	<ul style="list-style-type: none"> • local/regional inst. • Credit unions • Local stock market

The holding vehicle certainly provides opportunity for future participation in or cooperation with other revolving funds.

On the one hand, HEID might be able to interest leading (AAA) banks such as European Investment Bank to invest against fairly advantageous conditions using the benefits of the ERDF funding in respect to risk aversion.

On the other hand HEID is interested to look after opportunities for local private investors to co-invest in some of the development funds HEID is investing in. For example structured by a local stock market.

3 Setting of focus and objectives

More specific the **Operational programme The Hague 2014-2020** defines the transition of the economy towards a smart urban strategy. This Operational programme, as part of the ERDF Operational Programme for West Region (2014-2020) relates the local and regional policy goals to the European Agenda 2020.

To empower the local economic profile The Hague challenges the opportunity to built up on the image of governmental city and city of peace and justice a stronger basis in job growth, top (international) business and local economy. The Operation programme therefore will be investing in three priorities:

- ✓ Smart growth: Innovation
- ✓ Sustainable growth: Low carbon economy
- ✓ Inclusive growth: Sustainable urban development

Innovative SMEs have difficulty gaining access to financial resources for their innovations. Recent research shows that despite the existence of a number of financial instruments from the central government and the private sector both young and existing SMEs are facing a shortage of growth capital. These shortages are at largest in the so-called 'valley of death', the crucial phases of proof-of-concept and valorisation of innovations. Both the supply of capital and the access to capital are problematic. The Holdingfund will look after ways tot effectively invest especially in important local economic clusters like security and for example the harbour development at Scheveningen. Again, orientation can either be thematic or geographic.

The Hague, just as other large cities in Europe, faces the challenge of lowering its carbon footprint. Investments are needed in the built environment in order to lower the energy usage of households and companies. Next to lowering the usage of energy, the generation of energy needs to be diversified, using more renewable sources of energy. The coalition agreement specifically envisions 'heath-energy' as a promising source for The Hague. It also recognizes that the sorting of waste can contribute to lowering the carbon footprint. The Hague acknowledges that the grand transition that is needed for a sustainable future cannot be achieved only by policy. It therefore attaches a great deal of weight to bottom-up initiatives from citizens and firms, and wants to encourage these initiatives financially.

Regarding local economic development The Hague wants to counteract the paradox of high growth potential in the knowledge economy versus social exclusion in deprived urban areas. Promising initiatives in the local development of several transformation areas, Scheveningen, Haagse Hout, Escamp, City Centre, Binckhorst needs to be encouraged, as well as important and promising business development, for example in tourism and greenery.

HEID: portal to revolving investment

Holding HEID for The Hague is the only structure for revolving investment using European funding. The governance is drafted in accordance with EIB advise and has been further elaborated following lessons learned from the CSI Europe project. HEID structurally engineers sustainable urban development using public funding to trigger private investment in the local and regional economy.

The foundation rules of HEID are:

- ✓ Strengthening the position of The Hague as international city of peace and justice;
- ✓ Promoting the city as attractive to entrepreneurs, employees, citizens and visitors;

- ✓ Advancing a healthy and sustainable economic structure, more specifically with regards to the promotion of clusters and stimulating vital, innovative SMEs;
- ✓ Encouraging talent and craftsmanship on the city's job market.

These rules will be used to formulate core indicators for the external rate of return of development funds. Within the foundation rules and building upon the JESSICA pilot HEID will be scaling up to new targets, funds without European funding and or a larger geographical scope. Of course only with the consent of the Investment Committee and the Board of Mayor and Aldermen. For each European funded new HEID investment in new development funds an ex ante examination of the necessity and effectiveness is obligatory. Ex ante examinations regarding funds supported with ERDF will meet the requirements set in regulation 1303/2013, article 37.

