**BUILD2LC Project**

**Boosting Low Carbon Innovative Building Rehabilitation in European Regions**

Bi-lateral Meeting Fiche

Template

4th October 2017, 14:00-17:00, Bračak Energy Centre, Zabok, Croatia

Donor or exporting Region: VIPA

Reception or importing Region: Agency for Investments and Competitiveness, REGEA

| **BI-LATERAL MEETING FICHE** |
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| *During the bilateral meetings, all necessary information to define the adaptation of the best practices by a region will be compiled, depending on the particular local conditions in each region, as well as the more appropriate methods and monitoring indicators. Each partner will develop at least one bilateral meeting on the themes of interest to make sure that all partners participate in this exercise in a balanced way.**The bilateral meetings will be developed in situ (max. 2 per region) and/or electronically (skype conferences, video conferences, or telephone interviews, etc.). The results of the bilateral meetings will be* ***documented by the host region (receptor region)*** *and will be useful to further develop the final version of the action plan in each region.* *Each partner region may host several partners in a multilateral meeting in case they are interested in pursuing and adapting the same working issues.* |
| **Basic information of the Good Practice(s) to be adopted:** | Pay attention to the benchmarking fiches and take basic information from it. |
| **Good practice to adopt: Innovations in Financial instruments (FIs)*** Specifically addressing a guarantee scheme for loans granted by commercial banks for projects aiming to improve energy efficiency of public buildings and public lighting

Topic of practice: New financial instrumentsDescription of practice:Key problem that was present in Lithuania was that mainstream financial institutions, such as commercial banks, are risk averse and conservative when it comes to long-term financial commitments. Financing periods proposed by banks are too short for the investments in the non-commercial infrastructure (including deep renovation of buildings) both for energy service companies (ESCOs) and public-sector investors. To counter that situation, an Energy Efficiency Fund (ENEF) was established in 2015 by the Ministry of Finance, the Ministry of Energy and VIPA, which was appointed as the manager of ENEF. The Fund implements two financial instruments: loans for financing renovation of central government buildings and guarantees for loans granted by commercial banks for energy efficiency projects. It operates under the program approved by Lithuanian Government which aim is to increase the energy efficiency of public buildings for heating and lighting, to ensure the effective use of the State funds allocated to the improvement of energy efficiency of public buildings, to reduce emission of greenhouse effect gas (CO2) and to ensure the compliance of central government buildings with hygiene standards.The fund manages 80 mil euros of funds (65 mil for the modernization of central government buildings and up to 14,5 mil for street lighting modernization projects). Since loans and guarantees are recoverable financial instruments they are re-invested in new energy efficiency projects meaning that more projects can be financed in the future (until 2030). The implementation of these financial instruments promotes ESCO market in Lithuania. Public-private partnership (PPP) projects are also eligible to be financed through this scheme. Facing a much lower risk for loan defaults, commercial banks are encouraged to participate in energy efficiency projects as financing bodies.There are two ways for financing central government public buildings: * When the manager of central government building is a budgetary institution VIPA provides 80 percent preferential loan of the value of contract work to it. The 20 percent of the contract work is given as a loan by ESCO. ESCO is selected by public procurement procedure. The manager of the renewable building signs a contract on ESCO services with ESCO. VIPA signs a loan contract with ESCO.
* When the manager of central government building is a public institution or a manager of centrally managed state property and intends to borrow directly from the ENEF, VIPA provides 100 percent preferential loan of the value of contract work to the manager of the building. The contract work is purchased by public procurement procedure.

Up until October 2017 7,5 million euros of loans were disbursed for renovation of public buildings with more buildings to be financed in the near future.

