Investment Strategies and Financial Tools for Local Development

Edited by Greg Clark and Debra Mountford



OECD

Local Economic and Employment Development (LEED)

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Foreword

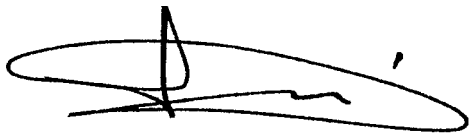
Successful local development involves achieving a high investment/high return equilibrium, just as much as it does for the most successful businesses. Success in the open knowledge driven global economy requires places to be truly distinctive, appealing and productive. Just as firms must innovate and invest to succeed, localities have to adjust, reinvent, and differentiate themselves. They have to change the old patterns of land and resource use, and connect assets with opportunities in new ways and over new spaces. They must modernise infrastructure and build up human capital. This can have positive impacts on entrepreneurship, innovation, skills, and other factors of growth. But this involves adjustment costs, in the form of investment to re-engineer the locality for the new economic functions and flows that it must facilitate. It can take 30-50 years of re-investment to fully recalibrate a local or a regional from the industrial mode to the knowledge mode.

It requires investment, and it does yield returns. But many localties do not have the surplus cash, or the financial powers and leverage required, to make the investment, and capture the value it can produce. Localities find themselves within a vast range of frameworks that do not give them control over their own investment. They become stuck in a low investment/low return equilibrium. Periodically, an opportunity arises to make new investment and share risks and costs with other public and private entities. These opportunities do not come often and must be seized with purpose. Hosting a global event, winning a major investment, or attracting new population can be the trigger for increased financial resources. It is not surprising that many localities spend considerable effort trying to make these kinds of changes happen.

The need to develop systematic thinking about local development finance is appearing consistently in our work. In part, this reflects the growing sophistication of many local economic development practitioners (as evidence by our case study reviews) and in part this reflects the need to chart a course through multiple financing options. Investment is itself a driver of growth at local level and increasingly practitioners are seeking to attract investment which will enhance enterprise and innovation, human capital and skills, trade and employment.

Starting with this publication, the OECD LEED Programme will develop a framework of more in depth exchanges between Member States and LEED Partners on local development finance issues and on Local Investment Strategies and Tools. This framework will include further case studies and cross cutting assessments, reviews, and seminars. Armed with the right tools and approaches, local development can emerge as an important arena for new investment that yields internal and external rates of returns that neither public nor private sectors can afford to ignore.

As the OECD LEED Programme celebrates its 25th year focusing on tools for local development seems appropriate. At the heart of this lies the issue of finance and investment - a theme adddressed by our Programme throughout its life. I would like to thank Greg Clark, Chair of the OECD LEED Forum on Development Agencies and Investment Strategies and author of this book and Stuart Patrick, Director of Scottish Enterprise Glasgow for funding the work and his continued support of the LEED Programme.



Sergio Arzeni
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ACKNOWLEDGEMENTS

This work stream within the LEED Programme is managed by Debra Mountford, Policy Analyst and Manager of the OECD LEED Forum on Development Agencies and Investment Strategies. Greg Clark, author of the report is a city and regional development advisor, speaker, and facilitator, with 20 years experience, principally in leadership roles in city agencies in London, UK, and advisory roles with many cities/regions, Governmental and inter-Governmental organisations, internationally. He currently holds a portfolio of core roles; including Lead Advisor on City, Regional, and Economic Development at the Department for Communities and Local Government, UK, and Advisor to the OECD, British Council, and Urban Land Institute on City and Regional Development. He is chairman of the OECD LEED Forum on Development Agencies and Investment Strategies.

Damian Garnys was responsible for the production of the publication and Kay Olbison for proof-reading.

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PREFACE

For the past decade, Glasgow has developed its relationship with the OECD through the LEED Programme. It has been a period of healthy growth for the city and the questions the city's leaders and policy formers have posed are constantly evolving. As I write this preface Glasgow has been celebrating the 40th birthday of the launch of the Cunard liner, Queen Elizabeth 2, the QE2. Nothing gives Glasgow more pride than the quality of its workmanship in engineering ships. Thousands have crowded the shores to welcome the QE2 back to home port. Back in 1967 the world for Glasgow was about to change forever. The city was set to face some thirty years of steady decline; coping with the challenge of replacing the city's wilting strengths in heavy export based manufacturing. Methods of financing investment in replacement infrastructure, skills and technology were relatively narrow and mostly involved direct subsidy of one form or another. Money was always in short supply.

Now today, as the QE2 returns to the Clyde, fortunes could hardly be more different. After ten years of renaissance, the city is alive with new opportunities in financial services, in tourism, in life sciences, in creative industries and in advanced engineering. As its fortunes have turned up, so too has the value of its assets, whether in land, in skills or in innovation. We have significantly more scope to explore the possibilities for presenting these assets to the market place to encourage joint public- private investment. These asset values give us some scope for manoeuvre. We are radically re-assessing the shape of our housing, our transport, our universities and colleges, our schools and our land use planning. We have are well on the way to transforming our city's waterfront to the Clyde and we have grand aspirations for the regeneration of the East End of the city where so much of our engineering heritage lay. And in each case the respective roles of the private and public sector financing has been a crucial issue. This has therefore been a perfect time for engaging with the LEED Programme.

We asked the LEED team to challenge our thinking as we set out a strategy for Glasgow's growth for the next ten years. This book is one product of that challenge. It comes from discussions we had about the need for an explicit financing strategy to complement the investment plans we would traditionally set out in our glossy documents of vision and intent. Alongside the long wish list of investment demands

we would challenge ourselves to think creatively about the methods and skills we might need to make our proposals attractive to funders.

Of course the book makes absolutely clear just how important the broader economic, fiscal and governance frameworks are in distinguishing what can be achieved at the level of a city in any one country. Each country, each city, each community will have to come up with its own responses. It will have its own package of assets and its own freedoms and constraints. But the principles laid out are likely to be relevant to anyone struggling with the delivery of an ambitious development strategy.

I know that Glasgow's leaders find enormous value in the work of the OECD LEED Programme and I know that nothing is more important than establishing from where the money for development will come. We certainly intend to squeeze as much out of the principles set out in the pages ahead as we can. Our thanks therefore go to the LEED team- and especially to Sergio Arzeni and Debra Mountford - and to the continuing support that the OECD offers the city of Glasgow.



Stuart Patrick
Director, Scottish Enterprise, Glasgow

I. Overview: Why Local Development Finance?

I.1. A growing investment in local development to achieve wider goals

Financing local development is not simply a question of finding the public money required to invest in a local productive base, or wider economic development opportunities. How local development is financed plays a key part in defining what the goals of local development may be, and the extent to which the outcomes will be sustainable in both financial and economic terms. There are different kinds of local economic development, that involve different means of financing. One measure of success of local economic development will be how much external finance and investment is ultimately attracted, and the extent to which local markets become sustainable without continued public investment.

Financing local development involves both public and private finance, inlcuding philanthropic financing, and the mix of these varies very broadly over the OECD Member Countries. Local development has turned a corner in recent years and has gradually moved into the main stream of thinking about how nations, regions, provinces, and states can become more productive, create more wealth and jobs, foster new and growing firms, build human capital, and improve incomes at the local level. There are multiple reasons why local development has become more important:

- Sustained and substantive efforts by national governments and inter-governmental organisations such as national policies in France, Italy, Spain, Canada, Mexico, Japan, Germany, the USA, and the UK, the EU's Regional Development Programmes, the work of international financial institutions such as the EIB, World Bank, Inter American Development Bank, have all served to increase confidence in the idea of a local development dimension to successful and balanced national economies.

- At the same time, economic analysts have realised that the longer term impact of key drivers such as globalisation, human population increase, mobility and ageing, technology development, and climate change and challenge have all served to increase the potential of local economies to add value to national success. The same drivers that enable national economies to grow; nimble regulation, trade, productivity, innovation, skills, connectivity (for example), are also now widely recognised to be key drivers of how local economies perform. Moreover, local and regional development policies are seen to require better co-ordination between these drivers and to benefit from effective leadership and strategic planning which can help them to adjust effectively, and perform much better within the more open and internationalised economic context of the 21st Century.

- Equally, analysis across OECD countries has highlighted that intra-regional and inter-local economic disparities are widespread, and even growing, giving rise to a realisation that national policies alone will not easily address such disparities and that local solutions are also required.

- Lastly, substantive progress in the practice of local development is beginning to show that special purpose agencies, and 'expert' teams and organisations, are able to achieve more than generic arrangements. High quality strategic planning which integrates the different roles of local government (leadership, regulatory, planning, service provision, asset management, and local economic programmes) with specialised practitioners in development agencies, chambers of commerce, and place marketing organisations are able to achieve much more than would be possible within a generic municipal skill set. Local economic development is building a wider tool box, and becoming more of an established public/private 'industry'.

This progress is most visible in the ways that national and federal governments are seeking to broaden their local development efforts, international financial institutions are raising the range of interventions they will support, and local governments are innovating much more rapidly in how local development is supported and resourced.

The private sector has begun to take much greater interest in local development, especially in large cities and stronger regions, providing a wider base of financial support often in tandem with a public body. The result has been a much

wider set of financial tools available for local development, and these are the subject of this book.

Table I.1. Credit ratings of Standard & Poor's "World's Top 10 Economic Centres", 2006

Ranking	City	Credit rating
1	Paris	AAA/Stable/- -
2	Greater London Authority	AA+/Stable/- -
3	Los Angeles	AA/Stable
4	Madrid	A/Stable/A-1+
5	Toronto	A/Stable/A-1+
6	Yokohama	AA-/Positive/- -
7	Chicago	AA-/Stable
8	New York City	AA-/Stable
9	Milan	A+/Stable/- -
10	Moscow	BBB+/Stable/- -

Source: www.standardandpoors.com, accessed September 2007.

Table I.1 shows one important dimension of this trend, the growth of credit ratings for local governments, which are in part based on the assessment of the local economy and it's likely long term performance. Standard & Poor's have produced a list of the top ten rated economic centres in the word based on the following criteria:

- The economic importance of the countries in which they are located (all of which are G8 members);
- Their role as the major economic centre(s) in their respective country. This sometimes coincides with being the capital city but not always;
- The depth of services that they provide, as well as the economic importance that each city provides to its respective services area and to the country as a whole, and;
- Their size – all the selected cities have more than one million inhabitants.

These cities have subsequently been assessed according to their credit rating (See Table I.1). The top ten economic centres all have investment grade ratings ranging from BBB+ (Moscow) to AAA (Paris). Standard & Poor's suggests that,

> *"This excellent credit quality partly reflects the importance of economic performance as a key factor when evaluating the creditworthiness of local and regional governments (LRGs). A strong, dynamic, and diversified economy often correlates with robust and growing tax revenues with positive implications on a government's financial flexibility and budgetary performance."*

However, the ratings trends of these cities have been less consistent over time. While Paris and London's ratings have remained stable since they were first issued in 1993 and 2002 respectively, all the other ratings have changed over time. More in-depth financial information can be seen in Table I.2.

Table I.2. Financial statistics for Standard & Poor's "World's Top 10 Economic Centres", 2006

City	Op/GF revs (mil $)	5-yr AAG (%)	Rev PC ($)	Op/GF exp (mil $)	5-yr AAG (%)	Exp PC ($)	Op bal / UGF bal (mil $)	% Op/GF revs (%)	5-yr AAG (%)	CapEx (% exp)
Chicago	2 664	3.8	937	2 740	2.9	964	58	2.2	17.1	13.7
London	10 216	17.3	1 375	10 231	17.5	1 377	-15	-0.2	-10.3	0.1
Los Angeles	3 689	5.0	938	3 346	3.8	850	579	15.7	12.8	15.9
Madrid	3 691	8.6	1 168	3 430	11.5	1 076	262	7.1	-13.7	30.8
Milan	2 387	1.3	1 825	2 246	0.4	1 717	141	3.6	5.2	25.3
Moscow	16 407	22.0	1 577	10 623	23.8	1 021	5 784	35.3	13.2	35.9
New York	52 164	6.7	6 405	47 714	7.1	5 859	418	0.8	1.2	13.2
Paris	7 157	4.6	3 308	6 496	5.4	3 002	661	9.2	-5.6	18.1
Toronto	5 329	5.8	2 042	4 861	5.4	1 862	468	8.8	4.4	15.2
Yokohama	10 697	-0.9	3 005	7 479	1.0	2 101	3 218	30.1	-3.7	18.2

Notes: All data as of 2005. $=USD. Op-Operating; GF-general fund; PC-per capita; Exp-expenditures; AAG-Average annual growth; UGF-unreserved

Source: http://mba.sdabocconi.it/uploadimg/milano_top_10.pdf, accessed September 2007.

The cities have undertaken different methods of raising revenue, ranging from increasing the tax base to partnerships with private entities.

Investments that help city and regional economies to perform better can add value to other localised transactions too, by providing a more competitive platform for business, raising local incomes and revenues, improving asset values, and increasing further demand for financial services.

I.2. Key themes

Local economic development requires local economic investment

Economic development is not like orthodox public services, where a defined service is delivered to a relatively well-known customer/population base within a defined geographic area. Economic development operates both within governmental spheres and within markets, where the final customer might be one of many at the start, and where factors well outside the control of local and provincial governments impact upon the outcome.

Economic development processes also happen within a wider geographical space than local government, and in some cases at a larger scale than provincial or regional (or even national) governments, which implies that substantial inter-government co-operation is required. Equally, the time frame in which economic development outcomes appear are more akin to business cycles (12-15 years) than to the electoral cycles (3-4 years) of governments. Given all of these factors, it is highly desirable that economic development is orchestrated as:

- A partnership activity between public, private, and institutional sectors, with substantial vertical and horizontal collaboration on the public sector side.

- A long term effort that will also produce important milestones within short time spans.

- Activity that is customer and investor facing and utilises appropriate organisational vehicles to deliver this (such as development agencies/corporations).

If this is accepted it becomes clear then there are two roles for public sector organisations and governments:

i) Attend to the fundamentals of delivering economically sensitive public services in a robust and effective way (including infrastructure, education, planning, amenities, etc). This would also include ensuring that there is the necessary co-ordination of public sector endeavours in place, such as co-ordination of investment in different types of infrastructures or the co-ordination of regulatory regimes.

ii) Government should collaborate extensively, and foster co-operation, at a broad regional level with private and public sector actors, to ensure that market sensitive development interventions are delivered in a professional and supported manner. This would include planning and development, branding and promotion, support for businesses and investors, investment facilitation and financial engineering, management of commercial spaces and fostering of entrepreneurship and innovation.

Local economic development is a strategic activity best delivered through collaborative efforts that are negotiated through a clear strategy which identifies appropriate long term local economic rationales and niches and seeks to build upon natural and latent comparative advantages.

There is a vast literature about how to develop local economic strategies, but very little written about how to establish complementary local investment strategies. Much local economic development assumes the need for private sector co-investment but does not organise itself fully to secure that investment. Many local economic strategies are never fully implemented because the investment resources have not been identified in advance and the private sector has not been effectively engaged.

Local economic development without local economic investment is not likely to achieve much over time, but little attention has been drawn to the innovations in local investment mechanisms that local economic development requires.

Despite growing and substantial literature on local economic development, there have been limited but noteworthy publications on local development finance to date. This is perhaps because there is limited cross over between the disciplines of development finance and local development at the practitioner level, and until recently the main context for this discussion has focused on local government finance and its link to local economic development. Most local development is led or encouraged by local government and the system for local government finance in OECD Member States is a key part of both the incentive structure, and the resources mechanisms, for local development.

However, when local development works well, it produces real returns to those who invest: jobs, incomes, growth business, improved asset values and tax revenues for the public sector, profits, new niche markets, and a rising flow of further investment opportunities for the private sector. For philanthropic organisations, successful local development can provide important social outcomes (jobs, incomes, enterprises, assets) and it can have a demonstration effect, showing what can be

done. For these reasons there is a renewed interest in the means of financing local development and there is extensive financial innovation across the OECD countries.

This book presents and highlights many of these innovations, offering an observatory on innovative local development finance focusing on the roles of actors such as:

- Local Governments.
- National Initiatives.
- Development Agencies, Development Banks, and Regional Funds.
- International Financial Institutions.
- Foundations and NGOs.
- Commercial Banks and Investors.

The purpose of the book is both to present these innovations and show how they work, but also to put financial innovation in the wider framework of how local development is evolving.

I.3. The literature so far

In 2003, the OECD LEED Programme published the first review on the subject, *Private Finance and Economic Development: City & Regional Investment*, which developed the thematic assessment, reported on the proceedings of a conference held in London and presented six expert papers on the subject.

One of the earliest key texts on local development finance is Blair (1995), an undergraduate level text on regional economics. Blair's text provides a comprehensive user-friendly introduction to economic development, broadly describing regional development theories, economic development theories, economic development practices, and analytical techniques for assessing the performance of regional and local economies. Topics addressed include regional growth and development, land use, metropolitan government and finance, housing, development strategies, and neighbourhood development. The text is widely thought to be a useful introduction to the key issues of local economic development, and is particularly strong on economic topics, although some critics have suggested it

inadequately covers planning issues. The book has also been criticised because its chapter on government is "almost strictly a lesson on public taxation and the allocation of public goods, and less on ways in which government can induce local economic development."

Since the turn of the millennium, there has been a minor proliferation of key texts on local development finance. Blakely & Bradshaw (2002), first published in 1990, explores the theories of local economic development and addresses the dilemmas communities face. Blakely and Bradshaw investigate planning processes, analytical techniques, business and human resource development, as well as high-technology economic development strategies. The book is distinctive for its 'hands-on' practical approach as it guides the reader through the steps of securing the funds necessary to meet community needs for cost effective services and facilities. The third edition (2002) of the text is a particularly useful volume as it includes case studies, illustrations, and exercises which demonstrate how each theory can be employed in a real-world setting. It also incorporates, for the first time, new arguments for implementing local economic development initiatives, and is thoroughly updated to reflect the financial boom of the 1990s and subsequent collapse, the policies of the Clinton and George W. Bush administrations, and the aftermath of September 11th.

In 2001 Dr Edward Blakely wrote a similarly practical text with Susan Giles, entitled *Fundamentals of Economic Development Finance*. As with Blakely and Bradshaw's 2002 text, Fundamentals of Economic Development Finance takes a practical approach to its subject matter, and is distinctive for its focus on the financial issues behind local economic development – as opposed to the social good associated with such projects which many texts choose to focus on. Blakely and Giles (2001) examine the fundamentals of financing local economic development from the perspectives of both the private and public sector. They show how to link public community funding and private marketplace funding and describe how private development can incorporate community programmes as an asset to a development project or programmes. The book includes numerous examples, eight real-world cases, a glossary of terms, and a model local economic development business plan.

A further classic text which has been rewritten for the modern day, in particular taking into account the vast changes which took place in local development finance in the 1990s, is White, Bingham and Hill (2003). This book is a comprehensive compendium of articles by some of the field's leading scholars and professionals, and offers a balanced survey of the major mechanisms for financing economic development today. It explores the details of all the standard developmental tools,

such as tax incremental finance districts, angel and venture capital, and tax abatements, as well as newer tools that have proven effective, including micro-enterprise lending, stadium financing, brownfield financing, and revolving loan funds. Tools for rural development finance are also covered, and in addition to describing the various programmes and providing examples of how they work, the book also evaluates their relative effectiveness against alternative techniques.

One of the most recent key contributions to the academic literature is *Economic Development Finance* by Karl F. Seidman (2004). The text is highly regarded and pulls a vast and diverse array of information about development finance together into one volume. Seidman explores the technical aspects of business and real estate finance and surveys the full range of policies, programme models, and financing tools used in economic development practice within the United States. He examines private, public, and community financial institutions, and policies and methods for financing local and regional economic development projects. His treatment of policies and programme models emphasises their applications and impact, key design and management issues, and best practices. A separate section addresses critical management issues for development finance programmes: programme and product design, the lending and investment process, and capital management. Clear and comprehensive explanation of theory is supported by numerous case studies throughout the book. John S. Strong of the School of Business, College of William and Mary has suggested that the book's main strength is Seidman's ability to "summarise concepts, programmes, and institutions and then draw from them issues, lessons and challenges."