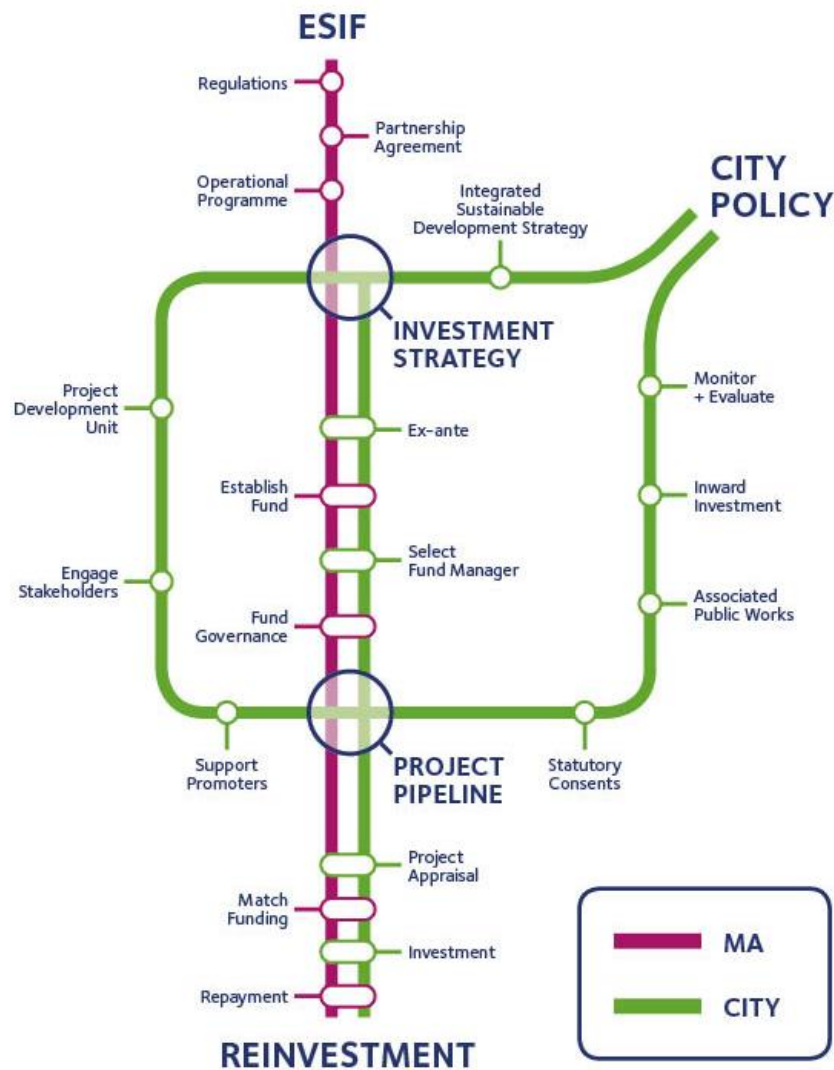
The Hague in cooperation with the province of South Holland and the municipality of Rotterdam started a capital market research for the priority "innovation" and the priority "Low-carbon economy". There are no specific models or regulations for the preassessment of other not European funded funds.

4 Actions Schedule

Holding HEID manages from the start two Urban development Funds, ED (Energy fund) and FRED (small scale local business units fund). These UDFs were implemented under the JESSICA philosophy. In close cooperation with the partners HEID experienced and learned how ideas about implementing revolving funds work when brought in operation. During the 2007-2013 programming period no standardized funding instruments were available, as the JESSICA and JEREMIE initiatives concerned pilots and therefore only provided guidelines to set up funding instruments. Standardisation – especially in the case of a notification-free state aid approach – was not the case. In developing the operational framework HEID has drafted its own ‘of the shelf’ models regarding the CV-agreement and the management agreement. The flexibility and practical use of the structure has already proven to be successful when in 2013 the Ministry of Economic Affairs accommodated a new development fund for Fishery (VIN) to HEID.

Using the lessons learned from cities across Europe in the URBACT CSI network The Hague has managed to make a well structured route map for implementing new funds, which is shown in the CSI Europe Route Map.

CSI Europe Route Map



The CSI Europe network has been eager to share its thoughts and advise upon the new regulations in an open letter to the European Commission. This way cities do have serious impact on better understanding and simplification of the regulations. As this influences the first step in the route map (purple line) for The Hague it is very important to maintain this kind of partnership with the Commission.

From “implementing regulations” to “repayment” the role of the managing authority is clearly defined. In international perspective The Hague has an extraordinary role in its cooperation with the managing authority. By means of **subdelegation** The Hague takes own responsibility for part of the operational program straight from the partnership agreement. This unique position made possible that The Hague could establish itself a Holding Fund and its governance. HEID has in accordance with the managing authority and the city of The Hague (program authority) gained responsibility during the JESSICA pilot to implement further steps itself from the establishment of the Fund downwards. By implementing governance a solid structure resulted which can be long lasting and can be used flexibly.