| **Reception region status** | Pay attention to the benchmarking fiches and take basic information from it |
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**Financial instruments for energy efficiency projects**Agency for Investments and Competitiveness (AIK) is an agency of the Croatian Government, whose main tasks are to provide investors with full services for the implementation of (energy) investment projects, to propose measures for the improvement of the business environment (within the Operational Programme for ESIF) and to promote Croatia as a desirable investment destination. In the preparation and implementation of PPP projects, the Agency has a key role with the Ministry of Finance which grants approval for the PPP projects regarding their compliance with the budget projections and plans, fiscal risks and constraints regulated by special regulations, as well as the financial and fiscal sustainability of the project proposal. Similarly, the Ministry of finance approves the PPP project proposal. In this sense, the Agency and the Ministry of Finance consists the functional unit. The process of approving project proposals includes other relevant ministries and other central state administration and local and regional self-government responsible for the adopted sectoral development plans and strategies with defined objectives and expected impacts.The Managing Authority for ESIF in Croatia (Ministry of Regional Development and EU Funds) has allocated approximately EUR 625 million of the Operational Programme to support transition to low-carbon economy (TO4) in the 2014-2020 Programming Period. Even though an increased use of Financial Instruments (FIs) in all Thematic Objectives (especially for the energy sector), has been recommended for the 2014-2020 programming period by the European Commission, little has been done in this regard so far in Croatia. Most of the projects in this area have been financed via grants so far. The main objective is to move away from grant mechanisms towards FIs, especially revolving funds that could help leverage private sector resources. In the current economic climate, financial intermediaries in the private sector (ESCOs) are limited by solvency constrains and strict risk management requirements. These factors may make it more difficult for investment projects to secure financing. High level of uncertainty in regard to economic outlook and financial position of enterprises resulting in the negative effect on the availability of finance, especially for SMEs, as banks are highly risk averse. There are several national schemes for energy efficiency, but they are not always applicable for the energy efficiency measures needed in large scale projects (PPP). The majority of ESCOs involved in EE/RES interventions on public buildings are construction companies. The ESCO market in Croatia is still at early stage of development, with a number of obstacles still hindering the possible scaling-up of the model. Also, due to the limited availability of skilled personnel and financing experience, both public and private actors in the EE sector underestimate the benefits of energy-cost reductions, resulting in limited interest in EE financing. The limited public-sector capacity to deliver complex structures is the single most important barrier that has to be addressed. Additionally, the market for PPPs in Croatia is rather immature and is not currently seen as a significant source of supply to cover the investment needs of public institutions. As a result, sufficient governmental support is needed to boost this market and benefit from PPPs.

| **Attending partners and stakeholders** | Mention persons, charges and stakeholders involved in this bi-lateral meeting |
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VIPA – Kristina Vaskeliene and Žaneta MaskaliovienėAIK – Damir Juričić, Slavko ČolakREGEA – Velimir Šegon, Josip Čengija, Ivan Pržulj |
| **Description and outputs of the bi-lateral meeting**AIK stated that the current supply of finance by commercial banks and the Croatian Bank for Reconstruction and Development (HBOR) has been estimated to fall short of meeting the expected demand for investment, suggesting a funding gap in the market. The most immediate investment needs for energy renovation of public buildings (funding gap) is between €200 million and €300 million, including long – and short-term financial needs. Due to weak financial position of public investors these needs can be addressed through involvement of private investors by supporting lending to enterprises (ESCOs) and offering guarantee schemes. The potential demand for funding remains unmet, also because financial products offered are unsuitable and/or expensive. Insufficient availability of finance, however, is not the only factor preventing projects from going forward, with other limiting factors including the following:* There are legal ceilings on investments made by cities due to borrowing restrictions imposed on municipalities (Tax Act).
* Small municipalities are restricted in long-term programming of strategic investments due to limited budgets
* Since large energy efficiency projects require a balanced mix of savings-generating and other operations to ensure financial sustainability, development of complex capital-intensive projects requires considerable time and expertise, which is not always available in Croatia
* Since most Croatian cities are small in size, energy efficiency projects need to be bundled to reach financial sustainability.
* Urban renovation is not encouraged because financial products currently available on the market are too expensive

VIPA representatives noted that given the above, financial instruments, if deployed via an effective, well-managed implementation structure, could alleviate several of the aforementioned problems, thereby bringing added value to the Croatian financial market. However, to introduce FIs, managing authority has to possess adequate human capacity - highly qualified employees to develop innovative instruments. FIs in the context of urban renovation (buildings and public lighting) could provide significant value added and include:* Loans (medium and long-term) to facilitate medium and long-term financing on attractive terms (soft loans), thus supporting financial feasibility of projects
* Equity for PPPs/SPVs to leverage additional financing and help share operational risks
* Equity for ESCOs in the energy efficiency for buildings/public lighting investment area to make projects financially viable and help leverage additional financing
* Constant technical assistance during various stages of the project – ensuring up to 100% of preparation costs can build a strong pipeline of projects