Important additional literature has been produced by many practitioner organisations. These include networks of economic development professionals such as International Economic Development Council (IEDC) in the USA and European Association of Development Agencies (EURADA) in Europe. IEDC's *Economic Development Finance* publications remain an important and substantial primer on this subject. Equally, the World Bank and other international financial institutions have been key promoters of information about economic development finance tools.

I.4. Variations and innovations

Local futures: common challenges but different tools

This book takes a practitioner approach. It reviews case studies of almost 50 financial instruments and mechanisms, drawn from across OECD member and non-

member countries, and it begins to define how a local development programme can generate an investment strategy to accompany and reinforce its purpose.

Financing tools for local development vary substantially from one place to another. For example:

- Tax credits and incentives in the USA have tended to do the work that grant in aid does in the UK when it comes to urban re-development.
- Guarantee systems in Europe have tended to address the small business lending issues that, in the US, are tackled through progressive regulation.
- Town centres investment mechanisms began in Canada (and spread rapidly throughout the USA) through clear statutory frameworks and have been achieved through voluntary partnerships, or chambers of commerce, in most of Europe.
- FDI deals which are sweetened with tax abatements in one place are supported with direct subsidies in others.
- Public bonds are issued in some countries to support the activities that in other countries are the preserve of private fund managers.

US cities are funded in a range of ways, as illustrated by Table I.3.

Table I.3. US Cities - where the money comes from

Source	Percentage
Federal Government Grants	5.4
State Government Grants	24.9
Property Taxes	21.4
Charges and fees	17.9
Borrowing, Capital Receipts, other taxes	30.4

Source: Wallian, 2005, available at ippr.nvisage.uk.com.

Fiscal systems and local development

This argument may be elucidated in direct terms. There is evidence that significant differences exist in how much tax is levied at local level, how much of local tax is spent at the local level, and how far local governments are dependent upon transfer payments from higher tiers of government. Research carried out by the

Council of Europe in 2000 demonstrates that the percentage range of local sources of local government taxes in local government budgets varies between 1-2% in several countries to 60% in many others. Across Europe, and across the OECD, we have a very wide range of different local government finance models.

We know that how sub-national Government is funded does make a difference to how sub-national economic development is pursued, and there are clear differences between relatively centralised and de-centralised countries, as well as between countries with high average tax levels versus countries with low average tax levels:

- Countries with high tax levels tend to rely on public investments (transfer payments) to trigger and support publicly led economic development efforts, whereas countries with low tax levels tend to presume greater private sector activism and leadership in the economic development arena. The former focus more on tackling spatial economic disparities, the latter on promoting regional growth combined with corporate responsibility towards poor areas.

- The higher the proportion of local taxes within local and regional governments' budgets, the more likely that sub-national governments are to pursue economic development whole-heartedly, as a means to grow their local/regional tax base. Economic development becomes a means to grow the tax base in order to finance local services, assets, and amenities, leading to entrepreneurial behaviour in the sub-national public sector. This has been a common observation in more decentralised countries such as the USA for many years.

- However, the higher the degree of transfer payments within local government budgets, the more likely it is that economic development is an activity pursued by sub-national governments to address social and spatial disparities. This is often encouraged and fostered by national governments, through transfer payments, often within a national framework to address inter-regional and inter-local disparities. This is common for example in the UK and in Denmark. In this scenario, whilst sub-national governments continue to have an incentive to attract private investment, they also have an incentive to attract public transfer payments. The former requires promoting their region or locality as place of private investment opportunity, the later requires promoting it as a place of public policy need. There are tensions between these approaches.

What emerges from these different approaches are, in effect, different forms of local economic development with different goals and intentions. Between them we have a multiplicity of hybrids integrating the attempts to make local/regional economies more entrepreneurial in order to generate tax base, and attempts to address social and spatial disparities from higher tier transfer payments. Most OECD countries will see themselves as operating somewhere between these two extremes, but most are nearer one end of this continuum than the other.

So, different incentive structures give rise to different approaches to attracting and utilising private finance. But, private finance is essential in all models, both as a means of achieving long term economic development, and also as a vehicle for making economic development interventions more financially and commercially sustainable.

This gives rise to different approaches and partners:

- Local development efforts that are focused on generating a local tax base are highly oriented towards attracting and expanding business investment and physical development, including many efforts to foster an attractive environment and a strong labour force for business. This means that the primary interface is with business, investors, and developers. Economic development finance in this scenario is often about incentives to private sector investment.

- Local development efforts that are focused on devising and implementing strategies to address spatial disparities are often much more oriented towards public and social sector activities, working on supporting the unemployed into work and on new sources of entrepreneurship and employment. They also often require extended liaison and lobbying with high tiers of government to attract funds. Economic development finance in this scenario is more about investments in hard and soft infrastructures that make privatre investment more likely.

This means that the nature of municipal finance has a big impact on how local governments play their role in local economic development. Tables I.4 and I.5 and Chart I.1 demonstrate the substantial range of different means to finance local government. Implicit in each of these is a distinctive incentive structure for local economic development, and a unique set of tools with which to pursue local development itself.

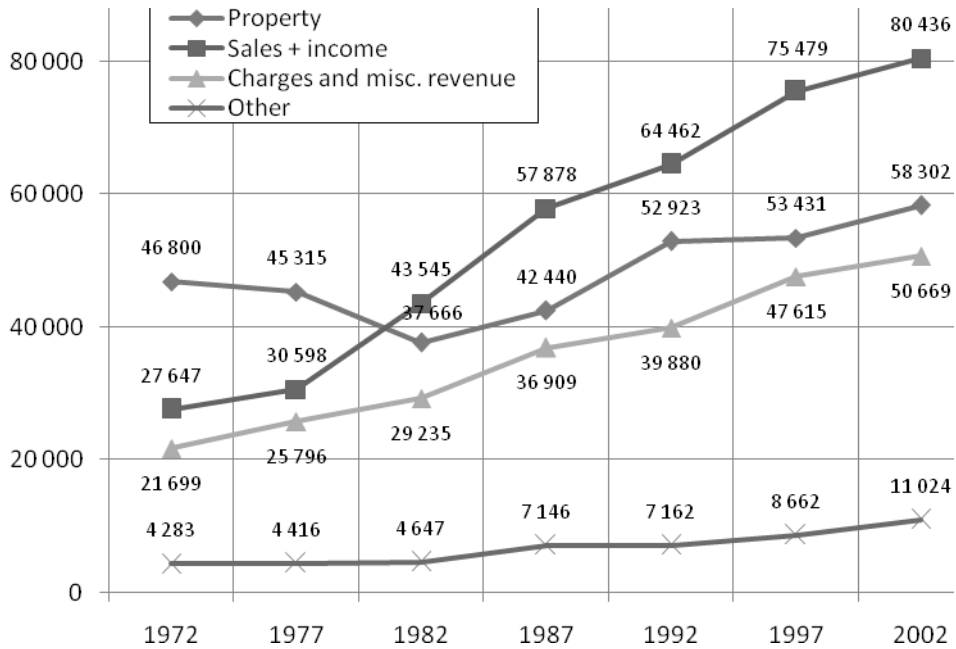
Table I.4. The diversification of municipal revenue composition in the USA

1972-2002 as a percentage of own-source general revenue

Category	1972	2002
Property Tax	46.6	29.1
Sales and Gross Receipts Tax	9.1	17.7
Income Taxes	5.4	7.6
Other Taxes	2.9	5.7
Charges and Misc. Revenue	18.5	40.1

Source: U.S. Census Bureau, 2002

Chart I.1. Revenue structure of municipal government, 1972 to 2002
in 2002 USD millions



Source: U.S. Census Bureau, 2002.

Table I.5. The nature of municipal budget incomes in Europe, 2002

Country	Initials	Local taxes	Fees and charges	Transfers	Capital raising	Other
Albania	AL	2.50	3.00	94.00	0.00	0.50
Austria	A	16.30	21.00	43.70	10.00	9.00
Belgium	B	40.75	6.00	44.26	0.00	8.99
Bulgaria	BG	1.00	10.00	78.00	2.00	9.00
Cyprus	CY	25.00	33.00	30.00	12.00	0.00
Croatia	CR					
Czech Republic	CS	16.00	12.00	45.00	11.00	16.00
Denmark	DK	52.20	22.30	24.50	0.00	1.00
Estonia	EE	0.10	0.90	91.00	2.00	6.00
Finland	SF	39.50	24.00	28.40	5.60	2.50
France	F	42.00	8.00	29.00	9.00	12.00
Germany	D	35.00	4.00	32.00	7.00	0.00
Greece	GR	27.00	8.00	63.00	2.00	0.00
Hungary	H	13.00	8.17	63.61	6.71	8.51
Iceland	IS	16.00	21.00	57.00	0.00	7.00
Ireland	IRL	64.20	18.00	5.40	4.60	7.80
Italy	I	31.00	11.00	42.00	7.00	10.00
Latvia	LV	65.00	1.00	29.00	0.00	5.00
Lithuania	LT	6.40	0.00	87.30	0.00	6.30
Luxembourg	L	32.88	24.88	33.16	8.00	0.00
Malta	M	0.50	0.00	97.80	0.00	1.70
Moldova	MOL					
Netherlands	NL	15.00	2.00	83.00	0.00	0.00
Norway	N	47.50	12.80	36.20	0.00	3.50
Poland	PLK	21.00	7.00	60.00	0.00	12.00
Portugal	P	23.00	10.80	49.30	7.50	9.40
Romania	RO	5.00	16.00	79.00	0.00	0.00
Russian Fed	SU	22.00	2.50	72.50	0.00	3.00
Saint-Marino	SM	0.00	0.00	31.00	69.00	0.00
Slovakia	SL	10.00	9.00	39.00	5.00	37.00
Slovenia	SV	6.80	13.90	79.30	0.00	0.00
Spain	E	29.80	18.50	27.10	14.90	9.70
Sweden	S	56.00	15.00	20.00	0.00	9.00
Switzerland	CH	46.00	24.00	18.00	3.00	9.00
Ex rep of Macedonia	FYR	62.30	28.80	1.50	0.00	7.40
Turkey	TR	4.76	20.90	48.86	0.00	25.48
Ukraine	UKR					
United Kingdom	UK	25.00	11.00	53.00	8.00	4.00
Average		25.73	12.24	49.03	5.55	6.88
Average for data gathered by CDLR		18.33	11.72	50.88	6.94	12.14

Source: Council of Europe, 2000.

I.5. Public/private collaboration and co-ordination

The key to most progress on local economic development finance is a new relationship with the private sector. Not just public-private partnerships, but a more advanced means to shared risks, costs, returns, and the stewardship of assets.

For those promoting local development in cities, regions or rural areas, private co-investment can add important ingredients that are otherwise absent. Development programmes are increasingly moving away from traditional attempts to substitute for the absence of private investment, and are now more concerned with explicit attempts to leverage private investment instead. Tackling market failure through 'market making' is the focus. Improving the incentive structure to make cities more bankable is the new agenda.

Private finance is key to local economic development because:

- It provides more capital than is otherwise available, and in a quicker and more efficient manner.
- It helps to rebuild local investment markets and averts other 'disinvestment' from occurring.
- It creates a greater commercial and professional discipline within city development policies and initiatives.
- It attracts wider interest from other commercial players, giving confidence that something of value must be occurring which might merit their interest.
- It builds a more sustainable finance strategy into local development initiatives, allowing public funds to be gradually unlocked for alternative actions.
- It repositions good local development activity as 'investment' rather than 'expenditure' in the modern economy.

Local Governments are therefore increasingly in search of the best propositions and instruments to attract commercial investment.

Equally, for private finance providers, participation in local development programmes can provide some important contributions to business strategy. It can:

- Utilise public sector support to help develop new business and market sectors that would otherwise not be easily accessed, acting as R&D activity for future financial product lines.

- Contribute to diversification of the asset classes over which investment is spread.
- Contribute to achieving ethical and/or local investment priorities.
- Provide some predictable returns in periods of instability.
- Build relationships with a wider set of partners from which other business might evolve.
- Strengthen local and regional economies in ways which can safeguard or improve other investments, or expand the market for other financial services.

The encouragement of both public and private investment by local governments, cities and regions can have different purposes, and take different forms including:

- Public/private partnerships in the form of contracts, leases, and joint ventures.
- Tax based incentives, credits, and reinvestment mechanisms.
- Participation of public funds in financial engineering and commercially managed investment funds.
- Use of public assets to encourage investment.
- Debt financing or other investment arrangements that are taken by cities on their own account (within their own municipal balance sheet), or by 'bondable' organisations outside the public finance system

Increasingly, new investment tools are emerging for cities. Business Improvement Districts (first invented in Canada, massively expanded in the USA, and now prevalent in South Africa, Australia, and beyond) have finally arrived in the town centres and commercial districts of many more countries. Regional Investment Funds (first piloted in Germany, and spread through Netherlands, Belgium, and beyond) have now spread throughout the EU's regional development system and continue to grow. New approaches to infrastructure levies and development fees (common in East and North Asia and in many other countries) are starting to be taken seriously in Europe, and are operating at a much larger scale in North America than before. Tax incentives that improve returns for private financiers, and guarantee systems that reduce their risks, are growing too; the first a North American, and the latter a European invention.

The key role of financial skills at the local level

An important additional theme now emerges concerning how local development finance can evolve. This issue is skills. Our assessment of how local development finance can work more effectively has placed stress on financial innovation, on partnership with the private sector, and with the need to develop clear investment strategies that complement and support local development strategies.

However, this assessment is based on a recognition that there are investment gaps continuously appearing at local level: a failure to translate investment needs into effective demand and bankable propositions for local development. These gaps are partly explained by weaknesses in the supply of finance, even though we know that there is no absolute shortage of investment capital available, and our case studies of the roles of international financial institutions, and commercial financiers shows a willingness of such institutions to innovate.

Some explanations focus on the weak returns, risks, and costs associated with financing smaller or less standardised deals. This explanation emphasises the limited attractiveness of some local development activities (such as early stage SME financing) relative to other asset classes. The projects may be bankable, but they are not as attractive in terms of the return on investment of capital, time, and skills required to make them work. These explanations emphasise the importance of improving the quality and consistency of local development projects and services, in order to reduce risks and costs and to improve returns for commercial and institutional finance.

Other explanations emphasise information failures or asymmetries, whereby neither project promoters, nor financiers, are appropriately aware of the scope of financing tools for local development. Systematic attempts to bridge these information gaps through brokerage and information services are seen to be successful in raising the ratios of projects successfully attracting external finance.

But underlying these explanations and attempted remedies, a skills gap also exists. Local development practitioners and financiers appear to lack some important skills that would enhance the vitality of local development finance markets. This gap expresses itself in several ways:

- At a high level there is limited understanding of how the key actors can engage each other. Local leaders rarely talk about the return on investment that their development strategies and projects can offer to financiers. There is a failure to frame the discussion in ways which are meaningful to the

investment community. Local leaders tend to focus on articulating social and public policy needs rather than potential returns and opportunities. At the same time, financiers focus narrowly on the internal return of projects and strategies and do not also articulate the external rates of return possible in terms of wider benefits that can build a shared approach to a local market. So at the heart of this is a communication skills gap that is rarely bridged.

- Local leaders also frequently also focus their analysis on the need for additional supply of capital and financial tools, rather than on the need to use existing financial instruments fully. Even when financial tools such as congestion charging, supplementary levies, PPPs, and debt instruments (such as bonds) exist, they are often seen as too complex, politically unpopular, or untested. This amounts to a leadership skills gap that can persistently prevent the full use of existing financial tools.

- In addition there are specific technical skills that are often in short supply amongst the local development practitioner community. These include project finance skills and corporate finance skills, strategic asset management, and long term financial modelling. It is not surprising that these skills are absent. In many countries these skills attract premium salaries that are not affordable for local development organisations. However, evidence from our case studies (e.g. LISC and the Enterprise Foundation in the USA) reveal that when these skills are systematically built amongst local development practitioners, they are able to access commercial and institutional finance much more effectively. Equally, experienced local development agencies are often able to attract or develop such skills over time and become more effective in the development of bankable projects. One reason that local development agencies succeed in this way is because they are able to recruit people with financial skills gained from commercial and institutional environments.

- Finally, there are softer skills such as negotiation skills and marketing skills that are important ingredients in making local development projects more appealing to external financiers. These skills are also often in short supply.

Overall, a renewed emphasis on the skills required for successful diversification and innovation in local development finance are largely overlooked. Where purposeful attempts are made to build these skills they are an important components of fostering the 'capable local intermediaries' identified in our ten

principles of local development finance. Renewed and improved efforts to develop such skills are a key imperative for all who aim to build the market for local investment.

I.6. Key principles

When we review local development finance we observe that there is a wealth of financial innovation going on across the world in how local development is supported. We have started to review these financial tools and have developed ten principles to begin a debate about how local development finance can evolve. These are summarised here and will be developed more fully later:

i) Smart finance for smart cities and regions, promoting the fiscal relationships with higher tiers of government right.

ii) Promote active private sector leadership in local development finance and investment.

iii) Metropolitan finance for metropolitan amenities, sharing costs and benefits between cities and their neighbours.

iv) Capturing and sharing the benefits of growth locally.

v) Flexibility in public funding to enable private co-investment in local development.

vi) A new approach to the management of public assets locally to achieve financial leverage.

vii) Fostering financial innovation in public and private sectors locally.

viii) Long term market building in local economies by the private sector.

ix) Focus on the quality of the local financial propositions not on the supply of finance.

x) Build capable specialist intermediaries at local and wider levels.

These ten principles are guiding our observations about what works in local development finance. The OECD LEED Programme is now preparing to undertake local and regional reviews of local development finance in order to build up a

worldwide set of lessons on what works in financing local development to create vibrant local investment markets into the future.

I.7. Summary

An important change is upon us in terms of what is needed to finance local economic development. Global opportunities for cities and localities have led to a renewed impetus for new financial tools. Properly appraised public borrowing at local and regional levels is no longer considered heresy. Using the tax system to provide a different incentive structure for place based, as well as issue based, investment has now become common. Addressing how public assets can be better used to generate private co-investment (rather than just sold for a once only 'current value' price) is now the new mind-set, and thinking about the organisational vehicles needed at local and regional levels to promote financial innovation has moved on. As cities have to help nations respond to shifts in new global value chains, so renewed interest in supporting investment into cities is occurring.

All of this has been increasingly supported by a realisation that improved local and regional investment is not solely about the supply of finance; the amount of money available from all sources. It rests much more upon the quality of propositions (the strength and quality of demand) that are developed, the robustness of their management, and the returns they can offer to private and public investors. Consequently, a renewed focus on generating better propositions ('stimulating good deal flow') and making the opportunities that are available better known to financiers ('brokering demand with supply') has also become a key feature of local endeavour.

II. What are the Financial Tools and Innovations in Local Development?

1 OVERVIEW

Successful local development involves achieving a high investment/high return equilibrium, just as much as it does for the most successful businesses. Success in the open knowledge driven global economy requires places to be truly distinctive, appealing and productive. Just as firms must innovate and invest to succeed, localities have to adjust, reinvent, and differentiate themselves. They have to change the old patterns of land and resource use, and connect assets with opportunities in new ways and over new spaces. They must modernise infrastructure and build up human capital. This can have positive impacts on entrepreneurship, innovation, skills, and other factors of growth. But this involves adjustment costs, in the form of investment to re-engineer the locality for the new economic functions and flows that it must facilitate. It can take 30-50 years of re-investment to fully recalibrate a city or a region from the industrial mode to the knowledge mode.

It requires investment, and it does yield returns. But many localties do not have the surplus cash, or the financial powers and leverage required, to make the investment, and capture the value it can produce. Localities find themselves within a vast range of frameworks that do not give them control over their own investment. They become stuck in a low investment/low return equilibrium. Periodically, an opportunity arises to make new investment and share risks and costs with other public and private entities. These opportunities do not come often and must be seized with purpose. Hosting a global event, winning a major investment, or attracting new population can be the trigger for increased financial resources. It is

not surprising that many localities spend considerable effort trying to make these kinds of changes happen.