The city line (green) in the Route Map is not yet fully explored. One of the most important lessons from the CSI network regards the development of project pipelines. To make efficient use of the funds sufficient feasible investment ready business cases are needed. In the future progress on this issue will be made, for example by awarding specific contracts out of Technical Assistance. ELENA facility for cities might be an instrument to generate more capacity and new methodologies for project acquisition specifically for the priority low carbon economy.

In the preparation towards HEID participation in new development funds there seem to be various interesting opportunities resulting from current and future policy perspective:

Policy goal	Indication development funds
Innovation	<ul style="list-style-type: none"> 🕒 Accelerator funding 🕒 Proof of Concepts Fund 🕒 Seed Fund
Low carbon economy	<ul style="list-style-type: none"> 🕒 Energy Fund (local/regional) 🕒 Energy Fund private property 🕒 Thermal Energy Fund (The Hague/R’dam/Province SH)
Sustainable Urban Development	<ul style="list-style-type: none"> 🕒 Fund “Ruimte en Economie” (small scale business units fund) 🕒 Recreation/tourism Fund 🕒 Fisheries Fund NL (VIN) 🕒 Harbour Innovation Fund 🕒 “Haags Veen” Fund 🕒 Credit unions

Indication March 2015

First short term steps to be expected are:

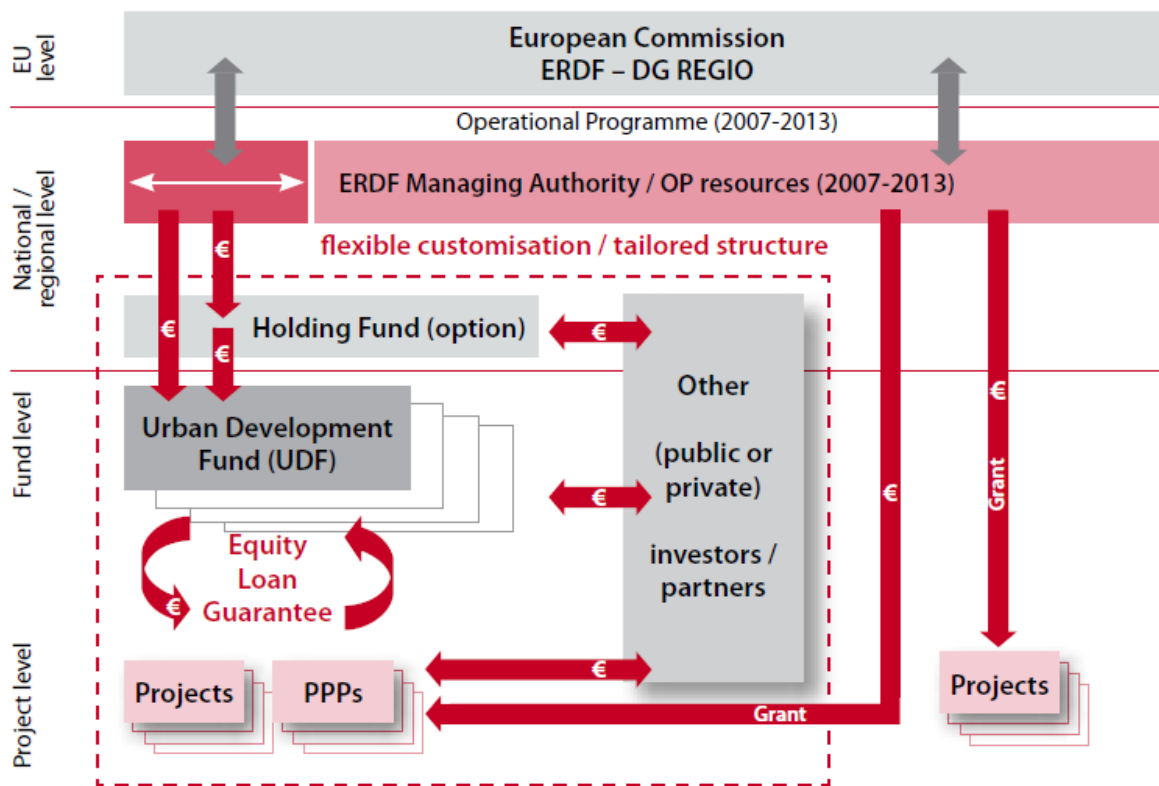
- ✓ Execute ex ante evaluation for the three new ERDF priorities
- ✓ Prepare new application for grants to be awarded to HEID, most certainly for ERDF OP 2014-2020
- ✓ Explore new initiatives like a local stock market, to attract capital from local investors
- ✓ Examine ways to multiply Holdingfund capital, discussing possibilities regarding EIB participation
- ✓ Show/present results from the JESSICA-pilot
- ✓ Built upon the lessons learned from the CSI network to enlarge the effectiveness of financial instruments.