VIPA noted that a clear demarcation line should be drawn between the categories of projects supported by grants and by FIs to avoid any type of competition between the two. Commercial banks in Lithuania also perceived ESCO projects as high-risk, requiring high collateral/guarantees and therefore ENEF targets this issue at its core. Asset based loans are not applicable to energy saving interventions financed through the ESCO model (since an ESCO would not own the real estate asset which it provides energy-efficiency solutions to).Given the similar characteristics of the Croatian and Lithuanian financial markets and the investment needs, VIPA and AIK believe that the optimal delivery structure would be through a Holding Fund (HF) which could be established to invest in several Urban Development Funds (UDFs) for different priority investment areas (energy, transport, etc.). One of the main attractions of the holding fund model is the potential economy of scale which can be achieved and related possibilities to offer better conditions for final recipients. Other obvious advantages include the potential to adjust resource allocations between different UDFs depending on market-related constraints and opportunities arising. Since the funds are repayable over the course of the project, they become available to finance additional projects. In such a way, the use of FIs can promote the long-term recycling of public funds and they potentially enable the reinvestment of ESI funds beyond the end of the programming period, helping achieve better value for public money. REGEA pointed out that since all ESI funds for renovation of multi-apartment buildings until year 2020 have already been allocated (grant scheme) due to extremely high demand, FIs in this sector would make the most sense.VIPA stressed the importance of planning in advance with a multi-year approach, which has proved to be of great importance to create the conditions for the programme to work and allow its progressive implementation on the ground. These plans are of national importance and a consensus on the level of a society has to be ensured before its implementation. In that regard the ex-ante study is the key step in the process: good knowledge of market conditions and needs of final recipients can only be obtained by making consultations with relevant stakeholders (financial institutions, central and regional governmental institutions, non-governmental sector, etc.) which can be a long, tedious process. However, use of FIs can help build institutional capacity through partnerships between the public and private sectors, can broaden the involvement of financial intermediaries/institutions in implementing EU regional policy and can encourage pooling of expertise and know-how, for example to improve the quality of projects. |
| **Conclusions** | Please indicate if you may adopt this (these) good practice(s) to include in your action plan. If not, say why. |
| Implementation of a financial instrument such as ENEF in full as it was presented by VIPA would present a challenge to both MA and financial institutions in Croatia. There are however certain parts of the ENEF (guarantee scheme for ESCOs and PPP projects) that AIK will explore in detail and discuss internally with the Ministry of Finance in order to be implemented over the next few years (through Operational Programme for ESIF). Croatia is new to FIs, so it is reasonable to expect that, even if implemented immediately, as suggested during the meeting, the actual results expected by the FIs would be actually achieved over a certain time frame. This is due to the natural need of “learning by doing” for all the involved actors (ESCOs, financial institutions, beneficiaries, etc.) in respect to operational, legal and procedural aspects, apart from the time required to set up the immediate procedural, procurement and legal framework for implementation. VIPA therefore, recommends that, in order to facilitate the achievement of the general objectives set out in the Operational Programme, and of the specific objectives arising from the various national programmes (e.g. NEEAP), from MA to consider to pair FIs with the more consolidated grants programme, in particular targeting those categories of beneficiaries and projects which cannot be reached through FIs. Given the current circumstances, FIs are unfortunately not considered a priority for EE interventions in public and private buildings, including multi-apartment buildings and family houses. Consequently, the implementation of such projects by using grant schemes might be necessary before the potential for use of financial instruments could be confirmed. The level of grants support required might differ across projects in the EE sector (depending on the type of buildings), and will need to be established by the MA in the course of OP implementation.

| **Additional information** | Please, mention relevant information attached as annexes as presentations, reports, etc. |
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* Meeting Agenda
* Attendance sheet
* Photos
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| **Contact details to obtain further information on the bi-lateral meeting (receiving region)** |
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| **Contact name** | Velimir Šegon |
| **e-mail** | vsegon@regea.org |
| **Organization** | REGEA |
| **Type of Organisation** | Regional energy agency  |
| **Website** | [www.regea.org](http://www.regea.org) |
| **Fiche completed on date:** | 4th October 2017 |