Despite differences in financing tools between localities, two basic forms of innovation are emerging.

i) There is a continued push by commercial intermediaries and investment institutions to create non-governmental approaches which define and develop new localised investment markets where there is confidence that good returns might be made.

ii) Within government at various tiers, there are efforts to innovate with public finance in ways which will make it more flexible and sensitive to commercial thresholds, and thus leverage private investment more effectively.

Given that there is renewed appetite in both the public and private sectors for financial innovation across the OECD, it is worth noting that localities within the OECD member states have come to have rather different local development financial instruments.

Nature of recent innovations

In this section we trace the important recent innovations of key players in local development. These are:

- Local Governments.
- National Initiatives.
- Development Agencies, Development Banks, and Regional Funds.
- International Financial Institutions.
- Foundations and NGOs.
- Commercial Banks and Investors.
- Inter-governmental Organisations.

Fifty different financial innovations are presented and discussed in order to fully illustrate the range of new financial tools and approaches that are in operation. A critical commentary is offered on each one. We begin with local government which is the primary initiator or convenor of economic development at the local level.

2 LOCAL GOVERNMENTS

Local governments are the key funders of local development. But, as we observed above, there are important differences in the ways that local governments are funded that impact upon how they finance local development. Mayors and regional leaders are now advocating planning and development strategies that increasingly seek to perform the role of being 'investment prospectuses' for their territories, demonstrating to financiers that they have the ability to grow in ways which can sustain borrowing to support economic expansion, and provide an acceptable return on capital deployed. Put simply, more private investment can help a city or region achieve more than public investment cycles and local tax systems alone can afford, especially in times of tight fiscal discipline.

It is arguably a key task of local and regional development activity to make cities and regions both more 'investable' and more 'investment-ready.' 'Investable' in that they need to clearly demonstrate how good returns can be made on investments in their territory, and be ready to help make those deals attractive. 'Investment ready' in that they must become involved directly with measures to stimulate a strong deal flow of good quality propositions for financiers to evaluate. Just as cities and regions still spend significant effort seeking to attract international corporate investments through Foreign Direct Investment (FDI) deals, and international talent through population growth strategies, they now need also to attract institutional and commercial investment into their locally focused financial instruments and assets.

The changes in global development over the past two decades have produced a different set of financing propositions at the local level from those in the past. Economic development in cities and regions is now much less about roads, bridges, and factories (which offer tangible collateral for financiers), and much more about soft and smart infrastructure, re-used brownfield land, high tech business space, creativity hubs, science parks, supply chains, knowledge capital, small companies, joint promotion, and community development. These offer less tangible collateral, and less well tested investment returns. They also offer more variable revenue covenants. Investing in these assets requires something new.

The public sector, at any level, can use its resources flexibly to help the private sector find means to commercially finance this new generation of job and wealth creation activities. National assistance through tax relief and incentives can be coupled with more localised participation in financial instruments to improve returns, or to reduce risks and costs, for private co-investors.

Local government financial innovations case studies

Based on our principles of local development finance, presented below are a suite of examples of local government innovation in financing local development. These are organised to illustrate key themes and principles.

Theme	Case Study	Region	Example
1.	**Creating dedicated local economic development revenue streams**		
	1	Philadelphia	Hotel bed tax
	2	Edinburgh	EDI
	3	Boston	Boston Redevelopment Authority (BRA)
2.	**Raising the local investment rate through borrowing**		
	4	Warsaw	European Investment Bank (EIB) loan
	5	Turin	Municipal bonds
3.	**Incentivising private sector investment**		
	6	Baltimore	Tax incentives
4.	**Capturing the value of local economic growth**		
	7	Copenhagen	Property value taxation
	8	Chicago	Tax increment financing
	9	San Francisco	Benefit Association Districts (BAD)
5.	**Sharing risks and costs with private sector**		
	10	Glasgow	Public/private partnerships
	11	New York City	Business Improvement Districts
6.	**Financial tools that promote sustainable development**		
	12	Vancouver	Gas tax
	13	London	Congestion charge

Each financial innovation is described and it's role in local development identified and assessed.

Theme 1: creating dedicated economic development revenue streams

When it is most effective local economic development can create enhanced local tax revenues, increase asset values, and provide a clear fiscal return to local and higher tier governments. In some situations, local and other governments have realised the positive potential of this and have sought to develop dedicated funding streams for certain aspects of local development, by identifying the potential for additional levies and tax increments to provide ongoing funding. Effectively, this involves, taxing the benefits of local development in order to increase investment in local development, with the aim of fostering a positive cycle of investment and growth.

Good examples of this approach include hotel bed tax revenues being designed and levied in order to support tourism promotion, enhanced amenities, and employment development within hospitality industries. Another example is the use of rental income from assets, such as small business accommodation, to help finance wider local economic development programmes and enterprise support.

Case study 1. Philadelphia: hotel room tax

Overview of the financing tool

Philadelphia's local government finances local urban development using revenues from hotel room tax. This tax is imposed on the rental of a hotel room to accommodate paying guests. The term 'hotel' includes an apartment, hotel, motel, inn, guest house, bed and breakfast or other building located within the city, which is available to rent for overnight lodging or use of facility space to persons seeking temporary accommodation. The tax is imposed at the rate of 7% of the amount paid by each patron for the occupancy of a room and is collected from the occupant by the hotel operator, acting as an agent for the City of Philadelphia.

City Council Bill No. 990116 amended the Hotel Room Rental Tax by providing an additional excise tax on hotel room rentals and designating the tax revenues to be deposited into a special fund to be used for tourist promotion activities. The new Tourism and Marketing Tax is 1% on the consideration received by each operator of a hotel from each transaction of renting a room to accommodate transients. This 1999 city ordinance tax is in addition to the existing 6% Hotel Room Rental Tax. Together they are collected as 7% tax. Revenue from this tax is dedicated to funding the marketing of regional attractions.

In 2005, the city's hotel tax generated USD 71 million, up from USD 65 million in 2004.

How the city uses the financing tool

Hotel tax revenue is a key source of funding for both the Philadelphia Convention & Visitors Bureau (PCVB), whose job it is to book the Pennsylvania Convention Centre, and the Greater Philadelphia Tourism Marketing Corporation (GPTMC). The GPTMC is Philadelphia's regional tourism marketing agency and is a private, non-profit organisation dedicated to building the region's economy and positive image through tourism and destination marketing. It was founded ten years ago by the city of Philadelphia, state of Pennsylvania and the Pew Charitable Trusts and has been funded, since 1999, by the 1% hotel tax. GPTMC invests heavily in research, targeted multimedia advertising and public relations that market the city as a fascinating, friendly destination in which to invest or simply to travel to. GPTMC has organised, for example, a Benjamin Franklin Fest. This event, like virtually every big event in Philadelphia, was convened, coordinated, produced and marketed by the GPTMC.

Value added of the financing tool

GPTMC Board Chairman Manny Stamatakis has suggested that,

> *"Travel and tourism generate USD 9 billion in economic impact and employ 125 000 people in the Philadelphia region…..investment in tourism marketing pays big dividends and demonstrates why we must continue to invest to maintain and grow our competitive position."*

Leisure travel to Philadelphia and its surrounding four counties has grown by 55% since 1997, the year GPTMC began advertising. In 2006, 8.86 million visitors stayed overnight and spent USD 7 billion in Greater Philadelphia, according to travel industry analysts. The GPTMC is widely credited with returning Philadelphia's fallen star to the tourism and travel map.

One project strongly promoted by the GPTMC was the Salvador Dali retrospective at the Philadelphia Museum of Art. This was not only a spectacular exhibition of a great artist's work, but also produced a major economic impact for the City of Philadelphia and the Commonwealth of Pennsylvania. It generated total economic activity of nearly USD 55 million, created 830 full-time equivalent jobs

with over USD 20 million in salary and wages, added more than USD 4.46 million to increased tax revenues, and provided a powerful incentive for cultural tourism to the region. These were among the findings of a report released by the Philadelphia Museum of Art, together with Advanta, the exhibition's corporate sponsor, in co-operation with the GPTMC and the PCVB.

Case study 2. Edinburgh: the EDI Group

Overview of the financing tool

The EDI Group is a private limited company, which was established in 1988 by The City of Edinburgh Council to carry out the development of Edinburgh Park, now established as one of the best business parks in Europe by the British Council of Offices. The EDI Group has gone on to develop most forms of property, from office and retail through to factories and housing for the homeless. EDI has particular development experience in both city centre and suburban projects.

As a private company, EDI must make a profit (and has consistently done so). However, its primary objective has always been the added social and economic benefit that development can bring about.

How the city uses the financing tool

The EDI Group works alone and in partnership with both the public and private sectors on specific economic development projects. For example, EDI has formed a Joint Venture Company (PARC) with the City of Edinburgh Council to deliver the long-term strategic regeneration of Craigmillar. The company is responsible for the creation of 2 200 new homes, one new secondary and three new primary schools, a new town centre with 300 000 square feet of retail, leisure and office space, a new library, and community and lifelong learning facilities. PARC is also responsible for ensuring the delivery of appropriate infrastructure for the area, the integration of existing public and local authority provision, and the creation of new landscaping, major public parks and civic spaces over a 15-year programme, together with raising the private funding (circa GBP 160 m) to carry it out and recycling a large part of the profit into the social infrastructure for Craigmillar.

The EDI is also currently working in a joint venture partnership with the Burrell Company, forming BUREDI – a development agency with the objective of delivering innovative solutions in the development of inner cities. Recent BUREDI

projects include the Tron project – a redevelopment programme which has created five separate buildings within the heart of Edinburgh's Old Town.

Recent individual EDI projects include the redevelopment of the former Traverse Theatre at West Bow and the former Greyfriars Hostel within the Cowgate area of Edinburgh. Aside from the Craigmillar regeneration, other current projects include the modernisation of Edinburgh Zoo and the redevelopment of Princes Street.

Over the years, the EDI Group has retained ownership of the majority of its completed commercial developments and this, coupled with strategic individual property purchases, has now resulted in the creation of a significant investment portfolio of over 100 individual properties. The sale of properties in the investment portfolio provides the EDI with funds to invest in further development projects. For example, the EDI recently sold Pentland Gait, a 62 000 sq ft office development in Edinburgh, for GBP 16.85 million to a private investor. The price paid reflected a net initial yield of 6%, which is essentially reinvested in the community through further redevelopment.

Value added by the financing tool

The company has delivered a variety of projects both in terms of size and nature. Larger projects, such as the Craigmillar regeneration and the Edinburgh Park flagship project have significant economic and social effects. The population of Craigmillar is expected to double as a result of the EDI's redevelopment.

The EDI brings the relative autonomy but discipline of a company approach, combined with private sector expertise, into the public sector, which can help raise investor confidence and facilitate effective joint working with other parts of the private sector. In terms of monetary turnover, the EDI recorded a pre-tax profit of GBP 1.2 million in 2003 – the majority of which is invested into new regeneration schemes.

The EDI has won several awards for its regeneration projects, most notably for the Tron project which secured first place in the Scottish Design Awards for 'Best Regeneration Project' and was also awarded 'Best Mixed Use Scheme in Britain' by the NHBC and Daily Mail. In addition, The EDI Group Ltd was placed, for four consecutive years, in the top 25 of the RIBA Journal "Top 50 Clients of the Year" Survey, and was the only Scottish company to be selected by the judging panel. This annual RIBA list has become a key measure of energy and commitment to contemporary architecture among public and private sector developers in the UK.

Case study 3. Boston: The Boston Redevelopment Authority (BRA)

Overview of the financing tool

The Boston Redevelopment Authority (BRA) is the municipal planning and development agency for Boston, Massachusetts. It was established in 1957 by Boston City Council and the Massachusetts Legislature, assuming the development powers previously held by the Boston Housing Authority and expanding them beyond public housing. In 1960, the City Planning Board was abolished and its powers were transferred to the BRA.

Today, the BRA holds the power to buy and sell property, to acquire property through eminent domain, and the power to grant tax concession to encourage commercial and residential development. The BRA's primary goal is to work with Bostonians, businesses and developers in order to provide direction for development in the city of Boston.

How the city uses the financing tool

The BRA's responsibilities include:

- Acquiring, selling and leasing real estate to achieve economic redevelopment and to promote public policy objectives, such as encouraging growth industries and appropriate land use policies.

- Issuing revenue bonds and notes, which do not constitute indebtedness of the city, to finance projects.

- Owning and operating three industrial parks.

- Providing financing and loan programmes for businesses, as well as technical assistance and other business services.

The most important method of financing local development is through the use of the BRA's assets: the BRA owns real estate throughout the city, which it sells when an attractive plan for the use of the property is submitted and approved. As such, it ensures appropriate development throughout Boston, and gains funds which it can use in further redevelopment projects and to provide loans for appropriate developments

Current projects include:

- *Boston Seafront* – the opening up of the waterfront to pedestrians by developing a parkway on top of the Central Artery Tunnel Project.

- *East Boston Municipal Harbour* – development of BRA owned properties along the waterfront.

- "*Housing on Main Streets*" - focusing on the city's neighbourhood commercial districts, Housing on Main Streets assists local communities in growing their commercial cores. The BRA provides development and planning assistance promoting multi-story and mixed-use development to increase area housing opportunities, housing choice and to enliven neighbourhood commercial districts.

- *Backstreets Initiative* – an initiative which has set a goal of preserving all industrial land in Boston so that businesses will have a space to call their own. The initiative also seeks to support the business community with workforce training, networking, providing site finding and other assistance to new businesses, and upgrading critical infrastructure. Backstreets Initiative offers a wide array of resources for companies looking to locate in Boston's industrial zones, including low-cost, tax exempt bond financing.

Decision making processes

The BRA's Economic Development Division is responsible for the coordination and management of the agency's activities and tools. The department is responsible for approving development projects and, through its review process, may require developers to adapt project designs so that they fit better with the City's development ideals.

The Asset Management/Real Estate Department is responsible for the management, maintenance and enhancement of all Authority-owned property outside of the Marine Industrial Park. This team monitors, assesses, enhances and promotes BRA-owned real estate leading to the eventual redevelopment or disposition for public purpose, and is responsible for the maintenance of an up-to-date and accurate on-line database of this property. The team seeks to maximise the value of the BRA properties and ensure that properties serve as assets to the communities and neighbourhoods of the city of Boston.

Value added by the financing tool

Some of the most significant projects which the BRA has taken on include the building of a new Government Centre in Boston's West End, and the renewal of the late eighteenth century Faneuil Hall Market Place, which was scheduled to be demolished. This project has been attributed to bringing life back into the then debilitated Boston downtown. As part of the city's *Leading the Way II* project, which ran from 2003 to 2007, the BRA has been responsible (jointly with the Boston Housing Association) for the construction of 10 000 new housing units, 2 000 of which are affordable housing units. The project has also reduced the number of elderly homeless people on the city's streets by 63% between 2004 and 2007. As part of the *Leading the Way* project, the BRA raised USD 17.5 million for affordable housing construction through sales of its property.

Theme 2: raising the investment rate through borrowing

A second theme involves local government borrowing to support investment in the productive infrastructure of a local economy. There are multiple forms of borrowing that a local authority might have access to. The case studies below show two that are becoming increasingly important. In the first example we see the City of Warsaw undertaking a large sacle loan from the EIB with multiple strands of activity that support local development in various ways. In the second we see the City of Turin issuing a bond to support infrastructure improvements associated with implementing it's strategic development plan for the city and preparing for the Winter Olympics 2006. The idea of borrowing to finance local development is an important means to crystalise the the longer term and investment orientation of local startegies.

Case study 4. Warsaw: European Investment Bank (EIB) loan for municipal infrastructure

Overview of the financing tool

The European Investment Bank (EIB) is the EU's financing institution. It belongs to the Member States and has a remit to foster the balanced development of the EU. The Bank has a subscribed capital of EUR 163.7 billion and its shareholders are the 25 Member States of the EU. EIB's lending in 2005 amounted to EUR 47.4 billion (2004: EUR 43.2 billion), while its borrowing in the capital markets in 2005 reached EUR 50 billion.

EIB lending activities are project-oriented and mostly geared to the financing of the fixed asset components of an investment. Since 1990, the Bank has lent more than EUR 34 billion to the countries of Central and Eastern Europe. In Poland alone, approximately EUR 11 billion has been made available, of which 2.2 billion was in 2005.

How the city uses the financing tool

The EIB has a well-developed co-operation with the City of Warsaw regarding project financing, including the following projects:

- *The modernisation of the municipal infrastructure of Warsaw*, *September 2005*. The project focuses on the financing of small and medium-scale investment schemes in the fields of transport, environmental protection, health and education, urban renewal and rehabilitation of municipal infrastructure and community facilities, services and tourism in Warsaw. The project objectives are to improve the urban infrastructure of the City of Warsaw in order to increase the quality of life of its citizens and the functionality of the City as well as stimulate new investments. The proposed EIB finance is up to EUR 125 million, although the total cost could escalate to EUR 400 million. In the past, the bank has provided EUR 50 million for the development and modernisation of the Warsaw municipal infrastructure, as well as EUR 45 million for the construction of the Water Treatment Plant "Poludnie".

- *EIB financing of Warsaw Airport expansion, December 2002*. The EIB lent EUR 200 million to the State enterprise 'Polish Airports' for the co-financing of a new passenger terminal and associated airside and landside work at Warsaw International Airport. The new terminal is to provide capacity for an additional 6.5 million passengers per year. This increases the airport's overall capacity to approximately ten million passengers, to deal with expected growth up to at least 2010. With a EUR 50 million loan to PPL granted in 1992, EIB helped upgrade Terminal I and associated infrastructure at Warsaw International, to increase capacity to three million passengers. Passenger traffic, however, has since grown at rates exceeding forecasts, reaching 4.7 million passengers per year in 2001 and is expected to increase to almost 6.3 million by 2005 and 9.4 million by 2010. Although the airport has dealt well with the excess traffic so far, it needs to be expanded urgently to meet current and forecast traffic levels.

Decision making processes

Sound technical features and financial and economic viability are the principal criteria of the EIB when assessing whether to advance a loan for a project or to provide a guarantee to another lender for a project.

In order to activate each branch of the EIB's credit, the positive opinion of Warsaw City Council is required. The City decides which projects are to be financed with funds but the EIB has a right to veto.

The EIB funds are designated for the following type of investments:

- Water and sewage systems' infrastructure.
- Transport infrastructure.
- Production sector infrastructure.
- Environmental protection projects.
- Health and educational infrastructure.
- Other infrastructure development projects.

The EIB funds are not permitted to finance tax commitments, administration fees, local fees, bank commissions, acquisition of parcels or financial assets.

Value added of the financing tool

The EIB loan advanced in 2005 for Warsaw's infrastructure development was the biggest in the city's history. The City will repay the amount within a period of 25 years. Very favourable loan conditions allowed significant savings to be gained in comparison to the offers available from the commercial banks.

The value added of EIB lending rests on three pillars:

i) Consistency between operations and the priority objectives of the EU.

ii) Quality and soundness of each project.

iii) The particular financial benefits obtained by the use of EIB funds.

With the aim of contributing to better and more investment, in recent years the EIB has developed specific value added indicators for regional development. Those indicators are now systematically applied in order to help understand how the projects the bank finances promote the European Union's policy objectives. When dealing with regional development projects, the bank has identified three broad categories of indicators for investments contributing to that objective:

i) Upgrading infrastructure in the regions, with a view to improving its quality and quantity.

ii) Developing productive economic activities.

iii) Enhancing human capital – health, education and social services – in assisted areas.

The local and regional development impact is further gauged by an assessment of the quality and soundness of each operation (second pillar of value added) and by its contribution to the economic recovery of the region. The bank calculates an economic rate of return – both in the private and the public sectors - and a financial rate of return for the investment that it is considering financing. If this cannot be done, it makes a qualitative judgment, taking all relevant factors into account. The EIB's enhancement of the financial viability of an operation (third pillar of value added) consists of longer maturities for its loans, innovative structuring, and the catalytic effect that an EIB loan may have by drawing in other sources of finance.

Case study 5. Turin: Buoni Ordinari Comunali (BOC) - municipal revenue bonds

Overview of the financing tool

Municipal bonds represent a new financing tool through which to collect funds from citizens and direct revenues towards public projects in the local area. *Buoni Ordinari Communali* (BOC) are titles which the local agencies can propose to finance legitimate plans, such as the undertaking of public works.

