

Case study: Joint European Support for Sustainable Investment in City Areas (JESSICA)

Deloitte entity:	Deloitte United Kingdom
Client name:	The European Investment Bank (EIB), in cooperation with the European Commission (EC)
Topics:	Innovative development financing mechanisms; development grants
Countries:	All 27 European Union member states
Timeframe:	2007-present
Services supplied:	Development financing and roll-out; investment management
Contact:	Philip Holt (pholt@deloitte.co.uk) and Neal Beevers (nbeevers@deloitte.co.uk)



Global Public Sector

The situation

Grants are an essential element of public/private investments the world over. But traditional grants, such as those provided through the European Union's European Regional Development Fund (ERDF), for some projects have two potential problems. First, sometimes projects need access to financing rather than gap funding grants in order to proceed, an issue brought into sharp focus during the credit crisis when capital markets dried up. Second, grant-based financing often features a time limit. In fact, the ERDF has annual spend requirements that don't always fit with a project's requirements.

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To address these issues, in 2005, the European Commission (EC) began to outline the Joint European Support for Sustainable Investment in City Areas (JESSICA), which would be deployed under the auspices of the European Investment Bank (EIB). JESSICA aimed to improve the effectiveness of grant financing. The program would use an innovative, market-based mechanism to make JESSICA funds available with the understanding that the investments would generate a return. So as opposed to one-off grants, the program would create a series of locally controlled, perpetually self-sustaining investment funds. The initiative essentially was designed to convert a grant mechanism (the ERDF) into a program of participatory investing, lending, and loan guaranty.

Project financing exists on a continuum. Projects that can deliver ample financial return for a given degree of risk can be financed on their own merit while those with literally no commercial viability must rely nearly entirely on grants. JESSICA, however, targeted the middle range of this

continuum, so-called “sub-commercial” projects. These are projects that, although by many measures are independently viable, still cannot obtain commercial financing. JESSICA investments in these projects could therefore generate a return, at least enough to preserve the investment capital employed.

JESSICA’s goals were clear: target those “sub-commercial” projects unable to proceed because they cannot raise private development financing and embed an investment mentality, lessening the reliance on “grant handouts.” Once a site was approved for the JESSICA mechanism, the ERDF would provide initial funding. From there, the local ERDF managing authority became responsible for JESSICA processes.

But transforming JESSICA from theory into practice was a challenging undertaking. Introducing market discipline to an arena accustomed to complete dependency on grants would require significant philosophical adjustments. And getting the program up and running would require considerable operational refinement.

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The solution

Recognizing the value of outside experience and assistance, the EIB turned to Deloitte public sector practices. Deloitte United Kingdom—with support from the Portuguese, Cypriot, Polish, Romanian, and Bulgarian public sector practices—assisted the EIB in conducting feasibility studies that would help to form specific processes for rolling out JESSICA across the 27 member states of the EU. The team undertook evaluation studies in four EU constituencies: London, Bulgaria, Portugal, and Cyprus. The key focus: what would be needed in order to help each nation’s ERDF Managing Authority obtain value through the JESSICA initiative.

The Deloitte team developed detailed business plans for the implementation of JESSICA in key jurisdictions. Vital factors included the identification of suitable projects, assessing the

appetite of private investors, and structuring the procurement and governance frameworks. A particularly useful outcome of the work in Cyprus and Portugal was the development of a financial modeling approach to the investment of private funding within JESSICA projects.

The Deloitte team also helped the EIB and its constituents design specific processes for harnessing JESSICA’s potential. This included building into JESSICA a certain amount of flexibility. While all JESSICA sites are managed by the local ERDF managing authority, the actual JESSICA funds are managed within a specifically defined vehicle known as an urban development fund (UDF), developed as part of the project. Each UDF in turn can then be managed either publicly or privately at the local managing authorities’ discretion. Part of the processes developed also included the directive that JESSICA applicants must be able to demonstrate how their projects will deliver financial returns. In other words, each UDF would need to conduct rigorous due diligence to improve the likelihood of earning a return on its investment.

The outcomes

JESSICA delivers value not only to the EIB and ERDF but also to the citizens of the EU. Through JESSICA, the EIB was able to extend the value of the ERDF program far beyond its scheduled decommissioning in 2015. In addition, by providing a form of evergreen mezzanine risk capital, JESSICA is enabling local authorities to progress economic development goals that would have otherwise stalled during the economic downturn.

In 2009, a new team from Deloitte United Kingdom was appointed by the EIB to assist in the selection of a UDF manager for England’s North West Development Agency (NWD). This work began with the scoping of the position and specification of the selection process but continued into areas such as developing the investment procurement process and drafting key loan/investment documents. The engagement also included soft-market testing of projects with potential public and private sector partners.

Then in 2010, Deloitte United Kingdom was again selected by the EIB to join its technical and adviser framework panel for the broader implementation of JESSICA throughout all 27 EU Member States. This framework agreement has been set up by the EIB to appoint suitably skilled and experienced financial advisors to the bank, who will in turn support its work in deploying JESSICA as it comes forward in EU member states.

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