With HEIDs perspective to revolving investment The Hague will also examine if the existing SME seed capital funds (Startersfonds I and II) can be adopted by HEID.



5 Funding scheme

The funding scheme in principal follows the structure as was designed in the Holding Fund handbook by the EIB/EU.³



This structure drafts the outline for JESSICA revolving investment. The structure has been elaborated in to a tailor made structure for The Hague. To make Holding HEID futureproof and broaden its scope to also make use of other funds besides EU funding in this investment strategy we point out some adjustments which were made for HEID to the global structure:

Funding HEID

- ✓ HEID funding capital exists in principal of public funding gathered by grant applications from European Funds like European Regional Development Fund) and EFF (European Fisheries Fund), but certainly national/regional and local public grants too.
- ✓ In future possibly private capital more specifically participation or loans from EIB will be examined using 'first loss' position of public funding.
- ✓ HEID is setup as a Holding as light as possible. Nevertheless HEID needs to finance its exploitation costs. In order to work budget neutral HEID charges to any development fund it is investing in a fixed 1% fee.
- ✓ At the winding up of the HEID investment in development funds remaining fund capital will be available for reinvestment unless managing authorities have enforced other arrangements. For example ERDF funding will stay within the HEID funding scheme.

³ Holding Fund Handbook, EIB/EU, 2010

Financing and / or granting

- ✓ In some cases revolving funding may complement the use of grants in all cases only in accordance to regulation.
- ✓ In order to develop project pipelines managing authorities might grant contracts or subsidise pipeline preparation.

Principles for joint support

- ✓ One of the basic principles for HEID is to be able to invest measure made. Flexible use of financial engineering instruments is needed to best meet market demands. Development funds therefore can make use of loan, equity or guarantee instruments. Other financial instruments will be considered when proposed in new investment strategies.
- ✓ As a key principle and as far as possible HEID will be investing against the same upside and downside risks as other public and or private investors will do (pari passu principle).
- ✓ Although deviation from market rules will be limited to the necessary minimum investments within the HEID structure are expected to be at sub commercial conditions (due to market failure).
- ✓ To increase the level of private investor participation preferential remuneration (preferential returns, priority returns, different investment timing) can be considered using the fair rate of return (FRR) principle.