Decision making processes

The issuing of the bonds is regulated by the Ministry of the Treasury, which indicates the level of investment, the amount of the loan, the issue price, the date of issuing, the duration, the date and the modalities of the reimbursement, the

characteristics of the coupons and the nature of the fixed/variable rate. The BOC loan is not assisted by the state guarantee.

Critical success factors

Any loan cannot exceed the amount of the expenses stated in the executive plan if a loan is to be given for public works realisation, or the value of the technical office of the issuing agency for any other kind of investment. BOCs with a variable rate will have the quarter, semi-annual or annual rate of *Buoni Oridinari del Tesoro* (BOTs) (Treasury Bonds) or alternatively the RIBOR as a reference price.

In Turin, case Law 724/1994 disciplined the issuing of Council Bonds, an instrument aimed at financing the investments of the local authority. It also set the conditions and limits for the issuing of such Bonds. Arguably the most important condition is that the Bonds may be issued only to finance the investment and not the short-term activities. Moreover, the Bonds must be issued for at least five years and the withholding of tax will not be applied for non-residents.

Value added of the financing tool

The stability of Turin's finances has been confirmed by Standard & Poor's credit rating system. It evaluated Turin as "AA – stable prospects". This gratifying assessment has meant that the city has recently seen a reduction in the average cost of its own financing.

An analysis of Turin's income over a five year period shows a lower rate of funding from the State and other public bodies (an average of 21.08% registered as a reduction on the balance sheet), which is compensated for by considerable growth in income derived from fiscal revenue (an average of 21.47% registered as an increase on the balance sheet).

Theme 3: incentivising private sector investment

An important goal for local government is to attract private sector investment, especially into activities that appear to offer the potential for good returns but are not viewed as attractive by private investors or fall below market thresholds. One means to do this is to use tax incentives. There have been many studies of how far tax incentives do genuinely provide the stimulus to make an investment profitable and one of the key insights is that tax incentives play a role, not just in making the

incentive possibility more attractive, but also in marketing the investment opportunity that may not otherwise be visible.

In Baltimore the process of local economic regeneration in poorer and historic neighbourhoods has required greater private sector investment into the inner city and rundown neighbourhoods. Tax incentives have played a major role.

Case study 6. Baltimore: tax incentives

Overview of the financing tool

City policy-makers frequently use the property tax, the City's main source of revenue, as a policy tool to stimulate economic and housing development. Special tax treatment is granted as an incentive intended to encourage targeted development activity.

The city tax incentives which are available from the City of Baltimore include:

- New Construction Tax Credit.
- Home Improvement Tax Credit.
- Rehabilitated Vacant Dwelling Tax Credit.
- Station North Arts & Entertainment District Special Tax Benefits.

How the city uses the financing tool

Each tax is used for a particular purpose:

- Newly Constructed Dwelling Property Tax Credit: this programme was designed to encourage the construction and purchase of new homes in the city. The programme provides a five-year city real property tax credit (50% in the first taxable year and declining by 10% points thereafter) on newly constructed or substantially redeveloped dwellings, if the property has not been previously occupied since its construction or rehabilitation.
- Vacant Dwelling Property Tax Credit: this programme was designed to encourage the renovation and re-use of residential vacant properties. It was

the first of a series of tax credits enacted in the mid-1990s in response to concern about lagging development in the City during and after the recession of the early-1990s. The programme provides a five-year tax credit with 100% relief from city property tax increase in the first taxable year. The credit declines by 20% points thereafter.

- Home Improvement Property Tax Credit: this programme was designed to provide an incentive to make improvements to residential properties and lessen the financial burden on property owners. The programme provides a five-year tax credit with 100% relief from city property tax increase in the first taxable year. The credit declines by 20% points thereafter.

- Brownfield Property Tax Credit: this programme was designed to encourage the redevelopment of contaminated and abandoned and/or under-utilised industrial/commercial sites. It offers a city property tax credit (for both real and personal property taxes) on the increased property taxes after eligible improvements are made.

- Tax Credit for Conservation Property: this programme was designed to support preservation of conservation areas or open space properties. It provides tax relief for the conservation of properties that have been unimproved, not used for commercial purposes and subject to perpetual easement that is donated to the Maryland Environmental Trust.

- Enterprise Zone Property Tax Credit: this programme was established in the early 1980s to encourage targeted investment in economically distressed areas as measured by unemployment, poverty status, population decline, or property abandonment. The City currently has eight enterprise zones. The ten-year city property tax credit (for both real and personal property taxes) is based on an 'eligible assessment,' which is the difference between the base year value and the actual taxable assessed value after improvements are made to commercial properties in the Zone.

- Fallen Hero Tax Credit: this programme was designed to provide property tax relief to the surviving spouse of a 'Fallen Hero,' an individual determined by the Fire and Police Employee's Retirement Systems to have died in the line of duty pursuant to applicable provisions of the City Code.

- Historic Restoration and Rehabilitation Property Tax Credit: this programme was designed to encourage preservation and investment in historic properties.

- Homestead Property Tax Credit: this programme was designed to limit the amount of the annual increase in taxable assessments for eligible owner occupied properties.

Decision making processes

Tax Credit law requires the Director of Finance to report the public costs and benefits of tax credit to the Board of Estimates and to the Mayor and City Council. Since the programme's adoption, administrative costs have been absorbed within existing City operations. In FY2006, the Baltimore City budget estimates real property tax credit expenditures totalling about USD 35.7 million. This represents an increase of about USD 10.4 million compared to the FY2005 projected expenses of USD 25.3 million.

Critical success factors

Based on interviews, data analysis and similar incentives in other cities, AB ASSOCIATES concluded that the tax credits could potentially play a much stronger role in neighbourhood revitalisation efforts and in attracting new residents to the city. This is largely attributed to the lack of a co-ordinated marketing effort that reflects a comprehensive vision of the role tax credits can play in the overall revitalisation and stabilisation of the city. Subsequently, there are no co-ordinated strategies that utilise the credits as a community development tool, no quantitative guidelines by which to measure its success, and no cross-promotional efforts. Nor are there efforts to combine the tax credits with existing financial incentives such as low interest loans or grants that could increase their usage rate and therefore enhance their effectiveness.

One repeated argument was the notion that tax credits were ineffective in a jurisdiction that continued to exhibit declining revenue trends. While this argument may hold short-term merit, it overlooks the long-term impact of creating incremental value and the ability to use these types of incentives to change the fundamental character of a neighbourhood as well as preventing older neighbourhoods from becoming destabilised.

Value added of the financing tool

The Finance Department has published survey results of the credit recipients since FY2000, searching for a response to the question of whether the tax credit

programme has encouraged new development. The results showed that the programme supported an increase of 104% in the number of building permits between 2003 and 2004. The tax credit has appeared to be a strong incentive in encouraging home purchase.

Theme 4: capturing the value of local economic growth

A major issue in local economic development is how to ensure that some element of the returns form growth generated by improved local economic performance 'feeds back' into further local investment, both to enhance the momentum of existing growth and investment, and to open up other locations where investment and growth might also occur. Localities that have a mechanism to do this find that they can accelerate local economic growth more directly and provide enhanced incentives for private sector co-investment.

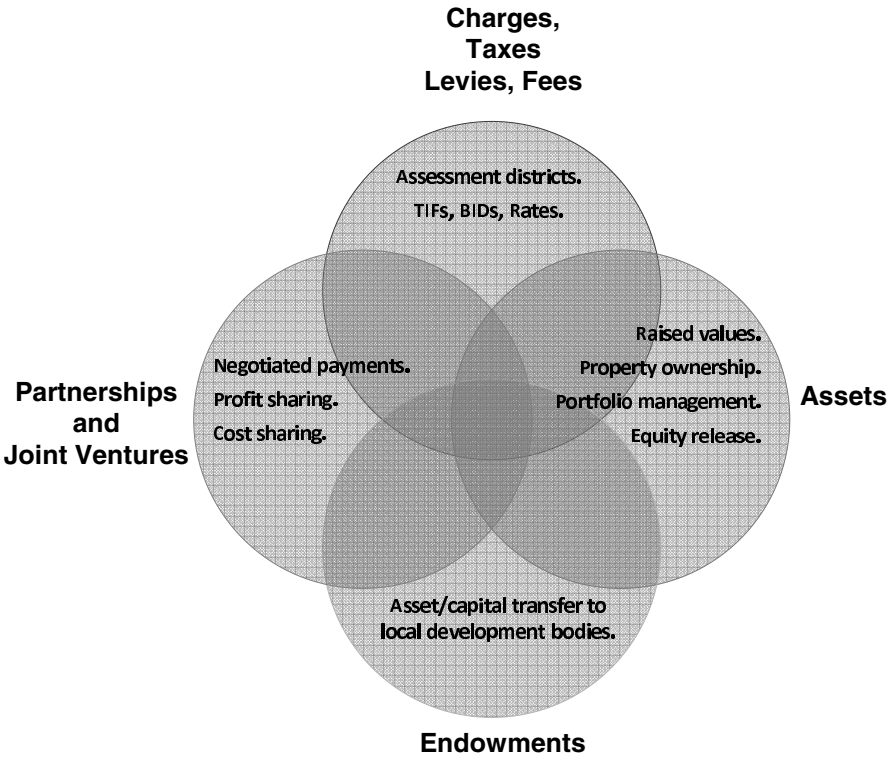
Value Capture Finance is a broad term applied to mechanisms which leverage the financial value created by the impact of development to help finance the infrastructure and other costs of making that development work.

There are different approaches used throughout the world; some are based on tax increments, some on development levies, some on planning applications, and others orchestrated around general property taxes, or based upon the strategic use of land holdings through joint ventures or a lease hold system (Figure 2.1).

Different countries have produced different approaches here:

- The Dutch system has tended to optimise the role of lease hold reviews to capture land value uplift in a context when substantial land holdings are in the public sector.
- The US system has tended to favour adding tax increments in redevelopment areas.
- The German system has employed joint venture land holdings approaches.
- The UK system has been based on negotiated planning levies.
- Denmark has favoured land development tax whereas France has chosen a land development levy.

Figure 2.1. Main mechanisms for value capture financing



Case study 7. Copenhagen: property value taxation

Property value tax in Copenhagen was imposed in 2000 and today helps to finance economic development in the city. Property value tax replaced the imputed rent of owner-occupied dwellings, which was part of the personal income tax.

Property value tax amounts to between 10% and 30% of the official property value. All property is valued once a year by the tax authorities. The tax is paid by private persons on all property owned in Denmark and abroad, and for properties located abroad either an agreement of double taxation or a reduction according to the taxes paid in the country of origin is applicable. Property value tax must be paid on owner-occupied flats, one-family houses, two-family houses and farms.

The tax is levied as part of the income tax which means that a person automatically pays one twelfth of the tax every month. The basis for calculating the property value tax to be paid in 2003 on Danish property was the lowest amount out of the following values:

- Property value as of 1 October 2003
- Property value as of 1 January 2001+ 5%
- Property value as of 1 January 2002 (different rules apply to foreign property).

How the city uses the financing tool

Real estate tax rates are set by law and cannot be changed by a county. The real estate tax system was adjusted in 1998, taking effect in 2000. In addition to land tax and reimbursement duty, a property value tax was introduced in 2000. Counties receive one-third, and the municipalities two thirds.

Critical success factors

Administration of any property tax is largely a matter of assessment. Unless assessment is both accurate and up-to-date, the successful operation of land-value taxation (LVT) is severely compromised. Where sales are infrequent or there are no land parcels with similar characteristics in the vicinity, the valuation of a site may present difficulties. However, sophisticated techniques have been developed to deal even with such situations. Computers, aerial cadastral mapping, and other technological innovations make for greater uniformity of treatment, rendering the process less susceptible to personal and political pressure

Value added of the financing tool

Taxation has a number of impacts:

- Citizen tax burden: most citizens pay substantially less under land value tax than under any other broad-based tax generating the same revenue.
- Effect on blighted property owners: LVT reduces the tax burden on those making improvements to blighted properties, whilst increasing the burden

on these properties in their current condition. This makes owners inclined to either improve the properties or sell them to someone else who will improve them.

- Public debt: switching to land value tax creates no public debt. It stimulates the economy, increases revenue from other taxes and thereby helps reduce debt.

Case study 8. Chicago: Tax Increment Financing (TIF)

Overview of the financing tool

'Tax Increment Financing' (TIF) is a particular tool that the City of Chicago can use to generate revenues for economic development in a specific geographical area. TIF allows the city to re-invest all new property tax dollars in the neighbourhood from which they came for a 23-year period. These 'new' revenues – also called 'increments' – arise if new development takes place in the TIF district, or if the value of existing properties rises, resulting in higher tax bills. These funds can be spent on public works' projects or given as subsidies to encourage private development. TIF also makes it much easier for the city to acquire private property and demolish buildings to make way for new construction.

A TIF district, once designated, lasts for a period of 23 years. The process includes the designation of a TIF district, a redevelopment plan for the TIF district, and redevelopment agreements with developers and companies who promise to fulfil some aspect of the plan in exchange for benefits from the TIF fund. TIF works by capturing all new property tax revenues from a specific area and reinvesting them in the area. TIF subsidies can go to private developers or be used for public improvements.

Unlike some other programmes, most of the city's neighbourhood TIF does not come with cash up-front. Money generally is not available until the TIF begins to generate its own tax revenue from rising property values, or a bond is issued to 'front-fund' the TIF. TIF projects do not compete with other citywide projects because they have a dedicated source of revenue (the "increment") to draw on.

How the city uses the financing tool

There are 130 TIF districts in Chicago, comprising nearly 30% of the land area of the city. TIF revenues may be used for a variety of infrastructure and other public improvements (including improvements to schools, parks, and other public buildings) or to directly subsidise private residential, commercial, or industrial development. These priorities are laid out in a 'redevelopment plan', approved by the city council, that outlines the priorities for the area and an estimated budget. The major limitation on TIF funds is that they cannot be used for the 'bricks and mortar' costs of construction (except for affordable housing), or for privately owned equipment.

TIF money may be used for:

- Planning expenses, such as studies and surveys, legal and consulting fees, accounting, and engineering.

- Acquiring land and preparing it for redevelopment, including the costs of environmental clean-up and building demolition. In older areas, making a site ready for a developer helps to reduce costs and eliminates a major barrier to redevelopment. To aid this process, the TIF law gives the City expanded powers to acquire private property through its power of 'eminent domain.' If the City can show it is acting for a 'public purpose' – a very loosely defined idea – it can force property owners to sell their land to the City at 'fair market value.' The City then re-sells the land to a private developer, often at a deep discount, or uses it for a public building.

- Job training and day care expenses for companies located within the TIF, or for companies that are planning to locate within the TIF. There are also proposals that advocate establishing job-training centres that would serve the job-training needs of all the companies within a TIF district, regardless of whether or not they have received a direct TIF subsidy.

- Renovation and rehabilitation of existing buildings.

- Financing and interest subsidies for the loans a developer takes out to pay for a project.

Decision making processes

Eight local taxing bodies, including the City, Chicago Public Schools, the Chicago Park District, and Cook County receive revenue from property tax. When a TIF district is created, any additional revenues over the base EAV go into the TIF fund, not to specific recipients.

The four key institutions involved in decision making process about TIF creation and revenue spending are:

i) County government: it has virtually no say over whether TIFs are created or how the money is spent, but, because the County is in charge of the property tax system, it does have some authority over who receives tax relief in a TIF.

ii) Community Development Commission/Chicago Plan Commission: whilst these bodies rarely refuse a proposal, they do preside over the formal public hearings on TIF redevelopment plans, subsidies, property acquisition, and land use. They can shape a proposal by asking DPD and developers tough questions based on their own concerns or public testimony

iii) Other taxing bodies (schools, parks, etc.): some public officials may have an 'inside track' in winning TIF-funded improvements (such as school repairs or park improvements), though that has not occurred much yet in Chicago.

iv) Developers/businesses: developers and businesses can often make powerful promises in terms of jobs and economic development to help gain support for TIF subsidies, as well as the ever-present promise of campaign contributions and other political support.

Critical success factors

TIF success or failure depends on how active the community is in its planning and implementation. The neighbourhood must remain affordable for those who live and work there. Thomas N. Jacob & Associates/EDG suggests that,

> *"The success of TIF is a reflection of public and private entities working co-operatively to meet the redevelopment goals and objectives of those municipalities".*

Value added of the financing tool

TIF generates a number of benefits including a decrease in federal funding, increased local control, a high degree of flexibility in fund use, an ability to combine with other programmes, a series of grants not loans, tax reallocation as opposed to increase, public benefits due to the retention/creation of jobs, the provision of goods/services to under-served communities, an increase in net city revenues (Sales Tax), and the preservation of historic buildings.

With consistent community participation, TIF can be a tool for implementing a community-based revitalisation plan through encouraging affordable housing development, improving parks and schools, repairing basic infrastructure, putting vacant land to productive use, creating well-paying jobs, and meeting other local needs.

TIF is a politically appealing tool because it does not require the city to increase tax rates. Instead, a TIF brings more money into the city's treasury by raising the value of the property that is taxed. Higher property values mean more property tax revenue for the City.

As advertised by the City, tax increment financing is supposed to be the 'last' and 'best' economic development tool Chicago has left.

Case study 9. San Francisco: Benefit Assessment District (BAD)

Overview

A Benefit Assessment District (BAD) seeks to overcome some of the problems associated with the general property tax. Benefit assessment is a fee on property, used to fund part or all of the capital investment that enhances the value of the property. Assessments must be proportional to any benefit to a property and a BAD cannot be established unless an engineering report identifies, and provides a method to calculate, the special benefits produced. In addition, property owners must be given notice and provided with a public hearing before an assessment district can be formed. In theory, assessments should apportion project capital costs between benefiting property owners based on the value of the additional benefits each receives. In reality, it is difficult to isolate the impact of one capital expenditure from other influences on property values.

Value added by financing tool

The San Francisco BAD was used to raise funds for the Bay Area Rapid Transit (BART) system (Ubbels *et. al*, 2004). Similarly, a BAD was also used to part-finance the construction of the Los Angeles Red Line. Overall, 9% of the USD 1.4 bn cost of this part of the Metro Red Line will be raised through BADs.

Theme 5: sharing risks and costs with private sector

Sharing risks and costs between public and private sector collaborators in local development is an important part of making the development activity sustainable in economic and financial terms as well as providing scope to achieve public goods and good practice innovations.

There are mutiple mechanisms for undertaking such cost and risk sharing and these include PPPs and privately funded mechanisms that support public sector endeavour. Two examples are given below; PPPs in Glasgow and Business Improvement Districts in New York City.

Case study 10. Glasgow: public-private partnerships

Overview of the financing tool

Public-private partnerships (PPPs) involve a government service or private business venture being funded and operated through a partnership between the government and one or more private sector companies. These schemes are sometimes referred to as PPPs, PFI or P3s.

In some types of PPP, the government uses tax revenues to provide capital for investment, with operations run jointly with the private sector or under contract. In other types (notably the Private Finance Initiative), capital investment is made by the private sector on the strength of a contract with the government to provide agreed services. Government contributions to a PPP may also be in kind (notably the transfer of existing assets).

Typically, a private sector consortium forms a special company called a 'special purpose vehicle' (SPV) to build and maintain the asset. The consortium is usually made up of a building contractor, a maintenance company and a bank lender. It is the SPV that signs the contract with the government and with sub-contractors to

build the facility and then maintain it. A typical PPP example would be a hospital building financed and constructed by a private developer and then leased to the hospital authority. The private developer then acts as landlord, providing housekeeping and other non-medical services whilst the hospital itself provides medical services.

How the city uses the financing tool

The two major projects where PPPs were involved are Glasgow Grouped Schools PPP and Glasgow PPP Healthcare Scheme.

Glasgow Grouped Schools PPP (2002)

Demographic shifts in Glasgow over a number of years had resulted in a fall in the overall school roll and a subsequent over-provision in secondary school structural resources. This situation, particularly when allied to the problem that many of the buildings were in a poor state of repair, underscored the belief that a rationalisation programme was required for secondary education provision in Glasgow.

Project 2002 was by far the largest local authority PPP undertaken in the UK at that time. It had a value of approximately GBP 1.6 billion over the life of the contract between accommodation, facilities management and ICT. The capital value was approximately GBP 240 million.

The outline business case for the PPP initiative proposed an overall reduction in secondary schools from 36 to 29 and included the construction of two new schools. Additionally, major extensions were planned for a number of existing schools, including some occupying listed buildings, with all retained school buildings being subject to complete refurbishment. Following a 15-month tendering process, 3ED Glasgow secured the contract.

A slightly unusual feature of the scheme was that the contractor was also required to provide full information and communications technology (ICT). The main features of the technology infrastructure, worth over GBP 20 million, were 15 000 desktop PCs for the classrooms, 5 000 laptops for the teachers, 350 Netserver network servers, a GBP 2 million Cisco network and a high availability support contract. This provided e-mail access for the 30 000 pupils and Internet access to all within a ten-year managed service contract from Hewlett Packard, with technology updated every five years.

Glasgow Healthcare Scheme (2003)

This huge scheme, the capital funding for which will be largely provided by the private sector, will transform the quality of healthcare in the city and arises from a review of acute services carried out by Greater Glasgow NHS Board and the NHS Trusts, published in August 2002. The review's objective was to develop a framework for radically improving the provision of core adult acute care in the Glasgow area, which is currently delivered from six sites. The review concluded that many of the facilities were outdated and not equipped to deliver twenty first century care.

Adult in-patient care will in future be concentrated at three sites; the Glasgow Royal Infirmary, Gartnavel General Hospital and the Southern General Hospital. It will be supported by the provision of two new stand-alone ambulatory care and diagnostic (ACAD) centres at Stobhill Hospital and adjacent to the Victoria Infirmary.

The facilities are likely to be procured in three phases over the next five years:

Phase one: Will see the provision of the two ACAD units and The Beatson Oncology Centre - a Treasury funded development at Gartnavel General Hospital.

Phase two: Will include the redevelopment of the Southern General Hospital on the existing site.

Phase three: Will involve two further redevelopments at the Glasgow Royal Infirmary and Gartnavel General Hospital sites.

Commenting on the scheme, Tom Divers, chief executive of Greater Glasgow NHS Board, stated:

> *"Following more than two years of public consultation, the strategy to modernise Glasgow's acute hospitals was approved by the Minister for Health and Community Care in August 2002. Now we have appointed our legal advisers we will move to appoint financial advisers and press ahead to implement the modernisation plan. First priority in this modernisation programme is to deliver, on time, the two Ambulatory Care Hospitals -Victoria and Stobhill- and the redevelopment of the West of Scotland Cancer Centre."*

Critical success factors

Successful PPPs require:

- Focused, dedicated and experienced public sector team – PPP Task Force.
- Clear legal and institutional framework.
- Transparent and competitive procurement.
- Realistic risk sharing.
- Public sector's capacity to manage its side of PPP and stable political commitment.
- Competitiveness of bidding process.
- Appropriate risk sharing – value for money.
- Economic fundamentals – viability and affordability

Value added of the financing tool

In terms of the Glasgow Grouped Schools PPP, the PPP framework allowed educational authorities to adopt and explore new opportunities. Previously these may have been neither achievable, nor indeed deliverable in a realistic timetable. Under normal procurement processes, this programme would have taken Glasgow City Council some 20 years to achieve fully and a decision was therefore reached to pursue a PPP arrangement, with the aim of delivering the modernisation programme by the end of 2002.

The approach enabled design flexibility to be incorporated at the outset and meant Glasgow was better placed to address changing needs. In addition, one of the more intangible benefits brought about by the new facilities is the increased morale of the teaching staff.

Glasgow Council and the private sector partner looked for a solution which was deliverable, innovative and flexible, and met the Council's core objective of 'Raising Education Standards.' Part of the innovative solution involved increasing the number of entirely new build schools, from the Council's initial expectation of two

to twelve. The project allowed improved staffing levels and learning and teaching resources, including ensuring that all classrooms and pupils had access to the Internet and a city-wide learning network and at the same time, refurbishing existing buildings, or where appropriate, building brand new schools. This partnership of teachers, facility managers and IT providers became now ideally placed to deal with the challenge of E-Learning.

In general terms, PPP value added features include:

- Better risk assessment/management and improved long-term visibility, not only on financial issues.
- Greater innovation in design and financing structures.
- Incentives to deliver assets on-time and on-budget.
- Incentives to improve operational and commercial performance.
- Bundling different phases - life cycle cost/benefit optimisation.

Using private sector skills for public sector services allows:

- Contracts for services, not procurement of assets.
- Output, not input, specifications.
- Payments related to service delivery.
- Whole life approach to design, build and operation.

Case study 11. New York: Business Improvement District (BID) programme

Overview of the financing tool

A Business Improvement District (BID) is a public/private partnership in which property and business owners elect to make a collective contribution to the maintenance, development and promotion of their commercial district.

The idea behind BID is modelled on the shared maintenance programme of many suburban shopping centres. Malls are typically single properties, managed by one entity that sublets the retail space to multiple tenants. Tenants pay a common area maintenance fee to underwrite services that enhance the appearance of common areas and provide cooperative advertising for the mall and its stores.

A BID works in much the same way. However, because the BID is set in an urban context, multiple property owners agree to the extra fee (assessment). Thus, stakeholders in a commercial district can align themselves in much the same way to improve their area. The purpose of a BID is to improve conditions for business in a specific area, attract and retain businesses, generate jobs and improve the quality of life for those who use the district. A BID enables stakeholders to decide which services to provide to meet the district's unique needs.

How the city uses the financing tool

In New York City, BIDs are critical partners in ongoing initiatives of neighbourhood revitalisation and economic development across the five boroughs. The BID's services supplement the services already provided by the City of New York. The 46 BIDs that currently operate in the city are the largest network of BIDs in the US. They employ over 1 200 people and deliver nearly USD 77 million in supplemental services and improvements for the direct benefit of approximately 63 000 businesses.

The BID model is a highly flexible development tool capable of succeeding in a variety of communities, ranging from neighbourhood 'main streets' in Harlem and Astoria to central business districts in Downtown Brooklyn and Lower Manhattan. Just as BIDs serve an entire range of neighbourhoods in New York, they likewise provide a diverse array of programmes and services. Annual operating budgets range in size from as little as USD 53 000 to over USD 11 million. Staff headcounts run from as few as three to as many as 172 employees. Programmes themselves run the gamut from fundamental 'clean and safe' initiatives to extensive business development strategies and comprehensive streetscape renovations. Table 2.1 summarises the supplemental services/improvements provided by the BIDs.

Each BID is governed by a Board of Directors that is elected by the members of the district. The Board of Directors has a fiduciary responsibility to the BID and hires the management that administers the BID on a day-to-day basis. The Board is divided into classes that include: commercial property owners, commercial tenants, residents and public officials. Public officials include the Mayor, Comptroller,

Borough President and a member of the City Council and are defacto board members. BID members vote for directors in their respective classes. The majority of directors must be property owners.

Table 2.1. Supplemental services/improvements undertaken by the BIDs in New York

Service	Sub-services
Maintenance	Street/sidewalk cleaning; graffiti removal
Public safety/hospitality	Public Safety Officers; visitor assistance
Business Development	Commercial vacancy reduction; business mix improvement
Capital Improvements	Improved streetlights; custom trash receptacles; directional street signage; custom news boxes; flower boxes
Landscaping	Planting trees/flowers; tree pit maintenance
Community Service	Fundraising; charitable events; homeless and youth services

Source: New York Business District Improvement Programme

Decision making processes

Funds to pay for BID programmes and services are generated from a special assessment paid by the benefited property owners (see Table 2.2). It is important to note that many leases have a clause that allows property owners to pass the BID assessment on to their tenants. The assessment is billed and collected by the City of New York and then disbursed to the District Management Association (DMA) which in turn delivers the district's services. The DMA is the formal name of the legal entity that is the BID.

Table 2.2. Assessment rates by property types

Property Type	Assessment
Occupied commercial or industrial properties	All are assessed and pay the commercial rate
Not-for-profit owned and occupied properties	Generally do not pay an assessment
City, State and or Federal Government occupied properties	Do not pay an assessment
Residential properties	Generally pay reduced assessment
Vacant properties	Generally pay reduced assessment

Source: New York Business District Improvement Programme

Critical success factors

The feasibility of implementing a BID depends on several factors:

- Property usage

  Residential properties should be kept to a minimum because they generally contribute a lower assessment; there should be few government and other tax-exempt property owners, since they are exempt from any BID assessment and there should be little undeveloped property.

- Stable commercial occupancy rates

  The ability to generate adequate assessment revenue is dependent upon the current economic activity in the district. Therefore, BIDs are best situated in areas that are economically stable, and do not exhibit vacancy rates in excess of 20%.

- Strong local support

  The process of organising and administering a BID requires public review, approval and support. It is important that locally elected officials and community board members understand and support the concept of BIDs. Generally, locally elected officials are supportive of BIDs because they recognise that BIDs deliver a higher level of service that directly benefits their constituents.

- Future development

  Funding for certain capital improvements may not include maintenance for the improvement. In some cases, capital allocations are made on the condition that the resulting improvement will be maintained over time with funds from another source. A BID can be an excellent mechanism to provide maintenance services for these improvements.

Value added of the financing tool

BIDs deliver a range of supplemental services in co-ordination with municipal services such as sanitation and maintenance, public safety and visitor services, marketing and promotional programmes, capital improvements and beautification in a designated area. Therefore, they invest in the long-term economic development of

their districts. Table 2.3 and 2.4 illustrate some of the succeses of the BID programme in the city.

The Table 2.3 compares the first recorded scorecard rate and the current rate for selected New York City BIDs.Scorecard ratings are given out by the Mayor's Office of Operations to measure sidewalk cleanliness. The average scorecard rating for all New York City BIDs in 2003 was 94%.

Table 2.3. Scorecard ratings for selected BIDs

BID	First Recorded Scorecard Rate (%)	Rate in 2003 (%)
Fashion Center	38.9	100.0
47th Street	80.0	100.0
34th Street	52.2	100.0
Times Square	54.8	97.6
MetroTech Brooklyn	60.3	94.7

Note: Scorecard ratings are on a scale of 0 to 100.

Source: www.nyc.gov/html/sbs/downloads/pdf/bid_guide_complete.pdf, accessed September, 2007.

Table 2.4. Commercial vacancy rates

BID	First Recorded Commercial Vacancy Rate (%)	Rate in 2002 (%)
Flatbush Avenue	30	3
North Flatbush Avenue	22	9
Sunset Park – 5th Avenue	20	5
34th Street	9	4
Lower East Side	10	5
Times Square	25	9

Source: www.nyc.gov/html/sbs/downloads/pdf/bid_guide_complete.pdf, accessed September, 2007.

Such programmes represent public/private partnerships at their very best. They have proven effective in revitalising neighbourhoods and improving business conditions in commercial districts by injecting vitality into the community. Beyond the core services of keeping streets clean and safe, BIDs have set benchmarks for their innovative programming in marketing, streetscape design, business development, public spaces and community service.

It has been suggested by Mayor Michael R. Bloomberg that,

> *"With more BIDs than any other city, New York City's programme has served as a model for other municipalities both in the US and abroad, and we are confident that they will play an important role in the future growth of our City."*

To summarise, the advantages resulting from such arrangements include:

- A cleaner, safer and more attractive business district.
- A steady and reliable funding source for supplemental services and programmes.
- The ability to respond quickly to changing needs of the business community.
- The potential to increase property values, improve sales and decrease commercial vacancy rates, and.
- A district that is better able to compete with nearby retail and business centres.

BIDs have been reproduced in other cities including, Toronto (40+), Los Angeles (30+), Vancouver (20+), and Philadelphia/Cape Town (10+) (number in brackets denotes the total number of BIDs in the city).

Theme 6. Financial tools that promote sustainable development

Concern about Climate Change and the wider sustainability of economic development at the local level is giving rise to a multiplicity of new mechanisms for incentivising cleaner and greener economic development and for providing alternative sources of financing for environmental improvements and for green economic development. The case studies of the Vancouver gas tax and London's Congestion Charge are offered below.

Case study 12. Vancouver: gas tax

Overview of the financing tool

In Vancouver, gasoline and diesel fuel are taxed by the federal, provincial and territorial governments. At the federal level, the excise tax on gasoline is ten cents (CAD, Canadian dollar) per litre; while the excise tax on diesel fuel and aviation fuel is four cents per litre. As of July 1 2006, the GST was 6% of the final price paid for fuel, including federal and provincial excise taxes levied at the producer/wholesaler level and embedded in the retail price. See Table 2.5 for a breakdown of Vancouver's gasoline tax structure.

The Government of Canada raises approximately CAD 5 billion per year from excise taxes on fuel, consisting of about CAD 4 billion from gasoline excise taxes and about CAD 1 billion from diesel and aviation fuel. During 2005, GST revenues from gasoline and diesel fuel, net of input tax credits, were estimated at about CAD 1.6 billion. On this basis, the GST rate reduction will save Canadians an estimated CAD 230 million per year on their purchases of gasoline and diesel fuel. Collectively, the provinces and territories raise about CAD 8 billion per year from excise taxes on gasoline and diesel fuel. These taxes are, in turn, used by local authorities to finance economic development.

Table 2.5. The gasoline tax structure of Vancouver, 2006

Component	Value
Retail Prices Excluding Taxes	66.4
Provincial Excise Tax (flat rate)	20.5
Federal Excise Tax (flat rate)	10
Total GST	5.8
Provincial Sales Tax	N.A.
Total Tax Component	36.3

Note: Tax components based on average retail gasoline prices (excluding taxes) for the first six months of 2006.

Source: Fuel Focus (NRCan), 2006.

How the city uses the financing tool

In July 2006, British Columbia's local governments received their first of instalment of Year 2 federal gas tax payments. Over CAD 29 million in federal gas tax funds were distributed to 151 local governments outside of the Greater Vancouver area and to the Greater Vancouver Transportation Authority (GVTA). This is in addition to CAD 60 million that British Columbia's cities and communities received in 2005.

This funding will result in improvements to Greater Vancouver's transit system by enabling the purchase of 225 new buses, the construction of infrastructure priorities such as cycling lanes and improvements to municipal water treatment. This will not only result in environmental improvements but will make a noticeable contribution to British Columbia's communities by allowing them to invest in the infrastructure priorities that they have identified. As Minister Chong suggested,

> *"By working with the Union of B.C. Municipalities, we came up with a unique made-in-B.C. approach which will see stronger and healthier communities with cleaner water, cleaner air and better transit."*

New projects funded by the 2005 gas tax increase include:

- *SR 500 New Interchange, Vancouver*. This will involve building a new interchange at State Route 500 and St. Johns Boulevard in Vancouver. Construction will begin in 2008 and is to be completed in 2010, supported by a partnership funding of CAD 26.3 million from the 2005 Gas Tax. Upon completion, this new interchange will decrease accident rates and reduce the amount of traffic congestion at the existing intersection. This project will improve mobility, decrease travel times and reduce delays. Pedestrians and bicyclists also will be provided with improved accessibility to the Discovery Trail system.

- *Vancouver/Portland Columbia River Crossing*. This project addresses safety and congestion on the I-5 corridor between Vancouver and Portland. It aims to reduce collisions by 18% at a cost of CAD 50 million. The Columbia River Crossing project is aimed at improving the mobility, reliability, and accessibility for automobile, freight, transit, bicycle, and pedestrian users of the I-5 corridor from State Route 500 in Vancouver to approximately Columbia Boulevard in Portland. Through an inclusive, collaborative process, this project will deliver a financially feasible

solution that strengthens the regional economy and strives to support community liveability.

- *I-205 New Ramps, Vancouver*. This scheme involves building a northbound off-ramp and southbound on-ramp at 18th Street, and new roads connecting Mill Plain Boulevard to 18th Street and 28th Street/Burton Road. Construction will begin in 2011 and is to be completed in 2013. It aims to reduce collisions by 17%, and will receive CAD 58 million in funding from the 2005 Gas Tax.

Decision making processes

Canada's government is committed to sharing gas tax revenues – CAD 5 billion over five years – with cities and communities across Canada. For British Columbia alone, this initiative is worth over CAD 635 million over five years. The Union of British Columbia Municipalities (UBCM) is a signatory to this agreement, and has played a lead role in the implementation of the agreement, including the delivery of funds to individual local governments and the GVTA.

Critical success factors

In order for the Gas Tax fund to be successful it is necessary to:

- Ensure that gas tax funds result in net incremental spending on infrastructure and that there will be no claw back of existing provincial infrastructure funding available to Local governments.

- Collaborate with Canada, First Nations, Local governments, and the private and not-for-profit sectors on other elements of the New Deal.

- Facilitate capacity building at the local government level, and support local government integrated sustainability planning.

- Strengthen the partnership role for local governments, as represented by the UBCM, in the management of this agreement.

- Enforce all terms and conditions of the Funding Agreement in a diligent and timely manner, and seek remedies from non-compliant Eligible Recipients.

Value added of the financing tool

Federal gas tax funds are leading to investments in important infrastructural projects that have a positive impact on local economic development. It helps to ensure that all of British Columbia's cities and communities enjoy a high quality of life, economic opportunity and a healthy environment. Federal gas tax funding provides local governments in British Columbia with a source of stable, predictable and long-term funding towards environmentally sustainable municipal infrastructure to help them address their infrastructure needs and meet sustainability objectives.

In the coming years however, Gas tax funds under the New Deal will be directed away from direct investment into the local economy and towards the achievement of three key environmental sustainability outcomes for Canadian cities:

i) Reduced Greenhouse Gas (GHG) emissions.

ii) Cleaner water.

iii) Cleaner air.

Case study 13. London: Congestion Charge

Overview of the financing tool

The London congestion charge is a fee for certain motorists entering the Central London area. London was not the first city to adopt road charging, but as of 2006 it is the largest city to do so. The organisation responsible for administering the charge is Transport for London (TfL).

The stated aim of the scheme is to encourage travellers to use public transport, cleaner vehicles, bicycles, motorcycles or their own two feet instead of motor cars and vans, thus reducing congestion and allowing for faster, less polluting and more predictable journeys. However, the congestion charge also plays an important role in financing urban development, in particular transport improvements, as by law, all money raised from congestion charging is added to what has already been spent on London's transport facilities.

The congestion charge was introduced on 17 February 2003. Initially set at GBP 5, but raised on 4 July 2005 to GBP 8, the daily charge must be paid by the registered owner of a vehicle that enters, leaves or moves around within the

congestion charge zone between 7am and 6.30pm, Monday to Friday. From 19 June 2006 a new "Pay-Next-Day" scheme was introduced allowing drivers to pay their congestion charge until midnight on the day of travel, or pay GBP 10 until midnight on the following charging day. Failure to pay by midnight means a fine of at least GBP 50.

The original congestion charge zone

In September 2005, the western expansion of the congestion charge was confirmed, and it was due to come into effect in February 2007. There are also plans by the Mayor of London to increase the charge to GBP 10 and proposals that from 2008 there may be discounts for vehicles with low rates of CO2 emission, followed by a GBP 25 rate for vehicles producing an emission of more than 226 g/km of CO2.

Congestion charging is a way of ensuring that those using valuable and congested road space make a financial contribution. The following explains why the Mayor decided to introduce congestion charging in central London:

- London suffers the worst traffic congestion in the UK and amongst the worst in Europe.
- Drivers in central London spend 50% of their time in queues.
- Every weekday morning, the equivalent of 25 busy motorway lanes of traffic tries to enter central London.
- It has been estimated that London loses between GBP 2–4 million every week in terms of lost time caused by congestion.

How the city uses the financing tool

During the early part of the ten year horizon of the Transport Strategy, it is envisaged that the net revenues from the proposed central London congestion charging scheme will help fund or bring forward improvements across Greater London with particular emphasis on a range of areas.

Short-term plans include:

- Bus network improvements.

- Accelerating or extending accessibility improvements, such as enhancing the Taxicard scheme or the more widespread implementation of 'bus boarder' kerb designs.

- Interchange improvements and other initiatives to improve the integration of the transport network.

- Contributions to the costs of developing possible tram or high quality segregated bus schemes and other major schemes.

- Safety and security improvement schemes.

- Accelerating road and bridge maintenance programmes.

- Increasing late night public transport.

- Additional funding for borough transport initiatives.