6 Framework for delivery

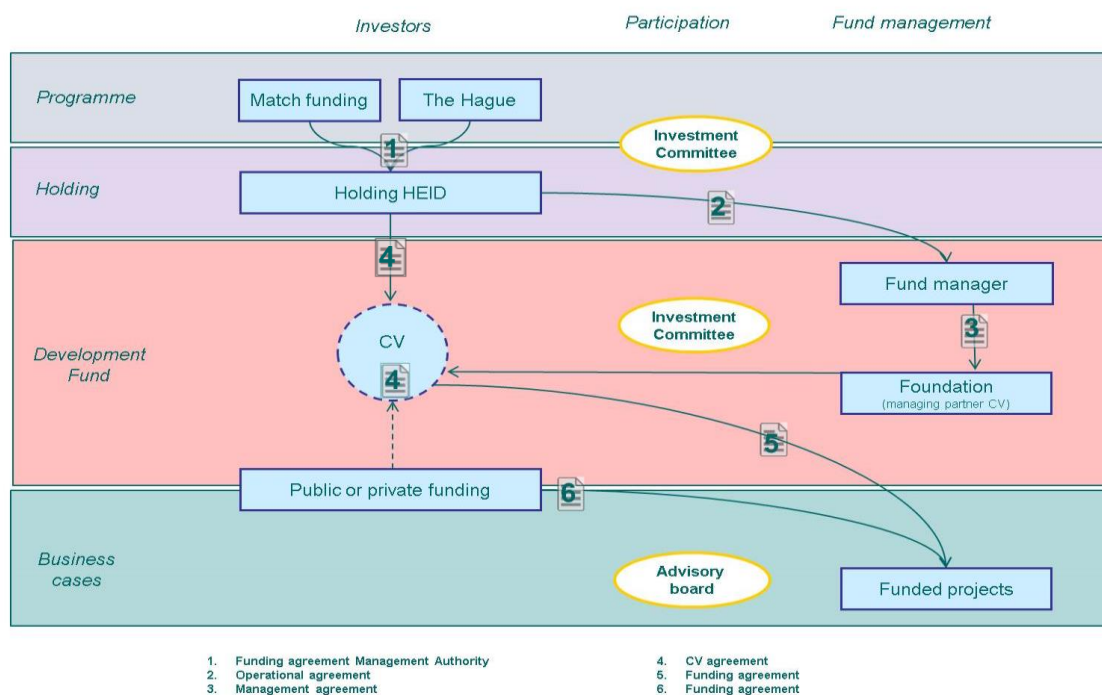
Starting the JESSICA pilot in the Netherlands EIB, Rotterdam and the Hague have been advised⁴ by Loyens & Loeff about the architecture that would best meet wishes and demands and also comply with legal requirements pertaining from European and national regulations. The framework for delivery has been established in line with the advise. At program level the managing authority of the ERDF program Opportunities for West delegated the responsibility for implementing the **Holding vehicle** to The Hague (responsibility as program authority). The Hague concluded on behalf of the managing authority the funding agreement with the Holding HEID.

HEID is monitored by an independent **Investment Committee** which consists of representatives of public authorities as well as of independent experts representing educational institutions, SMEs and the Chamber of Commerce. For practical and functional reasons and to maintain a “light” character the Investment Committee was constituted one on one from the Steering Committee Opportunities for West The Hague. These well informed and committed representatives have been asked to represent the Local Support Group for the CSI Europe network too.

In line with public procurement procedures which Holding HEID adopted from municipality The Hague and to assign the implementation of development funds to professionals HEID awarded a contract to a professional Fund management organisation. At development fund level the **Fund manager** installs an investment committee in which a representative of each investing participant in the fund is represented. Together with an independent expert they draft and agree on the investment strategy for the development fund (cooperative company with limited liability - CV) which is delegated from the HEID investment strategy. The fund manager decides on financing business cases and is able to receive policy advice of the **advisory board**.

Detailed descriptions of the specific roles and responsibilities for each partner are layed down in annex 2. A complete overview of the architecture is shown in the next schedule:

Governance Holding HEID The Hague



7 Description of the process

Based on the first experiences with ED, FRED and VIN the Holding HEID has gained experience in the process from idea to operational urban development funds. In every step that was taken HEID tried to deliver products which facilitate and enlarge efficiency for every next step to take or new fund to invest in. The cooperation with partner cities through Europe in the CSI Europe network is an important source to compare practical lessons learned and to put The Hague development process in perspective.

The process implementing new development funds can be described as follows:

Phase	Activity	Decision by
Initiation	Market analysis	Holdingfund manager
	Analysis availability funding capital	Holdingfund manager
	Development fund investment strategy	Holdingfund manager
	Decision to invest in new development fund	Mayor & Alderman
	Match funding The Hague	Mayor & Alderman
	Assessment state aid provisions	Holdingfund manager
	Application for grants	Holdingfund chairman
Implementation	Funding agreement+ conditions	Managing authority (MA)
	Soft market test	Holdingfund manager
	Public procurement procedure	Holdingfund manager
	Public procurement contract	Holdingfund chairman
	Agreement on governance / CV agreement	Holdingfund chairman
	Nominate delegates IC / AB	Holdingfund chairman
	Decision on statutory consent	IC / AB development fund
	Decision on investment strategy	IC development fund
Operation	Arrangements withdrawal funding	Holdingfund manager/MA
	Attract additional funding capital	Fundmanager(s)
	Develop project pipeline	Fundmanager(s) / coop. MA
	Advise on businesscases	Advisory Board (AB)
	Funding agreements	Fundmanager(s)
	Progress reports from development funds	Fundmanager(s)
	Progress reports to MA	Holdingfund manager
	Managementfee declaration	Fundmanager(s)
Evaluation/reinvestment	Evaluate progress reports	ICs / Mayor & Alderman
	Evaluate continuity funding capital	Holdingfund manager
	Evaluate contract fundmanager	Holdingfund chairman
	Return on investment	Fundmanager(s)

With a view to the large number of potential future funds to invest in the standardization in the process is important. Past experiences with most of the activities will be used to work on new models. This way we expect to deliver shorter turnover rates from idea up to investment ready funds.