- Restructuring fares on public transport.

- Improvements to the walking and cycling environment.

- Improvements to the street environment.

In the medium to longer-term, the net revenues could help to bring forward:

- The development and funding of expanded Underground and rail capacity with new services across central London, together with improved orbital rail services.

- New Thames Gateway river crossings.

- Schemes to provide improved access to London's many town centres.

- Light rail, tram, or high quality segregated bus schemes.

- Selected improvements to London's road system.

Decision making processes

The organisation responsible for administering the charge is TfL. All the plans related to revenue spending are part of the Mayor's Transport Strategy.

Critical success factors

Congestion charging is typically very complex and implementation is unlikely to be straightforward. London had a clear and very visible political champion, Ken Livingstone, the Mayor of London with the powers, personal and political skills and single-minded determination and commitment to drive the scheme forward, backed up by the fact that charging had featured in his election manifesto. The Mayor was supported by a determined, committed and enthusiastic team of 'can do' staff.

The scheme development benefited from having a very clear objective, namely to reduce congestion, and the fact that it was part of an overall transport strategy. Although charging schemes raise revenue in the medium to long term, they can be costly to set up in the first place and therefore money needs to be available to cover this set up phase. London was fortunate in that the national Government had provided adequate funds for this scheme development and implementation.

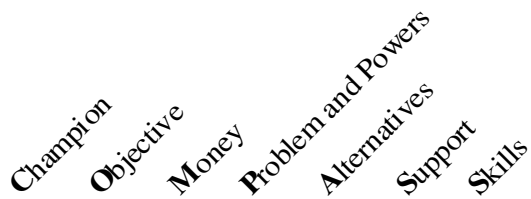
Charging was controversial but virtually no one disputed that central London had a severe traffic congestion problem and that 'something had to be done.' This provided some favourable impetus for the scheme, particularly as no other options (e.g. parking restraint) would be as effective in reducing through traffic. Where the problems are less severe or not recognised, implementation of charging is likely to be more difficult. The severity of an existing problem and the lack of other solutions help encourage charging. Similarly, charging is generally accepted as more justified where there are reasonable alternatives. London featured well in this respect in different ways. Firstly there was a reasonable alternative traffic route, the Inner Ring Road, for those vehicle drivers who did not have an origin or destination in the charging zone.

Public support and acceptability for the central London charge was another key success factor. Typically support was around the 50% level. Three key factors maintained and enhanced the level of public support for the scheme. It has been recognised for some time that support for charging is higher when the revenues are spent on improving transport rather than the charge being a general tax. In London the revenues were hypothecated to be spent on improving transport in London for the first ten years of the scheme. Secondly the large number of exemptions and discounts reduced or removed potentially strong opposition from a number of

specific groups including zone residents, taxi drivers, motor cyclists, groups representing disabled persons, public transport operators and the emergency services. Thirdly, much time and effort was spent on public consultation and liaison and engagement with stakeholders.

A wide variety of technical and management skills were brought together in London to create an integrated team. London benefited from the considerable amount of high quality research that had been carried out prior to TfL being created through the Government's ROCOL (Road Charging Options for London) programme, many of whose recommendations were part of the eventual scheme. Strong project management provided by both permanent TfL staff and external management consultants was a key factor in ensuring scheme progress together with technical skills brought together from a wide variety of sources including transport and engineering consultants, management consultants, specialist consultancies, TfL staff and new recruits. Other factors such as the use of proven technology, a clear procurement strategy and an enthusiastic team with a 'can do' attitude were also important.

To summarise, in London, a particular set of circumstances came together to allow the scheme to proceed. These may be summarised by the acronym COMPASS:



Value added of the financing tool

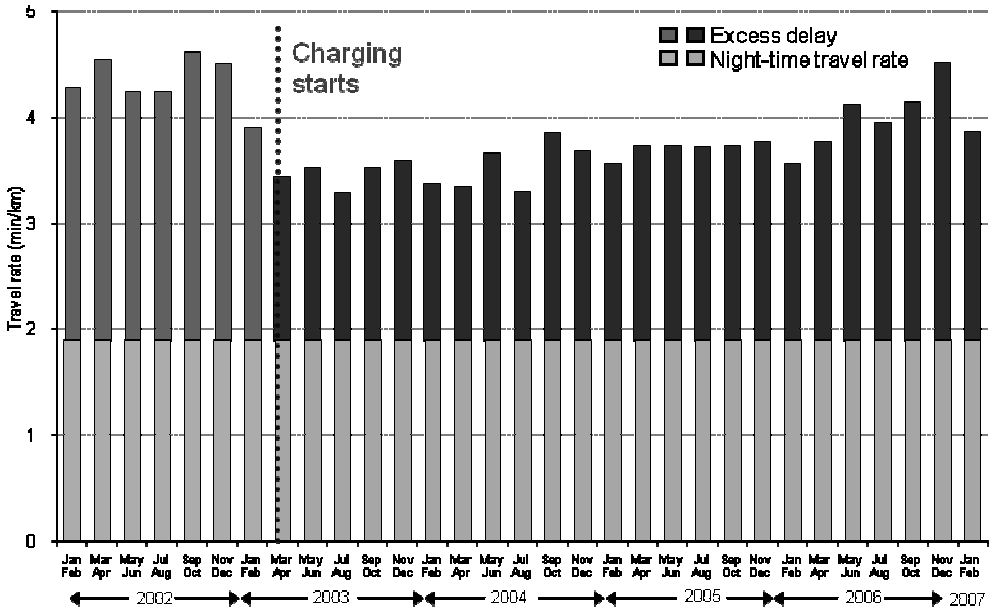
There has been major investment in monitoring systems and post-implementation studies that have been vital to understanding the impacts of the scheme. The key effects of the scheme according to TfL and Crane (2005) have been:

- Traffic congestion within the charging zone has reduced by 30% during charging hours.

- Traffic congestion on main roads into and out of the charging zone has reduced by up to 20%.

- Reliability has improved and the amount of time spent in queues or slow moving traffic has reduced (see Chart 2.1).

Chart 2.1. Travel rate in charging zone during charging hours



Source: http://asta.ivl.se/Workshops/NTM%20Filer/pres1/Buckingham.pdf

- The volume of traffic in the charging zone has reduced by 15%.

- There has been no increase in congestion along the main diversion route, the Inner Ring Road, where increases in traffic are being successfully managed.

- Of the 65 000 or so car trips that are no longer being made to the charging zone during charging hours, 50-60% have transferred to public transport, 20-30% divert around the charging zone and 15-25% have made other adaptations such as changing the timing of journeys.

- There have been significant improvements to bus services in the zone and beyond to complement congestion charging and bus patronage has increased significantly in the zone and throughout London.

- Public transport is successfully accommodating displaced car users.

- Comparative analysis of the many influences on the central London economy throughout 2003 and 2004 suggest that the direct impact of congestion charging on business activity has been small (although some retailers dispute this).

- There have been gains in environmental amenity, fewer road traffic emissions (e.g. 20% less CO2) and a 20% reduction in fossil fuel consumption within the zone.

- Net revenues of GBP 90 million per annum are being generated. In FY2005/06 the scheme generated net revenues of GBP 122 million (provisional figures) including additional net income in the period from July 2005, when the basic daily charge was raised from GBP 5 to GBP 8.These revenues have again been largely spent on improved bus services within London.

- Accidents within the charging zone are continuing to decrease.

- Amenity benefits for central London recognised by visitors, workers and residents.

3 NATIONAL INITIATIVES

National Governments and their agencies are the critical financial partners of local governments in pursuit of local economic development in many countries where there is a balance between local and national policies for local economic development. We have identified 13 case studies on national level inititiaves that demonstrate the span of such financing mechanisms. This also helps to underpin the recognisition that national level interventions remain very important to support local level development. Implicitly, national level financial instruments can benefit from advantages of scale and scope as we shall see below.

The 13 cases are divided into five themes:

Theme	Case Study	Region	Example
1.	**National investment banks/credit institutions**		
	14	France	Caisse des Dépôts
	15	USA	US Federal Reserve
	16	Canada	PILOT Funds
2.	**Local area based financial/investment instruments**		
	17	France	Société Financière pour Favoriser l'Industrialisation des Régions Minières (SOFIREM)
	18	South Africa	Urban development Zones
	19	Canada	Green Municipal Fund
	20	France	Urban Free Zones
3.	**Property redevelopment investment and joint ventures**		
	21	Worldwide	Real estate investment trusts
	22	England	English Cities Fund
4.	**Social enterprise finance**		
	23	USA	Enterprise Foundation
	24	Australia	Social enterprise finance
5.	**SME and innovation finance**		
	25	New Zealand	Venture Capital Funds
	26	Australia	Innovation Investment Funds

National investment banks/credit institutions

These show the important contribution of national lending institutions and a national approach to encouraging banks and other financial service providers to better serve local economies. Providing credit finance to local economic initiatives is not only a means to ensure that they are adequately financed to deliver, but it is also a way to impose useful external disciplines on projects and programmes, through the requirement to service debt. Equally, local economic development initiatives that can service debt (even if the debt is supported by public resources) are closer to being bankable that those that require grants. So facilitated loans are an important means for local economic projects to make a transition from subsidy to market finance, they act as a bridge between the two.

Local area based financial/investment instruments

Local area based finance and investment instruments are important tools for bringing market based investment back into certain locations that have suffered from disinvestment and decline. Providing an effective financial instrument to leverage other finance into deprived areas is a means to begin the process of reinvestment. Within this theme we look at instruments that include publicly backed investment, co-investment funds, tax incentives, and co-financing approaches. This demonstrates the importance of different tools in tackling the challenges faced by disadvantaged areas.

Property redevelopment investment and joint ventures

In this theme we look at the particular challenges to attarct investment into sites and properties which are underperforming relative to market norms and would otherwsie be unattractive for reinvestment either to the high risks or low returns or the costs associated with coplex and smaller investment. Our two examples offer complementary approaches, one based on incentives ot market based investors, the other focused on joint ventures between public and private sectors.

Social enterprise finance

Social enterprise fiance is an important area of innovation. Business like trading bodies operating to sociala nd public purposes are not easiuly financed by traditional grant aid nor by commercial finance and can find themselves without the financial resources required to become sustainable. National initiaives are well

suited to addressing these issues as this is a sectoral financing need which can exist on many doifferent kinds of localities and regions.

SME and innovation finance

SME and Innovation finance has been an important arena for national initiatives for several years. The transition from a large firm to small firm economy has required substantial adjustment from the financial system, and the system has been slow or incomplete in its response to need. In part this is for good commercial reasons of poor returns, high risks, or weak deal flow that mitigate the development of a strong in debt and equity finance for the smaller firms. In part, it also reflects a lack of effective information flows and brokerage between demand and supply sides. Most national initiatives therefore stress not just the supply of capital but also the preparation of good propositions and applications and active brokerage between the firms and the investors.

These national local development finance initiaives are highlighted below.

National investment banks/credit institutions

Case study 14. France: Caisse des Dépôts et consignations

Overview of the financing tool

Caisse des depots et consignations is a public sector financial institution which invests in infrastructure projects to promote local and regional development. Funding of EUR 422 million was granted in 2006, of which EUR 342 million was for capital and other investment purposes, and EUR 80 million for project design and engineering. Caisse des Dépôts has a long term commitment to private investors in and operators of infrastructure, and helps stimulate local development in sectors insufficiently served by the market.

How the financing tool is used

Urban redevelopment policies are strongly supported - Caisse des Dépôts invested EUR 172 million in property projects such as shopping centres, housing, tourism and leisure facilities and commercial property and raised its stake in local

property and property development agencies (SEM and local investment companies) by EUR 52.5 million (EUR 750 million on loan to some 500 companies). It also signed 54 new agreements in 2006, raising the number of agreements signed since 2004 to 157. Small and medium-sized companies received more than EUR 250 million in private equity and the *France Investissement* scheme was launched. There was also EUR 308 million in interest rebates on social housing loans and there was a sharp rise in loans from saving funds: EUR 5.5 billion (+25%) including EUR 5 billion on social housing and urban renovation.

Caisse des Dépôts is also active in the fields of IT infrastructure and local authorities, supporting micro-companies and stimulating employment, and managing a social cohesion fund. In 2006, as part of its capital investment policy, Caisse des Dépôts reorganised by splitting its competitive market operations in two subsidiaries (CDC Capital Investissement) away from investment in its public interest missions (CDC Enterprises). CDC Enterprises finances potentially high growth French small and medium-sized companies by capital injection, with a focus on market-specific development needs.

Caisse des Dépôts also centralises the deposits collected from tax-exempt savings books, using these funds to finance public interest missions, in the form of long term loans mainly for social housing. To ensure the security, liquidity and the financial balance of the mechanism whereby savings deposited in immediate-withdrawal accounts support long term lending, CDC converts part of the funds at its disposal into financial assets, mainly bonds and increasingly, equities.

Value added of the financing tool

There have been numerous loans for social housing and urban redevelopment:

- EUR 3.35 billion in loans for social housing development (construction and acquisition).
- EUR 438 million in loans to improve older property.
- EUR 890 million in loans for urban redevelopment (demolition, reconstruction of residential accommodation, housing improvements and urban redevelopment).
- EUR 391 million to finance accommodation for the disadvantaged.

Further help is also offered to low-income households, as one of the main causes of the housing crisis is that households find it difficult to move when confronted with a change in their economic and social circumstances. To help give more housing options to lower income households, CDD, in agreement with the French State, introduced a set of measures at the end of 2006, covering all levels on the housing ladder. Their main thrust is interest rebates on CDD loans from its shareholders' equity and longer terms for repayment. Provision has been made for:

- 4 000 units of supplementary emergency accommodation in 2007-08.
- 17 000 units of accommodation to promote home ownership among low income households where aspiring owners repay only after full acquisition.

There has also been considerable financing of transport infrastructures, reaching EUR 456 million. In 2006, six projects for exclusive-right-of-way mass transport systems (tramways, metros, bus) were financed and two new high speed lines, TGV Est and Rhin-Rhone were developed.

Case study 15. USA: US Federal Reserve

Overview

The Federal Reserve System, through its Community Affairs programme at the Board of Governors and the 12 Federal Reserve Banks, engages in outreach, educational, and technical assistance activities to help financial institutions, community-based organisations, government entities, and the public understand and address financial services issues affecting low- and moderate-income persons and communities.

The Community Affairs programme reflects the structure of the Federal Reserve System. Within the framework of a shared mission and goals, each of the 12 Reserve Banks establishes its own programmes and responds to local needs in its District. As part of a nationwide entity, the Community Affairs programme has the ability to collaborate on projects, to share information and resources, and to work together to accomplish goals at regional and national levels.

Community Affairs' Activities

The System's Community Affairs programme seeks to achieve the following goals through a broad range of activities:

- Foster the active engagement of depository institutions in providing credit and other banking services to their entire communities, including traditionally underserved markets.

- Encourage co-operation among community organisations, government agencies, financial institutions, and other community development practitioners to their mutual benefit.

- Develop greater public awareness of the benefits and risks of financial services products and of the rights and responsibilities that derive from community investment and fair lending regulations.

- Promote a better understanding by policy-makers, community leaders, and private-sector decision makers of the processes and resources that support successful community development programmes and best practices of community development.

Community Development Investments are designed to create new opportunities - primarily related to affordable housing, small businesses, and jobs - that specifically benefit lower-income neighbourhoods and populations. Community Development Investments are defined as equity and debt investment instruments that, in addition to providing a financial return, achieve the further goal of benefiting low- and moderate-income individuals and low- and moderate-income communities. Examples of Community Development Investments include Low Income Housing Tax Credits, New Markets Tax Credits, targeted mortgage-backed securities, community development venture capital, targeted government bonds, equity equivalent investments, and investments in organisations that have community development as their mission.

Such efforts are typically conducted through Community Development Corporations (CDCs) and other organisations whose primary purpose is to help meet the credit, housing, and economic development needs of low- and moderate-income communities. Because CDCs are mission-driven organisations created to promote community revitalisation, they are often well positioned to engage in development activities in the absence of private investment. Great diversity exists in CDC ownership affiliations, ranging from banks to faith-based entities.

Case study 16. Canada: PILOT scheme

An overview of how the financing tool operates

A PILOT is a payment in lieu of taxes (also sometimes abbreviated "PILT"), made to compensate a local government for some or all of the tax revenue that it loses because of the nature of the ownership or use of a particular piece of real estate. Usually PILOT relates to foregone property tax revenue. This revenue, once collected by the local government may be used to finance urban economic development. PILOT schemes are especially common in the USA. The federal government of Canada also has a programme for federal payments in lieu of taxes to local governmental entities in areas where the federal government owns property.

How the financing tool is used

PILOT revenues contribute toward the cost of local government in communities where federal property is located, and as such may be used to finance economic development.

Decision-making regarding revenue spending/capital investment

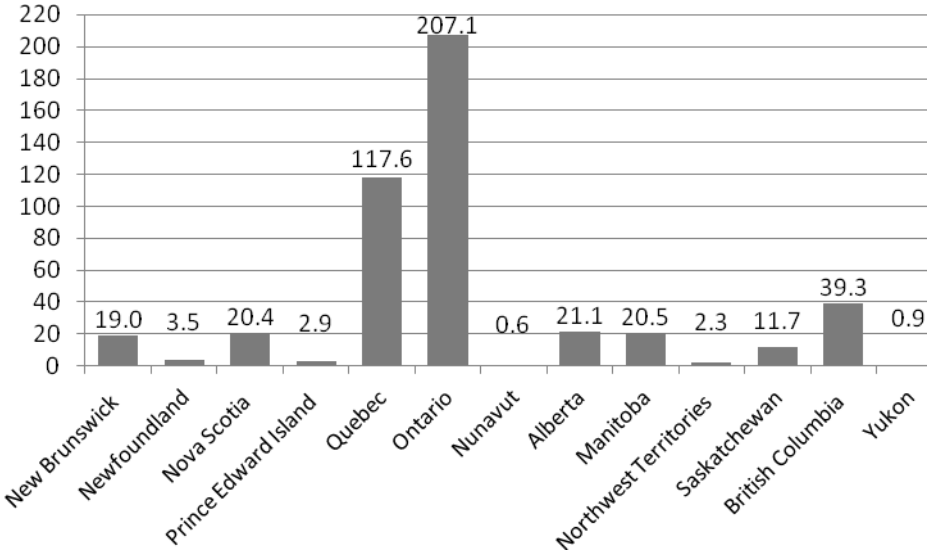
The Payments in Lieu of Taxes (PILT) programme is administered by Public Works and Government Services Canada on behalf of the Government of Canada under the authority of the Payments in Lieu of Taxes Act (see Chart 3.1).

Value added by the financing tool

The Government of Canada distributes more than CAD 460 million every year through the PILT scheme. Although the underlying logic to adopting PILOTs to fund the tax-exempt organisations' consumption of basic city services is sound, the amount of revenue generated from the policy is not very large. A recent study of seven major cities with PILOT schemes in the USA estimated that PILOT revenue as a percentage of the budget is less than 2% and for five of the cities it was under 1% (see Chart 3.2).

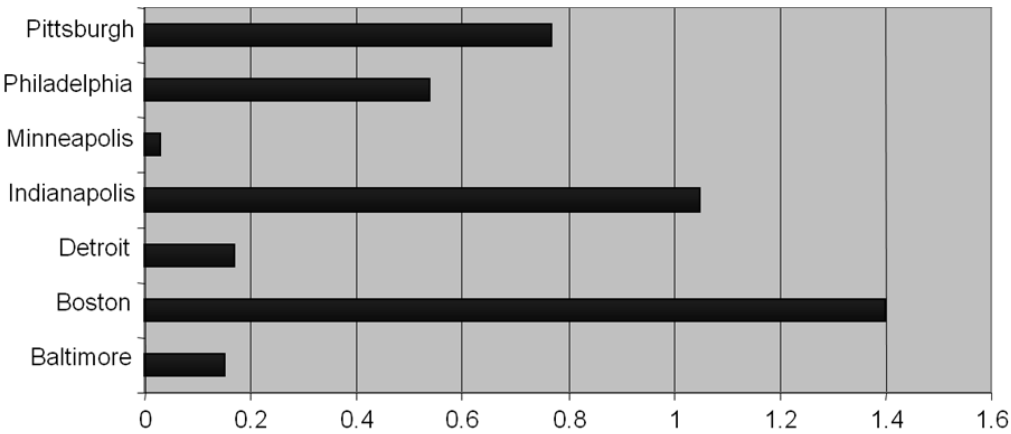
Chart 3.1. PILT payments by province for 2005

CAD millions



Source: www.pwgsc.gc.ca/pilt/text/va_june2006-e.html#a7

Chart 3.2. PILOT revenues as percent of municipal budget, 2002



Source: Brody, 2002.

Area based financial instruments

Case study 17. France: Société Financière pour Favoriser l'Industrialisation des Régions Minières

Overview of the financing tool

SOFIREM (*Société Financière pour Favoriser l'Industrialisation des Régions Minières*), was created in France in 1967 as a subsidiary of the Group of *Charbonnages de France* (Coal miners of France) with the purpose of acting as an economic development agency to facilitate industrial redeployment in declining mining regions. Its mission consists of facilitating the implantation and development of French and foreign companies in traditional mining regions affected by decline. The society is responsible for much of the economic revitalisation witnessed in former French mining regions, particularly in the north of France.

The SOFIREM approach was an original one in France – the society took responsibility in areas that would have not been able to survive alone, providing finance for inward investment and new business start-ups. SOFIREM also provides tailor-made packages to help fund SMEs and make use of financial instruments involving equity, and by providing loans at advantageous rates.

How the financing tool is used

SOFIREM acts as a service company as well as a financial partner. As a provider of services, SOFIREM studies all the aspects of investment in a project in order to evaluate its needs, to help in choosing the most favourable site, to elaborate or complete a development plan, to start-up the project by easing the administrative steps, and to obtain financial assistance. As a financial partner, SOFIREM directly participates in the financing of projects, providing loans at advantageous rates or by contributing funds in the form of minority and temporary shares under a joint account. The local authorities, regions, towns, Chamber of Commerce, local development agencies, private companies and financial organisations are all partners in the initiative. As such, although a national institution, SOFIREM provides an example of an initiative which focuses on development finance at the sub-national (i.e. local) level.

Value added by the financing tool

In over 30 years, SOFIREM has invested EUR 60 million and has helped to develop over 100 000 jobs in coalfield closure areas, helping to finance and carry out 4 000 projects.

Case study 18. South Africa: Urban development Zones / Empowerment Zones

Overview

Many of South Africa's inner cities have suffered from rapid degeneration as the result of capital flight into newer and better facilities in other parts of the cities. Reasons cited for the move included the offer of cheaper rent in better accommodation and the perception that many of the inner cities were not safe for companies' employees or assets. Many of the inner cities and their adjacent suburbs began to become the sanctuaries of new migrants and slum landlords, and thus it was keenly felt that if there was to be any hope of revitalising, regenerating, or rejuvenating the inner cities then the government would need to intervene.

As such, in 2003 the National Treasury developed an amendment to the Income Tax Act No. 58 of 1962, which would allow tax breaks and tax incentives within very specific areas of the metropolitan areas and larger municipalities in South Africa – these specific areas were named Urban development Zones, or UDZs. It is hoped that the tax incentive will promote private investment in property to rejuvenate the inner cities' economies.

Under the incentive, tax-paying investors within the designated area are allowed to deduct from taxable income their entire investment in refurbishing their property over a period of five years, at the rate of 20%. For new property developments, the deduction amounts to 20% in the first year and 5% a year for the next 16 years.

How the city uses the financing tool

UDZs have been established in 16 South African urban areas; Buffalo City, Cape Town, Ekurhuleni, Emalahleni, Johannesburg, Mafikeng, Mangaung, Matj - abeng, Mbombela, Msunduzi, Nelson Mandela, Polokwane, Sol Plaatjie and Tshwane were all identified as areas in which UDZs should be demarcated.

The Johannesburg UDZ

The Johannesburg UDZ is the largest in South Africa - 18 square kilometres of the inner city fall within the zone. The UDZ includes the central business district, Newtown and Braamfontein, as well as the high-density high-rise residential areas of Hillbrow and Berea. Other lower-density residential areas surrounding Johannesburg's Ellis Park area, such as Bertrams, Judith's Paarl, Doornfontein and Troyeville, as well as Bellevue, Bellevue East and Yeoville, are also included. The manufacturing and industrial strip to the north of the M2 East/West, from Benrose in the east to City West in the west, also falls under the city's approved urban development zone.

The Nelson Mandela Metropolitan UDZ

The incentive covers all construction costs related to the erection, extension, addition or improvement of UDZ situated buildings including:

- Land excavations and demolitions of existing buildings.

- Costs incurred in relation to permanent structures or works directly adjoining building construction or refurbishment sites for the purposes of providing:

Building access, sidewalks, parking and landscaping.

  - Electricity, water, sewerage, drainage and waste disposal.
  - Building security including fences, cameras and surveillance equipment.

Decision making processes

Any investor is eligible, if the following three conditions are met:

i) A building in the UDZ must be refurbished, improved, or erected, and the erected, extended or improved area must represent at least 1 000 m².

ii) This building must be solely used for the investor's trade.

iii) The investor must receive a certificate of occupancy for the building from the relevant municipality.

Value added by financing tool

In Nelson Mandela Municipality, the establishment of the UDZ has lead to several significant investments in the inner city area, including a ZAR 10 million (South African rand), 3 600 m² investment in a new technical service centre for a local Audi dealership. Similarly, Continental Cars and Maritime motors have constructed new premises within the UDZ.

As well as revitalising the appearance of inner city areas, the UDZ tax incentive supports other initiatives, such as policies to write off existing bad debt from inner city buildings in order to allow for these buildings to be sold, restored and refurbished. The incentive also provides a catalyst for public-private partnerships in mixed-used developments that provide social facilities integrated into new commercial and residential developments.

Perhaps the scheme's most innovative feature is that the tax deduction can be claimed against any income, and not only income from the particular building in which the investment has been made. This means, for example, that a salaried individual who owns a flat or a building in the zone can depreciate their refurbishment costs against their regular income tax. This encourages investment in affordable inner city housing and offers an enormous opportunity for the development of small scale landlords, which in South Africa also links to the creation of real empowerment opportunities for individuals who were previously disadvantaged during the apartheid regime.

Case study 19. Canada Green Municipal Fund

Overview

The Green Municipal Fund (GMF)[1] was established by the Government of Canada in its 2000 budget to stimulate investment in innovative municipal environmental projects that advance the progress of sustainable development in Canada's communities. The fund supports partnerships, leveraging both public and private sector funding to encourage municipal actions to improve air, water and soil quality, and to reduce greenhouse gas emissions. In 2000, the Government of Canada endowed the Federation of Canadian Municipalities (FMC) with CAD 125 million to establish the GMF. This was doubled in 2001-02 to CAD 250 million, and increased again in 2005 by CAD 300 million, half of which is dedicated to a new brownfield category.

On 31 March 2005, a new funding agreement was signed by the Ministers of Environment and Natural Resources and FCM to make the GMF a more sustainable, long-term funding source for municipal governments and their partners. The new agreement contains a number of significant changes including the creation of a single GMF with annual funding caps. Also new is a competitive process for obtaining GMF grant and loan funding for capital implementation projects: CAD 50 to CAD 70 million per year for loans, CAD 7 to CAD 10 million per year for grants. Funding of CAD 8 to CAD 12 million per year is available for grants for feasibility studies, assessments, field tests and sustainable community plans on a continuous intake basis. GMF continues to support municipal initiatives in energy, waste, water, sustainable transportation, and sustainable community planning. Brownfield remediation has been added as a new sector eligible for GMF funding. In addition, up to CAD 750 000 annually is allocated to the GMF Capacity Building programme, which continues support for Partners for Climate Protection (PCP) - a network of more than 125 municipal governments who have committed to reducing greenhouse gases and acting on climate change.

Green Municipal Fund's activities

GMF is administered by the Centre for Sustainable Community Development at the Federation of Canadian Municipalities (CSCD). The mission of CSCD is to demonstrate municipal leadership in sustainable community development by working with partners to implement holistic decision making, planning processes and innovative projects. It manages a number of complementary programmes and services, including GMF, Affordability and Choice Today (ACT), Partners for Climate Protection (PCP), the FCM-CH2M HILL Sustainable Community Awards and the Community Energy Planning Mission. GMF programmes are delivered through five administrative units within CSCD: Governance and Administration, Development, Operations, Credit and Risk Management, and Knowledge Management.

To date, 522 GMF studies, field tests, plans and capital projects have been approved for funding of CAD 302 million, leveraging over CAD 1.9 billion of economic activity in communities across Canada (Table 3.1).

Table 3.1. Regional balance of GMF funded activities

Region	Population[1]	% of Population	Since Inception	
			Approvals	% of Approvals
Atlantic	2 344 000	7.3	62	11.9
British Columbia*	4 285 500	13.3	109	20.9
Ontario	12 541 400	38.9	177	33.9
Prairies**	5 501 500	17.0	115	22.0
Quebec[2]	7 598 100	23.5	59	11.3
Total	32 270 500	100.0	522	100.0

Notes:
1. Source: Statistics Canada 2005 population estimates (based on 2001 Census).
2. In March 2004, the first municipal proposals were approved following the signature in 2003 of an agreement between the Government of Quebec and FCM authorising Quebec municipalities to receive GMF funding.
* British Columbia, including Yukon.
** Prairies (Alberta, Manitoba, Saskatchewan, Northwest Territories and Nunavut).

Source: FCM, 2005.

In 2005-06, 31 capital projects were approved through loans totalling nearly CAD 54 million and grants totalling almost CAD 10 million (Table 3.2). This includes funding commitments for CAD 15.4 million in grants from the first Request for Proposal (RFP) for brownfield remediation.

Table 3.2. Green Municipal Fund's activities

(thousands of CAD)

	2005-06			Since inception		
Feasibility studies, field tests and sustainable community plans	**Grants**		**Total project value**	**Grants**		**Total project value**
	10 970		24 150	35 776		98 894
Capital implementation projects	**Grants**	**Loans**	**Total project value**	**Grants**	**Loans**	**Total project value**
	9 653	54 929	388 888	42 193	226 307	1 708 020

Source: FCM, 2005.

Green Municipal Fund performance

CIBC Global Asset Management Inc.[2] manages the non-allocated portions of GMF. Financial performance, compliance and quarterly reports, as well as a yearly review are presented to the GMF Council. Directives for investments are contained in the GMF Investment Policy, which ensures investments made are consistent with the fund's objectives. In 2005–06, GMF unallocated funds earned 3.97%. Since inception GMF unallocated funds have earned 6.52%.

The original CAD 50 million allocated to GMEF must be disbursed by 31 March 2009. Since inception, GMF has allocated CAD 35.7 million in grants to municipal governments and their partners for feasibility studies, field tests and sustainable community plans (Table 3.2). There remains CAD 16.3 million to be allocated to municipalities and their partners in the next three years. Once the original allocation to the GMEF is disbursed, GMF will fund feasibility studies, field tests and sustainable community plans from the interest generated by the single new fund.

What type of projects does GMF support?

GMF funding supports a range of activities related to municipal environmental projects, from the early stages of project design up to and including the physical implementation of capital projects.

The GMF offers:

- Grant funding for feasibility studies, field tests, and sustainable community plans.

- Loan and grant funding for capital projects through a competitive request for proposals process.

To do this effectively, the fund supports a range of activities leading up to and including the physical implementation of an environmental infrastructure project. The fund distinguishes four types of project activities:

i) *Planning.* A project activity that demonstrates an integrated, systems approach to addressing community wide sustainable, energy, and environmental management objectives. Several different types of plans and planning processes may relate to Sustainability communities, Sustainable

Neighbourhoods, Green House Gas Local Action, Brownfield Redevelopment, or Community Energy.

ii) *Feasibility study.* An assessment of the technical, environmental, and/or economic feasibility of an environmental project. A feasibility study may include reviewing the current system or situation, identifying requirements for the proposed environmental infrastructure project, and reporting the effects and financing options associated with implementing the proposed project.

iii) *Field test.* A test of the environmental project's performance under the conditions in which it will operate. For example, a field test may assess a small-scale installation of a new system or technology to determine the implications of installing the system or technology on a larger scale.

iv) *Capital installation.* Implementation of an environmental infrastructure project after a study has deemed it to be feasible.

Case study 20. France: Urban Free Zones

Overview of the financing tool

Established in 1997, French Urban Free Zones (ZFUs) give French small and medium-sized companies tax and social security relief, but restrict that relief to companies who reserve one third of their jobs for local residents. In this way ZFUs use fiscal incentives to stimulate local economic development in deprived areas. ZFUs are operational in 85 areas within France.

How the financing tool is used

The revised ZFU programme is part of the programme of the French Secretary of Employment, Labour and Social Cohesion. Legislation enacted on 1 August 2003 defined 3 main axes in order to help to renew the towns identified, proposing:

- A complete renewal of the more deprived areas with the creation of a National Agency for Urban Renewal.

- Actions towards employment and economic revitalisation with the creation of 41 new Urban Free Zones.

- The aim of giving a 'second chance to families with high debts'.

Outputs envisaged from this revised programme include:

- The creation of 100 000 jobs in 5 years.
- Indirect effects expected: urban renewal, trade and services development, public services and facilities, better common transportation.

Decision making process

The criteria for selecting a ZFU are as follows:

- Number of inhabitants in the area.
- Rate of unemployment.
- Number of people under 25.
- Number of unqualified people**.**
- Fiscal potential of the area**.**

Value added of the financing tool

Evidence indicates that the requirement to recruit local residents has not been overly restrictive: the minimum local recruitment levels have been exceeded in ZFUs; the rate of new company formation was seven times higher in the ZFUs than in the surrounding areas, and the number of wage earning employees in the area quadrupled.

ZFUs focus specifically on providing an incentive to employers to recruit local residents from deprived areas, thereby having the potential to make a significant impact on the local economy through the economic multiplier effect and contribute to the area's overall regeneration.

Property investment and joint ventures

Case study 21. Worldwide: real estate investment trusts

Overview of the financing tool

Real Estate Investment Trusts (REITs) are used in varying forms in a number of countries with developed property markets, including the US, Australia, Canada, Belgium and France.

A REIT is a company that holds, and in most cases, operates income-producing real estate such as apartments, shopping centres, offices, hotels and warehouses. As REITS are income producing, they are taxable, and the revenue generated through them provides a means of financing urban development Some REITs also engage in financing real estate, and thus encourage urban regeneration and development. The shares of many REITs are freely traded, usually on a major stock exchange.

To qualify as a REIT, a company must distribute at least 90% of its taxable income to its shareholders annually. A company that qualifies as a REIT is permitted to deduct dividends paid to its shareholders from its corporate taxable income. As a result, most REITs remit at least 100% of their taxable income to their shareholders and therefore owe no corporate tax. Taxes are paid by shareholders on the dividends received and any capital gains.

North America

REITs were created in the U.S. in 1960 to give everyone the ability to invest in large-scale commercial properties. They have grown dramatically in size and importance since then, and today there are approximately 180 publicly traded REITs, with assets totalling USD 375 billion. The shares of these companies are traded on major stock exchanges, a fact which sets them apart from traditional real estate. REITs are classified in the following categories:

- Equity REITs own and operate income-producing real estate.
- Mortgage REITs lend money directly to real estate owners and their operators, or indirectly through acquisition of loans or mortgage-backed securities.

- Hybrid REITs are companies that both own properties and provide loans to owners and operators.

In Canada REITs were established in 1993. Since then the market has grown to contain 26 companies with an equity market capitalisation exceeding CAD 20 billion. There are Canadian REITs focused on almost every property type including retail, office, industrial, residential, hotel and health care. Canadian REITs differ from U.S. REITs in that they must be trusts rather than a choice in the U.S. of trusts or corporations. Provided they distribute to unit holders their taxable net income, they are not taxable at the entity level. Recent legislation in Ontario extended limited liability to many Canadian REITs, removing what was a significant concern to many investors. This legislation was followed by the recent announcement from Standard & Poor's that it would add income trusts to its Canadian indices. Several Canadian REITs should qualify for inclusion to the main S&P TSX Index, thus creating additional demand for their units/shares.

Europe

Belgium introduced a REITs-like structure in 1995, the SICAFI (Société d'Investissement à Capital Fixe en Immobilière). The Belgian legislature created a favourable tax regime for the SICAFIs in order to boost the development of Belgian real estate. The SICAFI is a listed property fund with a fixed amount of corporate share capital whose role is to provide tax neutrality for collecting and distributing rental income. Belgium is home to 11 REITs, with a combined equity market capitalisation of just under USD 5 billion, although only five are included in the FTSE EPRA/NAREIT Global Real Estate Index. Cofinimmo is the foremost listed Belgian real estate company and owns the seventh-largest office property portfolio on the European market. Cofinimmo has a market cap approaching USD 1.5 billion and is primarily focused (91%) on the Brussels office market. Befimmo is the second-largest Belgium REIT with a market capitalisation of USD 1 billion and is also primarily focused (95%) on the Brussels office market with the majority of its tenants related to the public sector. The other nine Belgium REITs combined make up USD 2.4 billion in market capitalisation.

France introduced its version of the REITs approach—Les Sociétés Françaises d'Investissements Immobilièrs Cotées (SIIC) in 2003. They were introduced firstly because France wanted to strengthen its competitive position with Dutch, Belgian and German funds by aligning the French tax regime with the exemption regimes applicable in neighbouring countries. Secondly, the country wanted to generate non-recurring budget revenue to help reduce the French fiscal deficit by way of an exit

tax property companies paid in order to convert to a SIIC. The SIIC is a non-transparent vehicle, with a corporate income tax exemption for specific items of income. According to the Institut de l'Epargne Immobilière et Foncière (IEIF), the French organisation which promotes SIICs, there were 20 listed SIICs (five of which are included in the FTSE EPRA/NAREIT Global Real Estate Index) with a combined equity market capitalisation of USD 29.4 billion as of 31 July 2005. In addition to these 20, a number of other companies have opted for the SIIC structure for the French part of their property portfolios. These companies include Dutch Rodamco Europe, Corio and Eurocommercial Properties.

In the UK, the introduction of REITs has followed the publication of the consultation paper *'Promoting More Flexible Investment in Property: A Consultation'*, alongside the Budget 2004, which considered reform to the taxation of the property investment market in the UK.

The UK Government introduced legislation in the Finance Act 2006 to enable the creation of REITs in the UK from January 2007.

Case study 22. England: English Cities Fund

Overview of the financing tool

The ECF represents a novel approach to regeneration funding with a move away from grant-based regimes to special purpose financing vehicles (UK Parliament, 2002). It is a public-private partnership, between English Partnerships, Legal and General and AMEC.

Initially, the fund amounted to GBP 100 million - raised by the investment of GBP 50 million in equity from the three partners, together with bank debt of GBP 50 million. An additional GBP 150 million of private-sector investment will be raised as a second stage. The fund invests its money on sustainable regeneration in urban areas, and paves the way for higher levels of private investment in towns and cities.

How the financing tool is used

ECF aims to show that high-quality, mixed-use area-based regeneration schemes provide viable, attractive and worthwhile opportunities for institutional investors in the medium to long term, alongside lasting community benefits and

environmental improvements. By making initial investments, the ECF hopes to generate a "snowball effect" of private investment to regenerate English cities.

ECF works with local partners across an agreed 'area of influence' in which they share risk and return over the longer term. ECF is currently focusing on the following projects:

- Canning Town, London, where there is a scheme to build a new commercial district, new housing and a refreshed high street.
- Liverpool Central Business District, where plans are well advanced for a highly specified new addition to the city's Commercial District.
- Westgate, Wakefield, with an opportunity to build a new urban quarter on largely underused and derelict land.
- Clayton Brook, Manchester, utilising the location close to the City of Manchester Stadium and Sport City, the Ashton Canal and proposed new tram route.
- Gateshead Town Centre, where it is proposed to create a higher quality urban centre linked to the renaissance of the Riverside.

Value added of the financing tool

As of May 2006, ECF had achieved an estimated total completed development value GBP 1.2 billion, more than 4.5 million sq ft of mixed-use floor space, provided almost 3 500 new homes and brought back into productive use approximately 72 acres of brownfield land.