8 Risk analysis

In order to ring fence the provided public funds from the municipal budget the Municipality of The Hague incorporated a holding vehicle. The Municipality of The Hague favoured the implementation of an **independent legal entity** managed by a person recruited by the municipality. This means the Holding Fund is **off balance** from the municipal administration.

The city of The Hague will be awarding grants to match fund grants available from for example the ERDF. As far as HEID is able to invest the grants within the scope of the regulations, the eligibility criteria and timetables the risk profile is very low. Furthermore each HEID investment is structured in a cooperative company with limited liability. This way HEID has no managing responsibility (**arms length principle**) for the development funds and risks are limited to the amounts funded to the development funds. The selected fund manager for each development fund bears the CV managing responsibility.

Risk management from the point of view of the Holding will be focused on:

- ✓ Investing in development funds using the well structured and standardized way (CV structure which is flexible, tax transparent and liability is limited); this way most arrangements are dealt with at the front.
- ✓ Delegation of fundmanagement to professional commercial fundmanagers who earn managementfee based on incentives related to amounts invested and amounts revolved. Commercial fundmanagers invest based on the market economy investor principle.
- ✓ Risk spreading by determining minimum targets for the number of projects to invest in and the target value of private funding and maximum targets for the funding percentage of the funds (50% on development fund level).
- ✓ Organizing a clear audit trail: transfer conditions and restrictions to the fundmanagers and look after them to transfer as much as is needed those to the final recipients. Financial instruments form part of the normal management and control provisions, as described in the European Common Provisions Regulations. The fundamental idea of which is that controls at the level of the final recipient of funding will only be carried out if necessary documents are not available at the level of the managing authority or body implementing the financial instrument.
- ✓ Treasury management; Fundmanagers will be reporting frequently about liquidity. Depending on regulatory prescriptions and arrangements with other funding partners HEID will take care of timely deposit of the funds to the fundmanagers. Active liquidity planning of HEID itself results in the agreement with fundmanagers to withdraw (during the first period mostly the granting period) 1% a year of the initial fundcapital in order to cover exploitation of HEID before depositing the remaining funding to the CV. Whenever this is not possible the fundmanagers are required to contribute 1% each year at the end of the previous year.

In contrary of the risk management we also consider the following (principal) advantages in comparison to the use of subsidies:

- ✓ Recycling of funds: the returns/receipts generated by projects by means revolving funds will be and reinvested to the same respectively new urban regeneration projects. The funds have a lasting legacy, whereas subsidies, on the other hand, have a once-only life span;
- ✓ Leverage: as revolving funds need to be repaid and may only be granted to projects likely to generate revenue, HEID increases the potential ability of private sector engagement in urban regeneration projects. Besides the leverage it creates, it strengthens – as a result of the cooperation – the competence in project implementation and management.

- ✓ Due to the fact that subsidies are not repayable and may be granted to non-profitable projects, there is no interest/option for the private sector to be involved;
- ✓ Flexibility: apart from the possibility of reinvesting revolving funds in other development funds, it enables the granting of a wide array of financing means. Development funds may provide equity, guarantees and loans, or participate in projects.
- ✓ Fundmanagers thus have the ability to grant tailor made financing;
- ✓ Expertise: as a result of the potential co-operation with the private sectors and banks, as well public as private partners will benefit from the expertise accrued by these entities.

9 Adjustment of the Investment Strategy

The Investment Strategy will be reflecting the best way in which HEID can be investing in urban development at the moment. Due to changing market conditions, economic climate, municipality elections and new timeframes of the European Structural and Innovation Funds adjustments in the Investment Strategy will be needed. HEIDs Investment committee is responsible to determine the necessity of such adjustments.

For each new participation of HEID in development funds the Investment Strategy will be part of the funding agreement. A short description of every single participation will be added in annex to this Investment Strategy, describing at least results of ex ante examination, target market, type of intervention, mix of financial instruments, conformity with the Investment Strategy, funding amounts and conditions and exit strategy. This way the Investment Strategy needs no adjustment for each new participation.