Social enterprise finance

Case study 23. USA: Enterprise Foundation

Overview

Operating in the US, the Enterprise Foundation develops and supports innovative models that give people with limited incomes the tools and opportunities

to become self-sufficient. The overall mission of Enterprise is to see that all low-income people in the US have the opportunity for fit and affordable housing and to move up and out of poverty into the mainstream of American life.

Enterprise offers financial products and services that support the entire affordable housing and community development spectrum. Enterprise is also one of the leading advocates for federal and local policy in support of affordable housing and community development. Since 1982, Enterprise has raised and invested USD 7 billion to improve low-income communities and currently invests at a rate of USD 1 billion a year. That investment produces major results; they have generated more than 190 000 affordable homes and strengthened hundreds of communities over two decades.

In 2005, Enterprise adopted a major new approach. The foundation aligned its non-profit and for-profit organisations in order to create a mission-driven organisation that delivers a co-ordinated array of affordable housing and community development products and services at a greater scale.

Enterprise Foundation's activities

Enterprise is a leading provider of capital and expertise for affordable housing and community development, tackling the challenges that other organisations will not attempt. Enterprise provides various products and services to organisations that share a commitment to making sure every American lives in a decent home in a thriving community. These include:

- *Tax credit equity and asset management*: Enterprise is one of the nation's leading syndicates of Low-Income Housing Tax Credit (LIHTC) equity for developing affordable housing. Indeed, Enterprise helped write the legislation that created the LIHTC programme in 1986 and went on to break-ground with innovative applications of it - such as service-enriched housing for the homeless - that others said could not be done. Enterprise is always focused on finding new and better ways to address the housing needs of low-income Americans. Enterprise asset management adds value and provides hands-on expertise that helps mitigate risk for affordable housing investments. From construction and lease to ongoing operations to Year 15 and beyond, Enterprise's asset managers ensure compliance, proactive problem-solving and timely reporting, protecting the interests of investors and developers and safeguarding the homes of low-income residents.

- *Commercial and mixed-use financing*: for commercial and mixed-use development, Enterprise is a leading provider of equity, mezzanine financing and senior debt. As one of the top recipients of New Markets Tax Credits, Enterprise has financed a variety of retail, office, industrial and mixed-use development enhanced by this investment programme. Enterprise also provides mezzanine financing for market-rate rental and for-sale housing with an affordable component.

- *Short-term debt*: a variety of short-term loan products are available through Enterprise's loan fund - a certified Community Development Financial Institution - for pre-development, acquisition, working capital and other financing needs.

- *Permanent financing*: affordable and market-rate lending products for multi-family housing are available through Enterprise's Special Delegated Fannie Mae Lender programme using the DUS product line. Enterprise offers development partners a national product line that includes financial expertise in 9% LIHTC and 4% tax-exempt bond financing, acquisitions, preservation and 501(c)(3) projects.

- *Public policy*: Enterprise has a long history of leading the dialogue in the nation's capital and in statehouses and city halls throughout America. Legislators and civic officials rely on Enterprise for an informed perspective on housing and community development issues. Enterprise continues to be a leading advocate for protecting and advancing legislation, policies and programmes that support and strengthen the critical work of community-based organisations.

- *Models, expertise and resources*: decades of experience at the forefront of community development—often inventing the means to achieve previously unattainable goals—has made Enterprise an invaluable resource for consulting and training. Enterprise assists community development organisations, faith-based groups, state and local governments, and developers of all experience levels to navigate the often dauntingly complex process of putting ideas to work in struggling communities. Enterprise's online knowledge base is one of the most comprehensive in the industry, complete with tools and models for every phase of the development process.

- *Development*: Enterprise Homes is one of the mid-Atlantic region's largest developers of quality affordable housing communities. Enterprise's

development expertise also includes market-rate for-sale, workforce housing and mixed-use communities. Enterprise has created homeownership and rental residences for families and individuals of diverse income, age and culture. Communities created by Enterprise have been recognised for excellence by numerous local and national awards

Decision making processes

Three particularly important groups of Enterprise leaders are Senior Management, the Board of Trustees and the Network Advisory Board. Together they are following a more productive, effective course on behalf of low-income people and communities nationwide. The vitality and relevance of Enterprise's work depend upon an intimate and accurate understanding of the needs and dynamics of the ultimate constituents, the residents of the neighbourhoods they build and serve.

The Network Advisory Board is representative of the 2 500 plus community-based organisations across 900 locations in the Enterprise Network. Accomplished leaders in the affordable housing and community development industry, the Network Advisory Board advises Enterprise on practitioners' technical needs in the field, lending policies and critical programmes. The board also provides feedback on Enterprise's existing efforts and new initiatives to revitalise low-income neighbourhoods, keeping them informed and focused on community priorities.

Value added of the financing tool

Enterprise works with a national network to advocate adequate, flexible public resources that leverage private investment and participation. Twenty years ago, they helped Congress create the nation's most robust affordable housing tool — the federal Low-Income Housing Tax Credit programme. Today, this tool helps produce more than 25 000 affordable homes every year. Yet proven programmes and policies like the LIHTC face growing threats. With the strength of a small, dedicated team in Washington, D.C., Enterprise leads national efforts to preserve and expand solutions for low-income communities.

Distressed neighbourhoods can attract new, wealthier residents without undercutting affordable housing. However, attaining equality for all classes, races, and income levels requires conscious effort and new approaches to finance, advocacy, and human resources.

Case study 24. Australia: social enterprise finance

Overview

Social enterprises are businesses that trade in the market with a social purpose. They are found in most economic sectors and are distinguished by the way they do business:

- They are commercial enterprises that trade in the market place in order to achieve explicit social aims and financial self-sufficiency.
- They are part of a stakeholder economy and are structured and governed by and for stakeholder groups or by trustees.
- Their surpluses are principally reinvested to achieve their social/community aims.

Of particular relevance to local economic finance are social enterprises called Development Trusts or Community Development Financial Institutions (CDFIs); these regenerate communities by investing in local community owned or small businesses through finance, business training and support. CDFIs raise their finance in the form of grants and loans and they invest via grants and loans.

CDFIs emerged first in the United States as part of the 1960's recognition that community development had a central economic dimension and that frequently what constrained community economic development was the absence of funds for investment in new projects. By their very nature, projects designed to generate employment and build social infrastructure in deprived communities were not viable by conventional banking criteria. Whilst CDFIs emerge independently from government, they often benefit from various forms of government support such as tax incentives or supportive regulatory arrangements.

How is the investment tool used?

The following case studies provide useful examples of CDFIs currently providing finance for local economic development in Australia:

The Maleny Credit Union (MCU)

The objectives of the MCU are to provide appropriate and ethical financial solutions to members, solutions that are socially just and environmentally responsible, and which empower the local community and are based on people, honesty and good will. While it primarily provides consumer finance to its members, MCU also makes significant business loans to local enterprises, especially other local cooperatives. In this role, it has been crucial in enabling Maleny to become the "cooperative capital" of Australia. Amongst many of its activities, the MCU allocates some 5–10% of its profits to a community grants scheme and provides loans to people on low incomes or social security who would otherwise be unable to access credit. The MCU has grown from two staff volunteers with AUD 50 000 local deposits to 14 staff and assets of around AUD 15.6 million.

Diocesan Development funds

Development funds have been established by dioceses in the Catholic and Anglican churches and by state synods of the Uniting Church. They are useful tools as they provide the diocese with funds for capital works without resorting to mainstream finance. Within the Catholic Church it is estimated that of the 32 archdioceses throughout Australia, there are some 26 archdiocesan-based Catholic Development Funds with approximately AUD 2 billion under management. Diocesan Development Funds collect and manage surplus funds of parishes and other church organisations such as schools, hospitals and aged-care facilities. These funds are invested by way of loans in new church projects such as new school buildings, aged-care facilities and church repairs. These loans are then repaid by the church schools, hospital or aged-care facilities, at or just below market interest rates. "Profits" are in turn invested in "unprofitable" church projects (e.g. homeless shelters and family counselling services) that cannot cover running costs or charge fees from clients.

In some dioceses, funds are raised from parishioners in the form of fixed term deposits and similar instruments. They are exempted from the Australian Securities and Investment Commission (ASIC) fundraising requirements. They are generally owned and registered with the legal entity that is the archdiocese and are regarded as private companies not subject to the normal requirements of having a prospectus and trust deed under the Corporations Law, and not examined or approved by the Australian Securities and Investment Commission.

Examples include the Perth Catholic Development Fund which had total loans under management in 1999 of some AUD 65 million; and the Brisbane Archdiocesan Development Fund which is estimated to have some AUD 200 million under administration.

Value added of the financing tool

These kinds of social enterprise finance provide an excellent means to recycle local monies for high local impact. They represent an efficient means to achieve social and environmental outcomes at the same time as making a 'return' and they provide high level of connection between the sources of funds (parishioners, churches, and amenities) and the beneficiaries (local people and local projects). They are value driven and sustainable.

SME and innovation finance

Case study 25. New Zealand: venture capital funds

Overview

Venture capital is recognised internationally for the key role it plays in the innovation process, especially in commercialising research and development, lifting exports, creating jobs and stimulating economic activity. In New Zealand, the government has identified a gap in the provision of capital and expertise for early stage companies with high growth potential. These are companies that have identified an opportunity to develop an innovative product or service and require capital and/or expertise in order to commercialise the product locally and internationally. It is in response to this gap that the government has established the VIF programme.

The Venture Investment Fund (VIF) venture capital programme, established in August 2001, is a "fund of funds" equity investment programme. The government has invested NZD 160 million, alongside private sector co-investors in a series of privately managed venture capital investment funds.

The programme is designed to increase the supply of capital to New Zealand based innovative young companies and over time, to accelerate the development of the venture capital market in New Zealand. This in turn, should help the

development of stronger local economies in urban areas in New Zealand. There is however also a distinctly international flavour to the investment programme, as the fund aims to help local businesses achieve global, not only regional and national success.

The overall goals of the venture capital programme are:

- To accelerate development of the New Zealand venture-capital industry by increasing the level of early stage (seed, start-up and early expansion) investment activity in the New Zealand market.

- To develop a larger pool of people in New Zealand's venture capital market with skills and expertise in early stage investment.

- To facilitate the commercialisation of innovation from Crown Research Institutes, universities and the private sector.

- To get more New Zealand businesses on paths to global success by increasing their access to international experts, networks and market knowledge.

How is the investment tool used?

The VIF venture capital funds select, invest in and assist the growth of innovative young companies early in their development. VIF venture capital funds are fixed duration, private equity, investment vehicles in which VIF is a cornerstone investor.

The government will normally invest up to one third of the total capital for each VIF venture capital fund. The VIF venture capital fund manager must raise the required matching capital from private sector investors. VIF (i.e. the government) can invest up to a maximum ratio of 1:1 matching capital alongside private investors (for seed and start up funds). If the investment stage focus of the venture capital fund is expansion or late stage, then the ratio on which VIF will invest diminishes.

Each VIF venture capital fund will operate for ten years, investing in a number of New Zealand enterprises before terminating and distributing profits to investors. VIF appoints selected private sector venture capital fund managers to operate individual VIF venture capital funds, and each VC fund manager will typically

invest in and manage a portfolio of 10-15 investments in high growth NZ companies.

A maximum of NZD 25 million of VIF capital can be committed to any single fund, with the amount of VIF investment commitment being determined by the investment strategy of the venture capital fund and the amount of capital committed by private investors.

Decision making processes

VIF appoints venture capital fund managers (VIF venture capital fund managers) to manage its investments. Each of the appointed VIF venture capital fund managers has been assessed as being of "investment grade" following a rigorous selection process supported through independent professional due diligence by Wilshire Australia, a specialist private equity advisor. Wilshire's due diligence involves a close examination of the organisation, strategy and investment portfolio of each VC manager. The VIF venture capital fund managers are currently BioPacific Ventures, TMT Ventures, No 8. Ventures, Endeavour i-cap and iGlobe Treasury.

There are standard criteria for the VC fund managers to follow when making investments:

- Initial capital investments are to be made in innovative New Zealand businesses. A New Zealand business is defined as having the majority of assets and employees in New Zealand at the time that initial investments are made.

- Initial capital investments can be made in early stage (seed, start-up and early expansion) through to expansion stage (expansion, late expansion) venture capital investments.

- Total investment in any one company must not be more than 15% of the total capital in the fund.

- Fund investment terms exclude investment in property development, retailing, mining, hospitality-industry businesses, re-investing and re-lending, as well as businesses associated directly with other investors in the fund or directly with the fund managers.

VIF venture capital fund managers, not VIF, make decisions about which companies to invest in. However, the VIF board is expected to exercise judgement with respect to implementation of the VIF programme and establishment of contractual agreements with VIF venture capital fund managers in line with venture capital industry best practice.

Value added by financing tool

Christopher Twiss, the Executive Director of the New Zealand Venture Capital Association has said that "the NZVCA believes that the venture capital programme is clearly having an impact on the level of investing in venture capital in New Zealand. We expect the programme's impact will continue to grow over the next few years as NZVIF funds continue to invest".

Case study 26. Australia: innovation investment fund

Overview

The *Innovation Investment Fund Programme* is an Australian government initiative designed to assist small companies in the early stages of development and hence strengthen local economies by commercialising the outcomes of Australia's strong research and development capacity. The IIF is a fund of funds providing venture capital to small, high-tech companies at the seed, start up or early expansion stages of their development.

How is the investment tool used?

The Australian Government is both the regulator of the programme and the major investor in each of the IIF funds. Under the programme, the Australian government licenses private sector fund managers who make investments in eligible investee companies, by utilising the AUD 358 million in capital provided by both the Government (AUD 220.7 million) and private sector investors (AUD 137.35 million). Each fund has a ten year life.

An eligible investee company may receive a maximum investment of AUD 4 million or 10% of the IIF fund's initial capital; whichever is the smaller amount. The funds are "revolving", which means that, as fund managers provide

returns on investments, the Government will reinvest its initial investment plus interest into the IIF programme.

Decision making processes

Each licensed IIF is managed by a private sector fund manager who makes the investment decisions in relation to the fund. Each fund manager is licensed by the IR&D Board and is subject to conditions regarding investment activities and fund operations specified in license agreements and associated investor documents. Managers will invest in companies throughout Australia.

There are also certain eligibility requirements which potential investees must meet. As a minimum, potential investee companies should:

- Be commercialising the results of research and development (as defined by the IR&D Act).
- Have an annual revenue of up to AUD 4 million, averaged over the past two years, with a maximum of AUD 5 million in either of these years.
- Have a majority of its employees (by number) and assets (by value) inside Australia at the time the licensed fund first invests in the company.

Value added by the financing tool

One of the first successes of the initiative is LookSmart - an Australian Internet search engine company – which has recently been successfully floated on the US NASDAQ stock market, allowing a AUD 31 million reinvestment back into the revolving fund.

Notes

[1] www.sustainablecommunities.fcm.ca/GMF

[2] CIBC Asset Management is one of Canada's leading asset managers with about CAD 60 billion of assets under management. These assets include those under institutional money management for pension funds, endowments and insurance funds, private wealth management (www.cibc.com/ca/am/)

4 DEVELOPMENT AGENCIES, DEVELOPMENT BANKS and REGIONAL FUNDS

Development agencies, development banks, and special regional funds play a key role in the financing of local development. These bodies are established explicitly to promote local and regional development and they have expertise in the arenas of local and regional reinvestment and financing. Most such entities apply themselves to developing specialist financing which can bridge between public grants and wholly commercial finance or between public assets and private investors. The goals of such funds are often make bankable deals which are sufficiently commercially attractive more acceptable to commercial financiers or to help secure growth of project and enterprises which can be become commercially bankable over time. In many cases these entities are key sites of financial innovation and they provide lessons that are widely replicated by larger institutions.

We cite five examples below, one each from USA, Italy, Germany, UK, and India. Each is different in its focus and construction, but together they illustrate the importance of this niche activity.

Theme	Case Study	Region	Example
1. Development agencies, development banks and regional funds			
	27	USA, Greater Philadelphia	The Reinvestment Fund
	28	Italy	Finpiemonte and Filombarda
	29	Germany, Stuttgart	Regional Investment Bank, L-Bank
	30	UK, East Midlands	Blueprint Fund
	31	India	Tamil Nadu Urban development Fund

Case study 27. USA, Greater Philadelphia: The Reinvestment Fund

Overview of the financing tool

'The Reinvestment Fund' (TRF) is a national leader in the financing of neighbourhood revitalisation and local economic development. What began in 1985 as a small community development organisation working in Greater Philadelphia, has evolved into a progressive, results-oriented, socially responsible community investment group that today works across the mid-Atlantic region. TRF delivers capital to those places where it can best transform lives and rebuild neighbourhoods. The fund works closely with a diverse network of investors and business partners to galvanise private initiative and capital for public investment schemes. Together, they are investing in homes, schools, businesses and a clean energy future.

TRF's overall mission is to build wealth and opportunity for low income people and places through the promotion of socially and environmentally responsible development.

How the city uses the financing tool

TRF does three main things:

i) It builds products that open up new markets.

ii) It provides data and policy analysis.

iii) It provides capital mainly for residential and commercial real estate.

TRF finances the revitalisation of low-wealth neighbourhoods, driving economic growth. Its financing can be broadly divided into the following categories:

- Housing: over the last 21 years, TRF has created over 14 000 homes for low-wealth communities and low- and moderate-income individuals. They target projects in specific areas where sales prices and rents are out-of-reach for residents, and focus on improving distressed areas with high potential for market recovery.

- Community facilities: to reinforce a community from the inside out, TRF finances a broad range of human services agencies, from charter schools

and child care centres to job training providers and social service organisations.

- Commercial real estate and businesses: by offering flexible financing programmes to local developers and entrepreneurs, TRF can spur both economic and neighbourhood growth at the same time. From large scale mixed-use developments to supermarkets, they finance projects that can provide products and services, as well as jobs for neighbourhood residents.

- Sustainable energy: TRF works to build a clean and sustainable energy future for the region. Recognising the delicate balance of economic and environmental factors, their financing encourages energy efficiency and the application of clean energy technologies

- Non financial help: TRF offers policy analysis and planning services to governments at all levels and organisations. These services can be particularly helpful to those looking to develop investment strategies. TRF's policy analysis services can help aggregate and analyse vast amounts of data on issues ranging from housing to real estate market value. TRF's planning services can help community groups and organisations develop and implement revitalisation plans that can support critical investment decisions.

TRF also provides a range of human resource services for businesses within its financing portfolio.

Critical success factors

In terms of building products, one of the most important lessons learned by TRF was that it had to have 'valuable products' somewhere in the organisation. Valuable products help entrepreneurs or developers to grow their businesses while also making money for the TRF. These types of products also distinguish the organisation as not simply an R&D mechanism for mainstream financial institutions, but one with a competitive advantage and intrinsic added value.

Secondly, it was found that subsidy should not immediately suggest inefficiency, as long as organisations understand what subsidy is and how to use it for the right things. 'Smart subsidy' is a term coined at the Development Finance Forum to capture this idea. The CFO at TRF created a model that expresses, product by product, what subsidy, if any, each utilises, and to what degree it is needed. A

development finance organisation must also have a pricing model that reflects an understanding of risks and transaction costs. An underlying element of this model must be an understanding of competition in the market.

Finally, In terms of providing data and policy analysis, TRF learned that information was, in many instances, its most important asset. Early on, the organisation grasped the special needs of borrowers and complexities related to its transactions, and had few loan losses, but it was not able to make money. A nuanced understanding of the market and market trends was lacking. The organisation had some of the best data in the region in certain markets, but it was being driven from one section of the organisation.

Information has become a way to move TRF from an R&D type of organisation - 'a well run non-profit' - to an organisation that can intervene with particular products in particular markets in a much more significant way. TRF also profits from the value that it has created. It has further begun to sell data tools to others, and to brand itself and its services in ways that few organisations in the field can.

Value added of the financing tool

TRF's approach to generating economic growth is innovative, strategic, and fiscally sound. They apply information and real-world knowledge of the communities they serve to pin-point rich opportunities and untapped resources. The fund has helped reclaim neighbourhoods others have left behind and their expertise has made them a national leader in the field.

The fund's results are concrete and measurable, immediate and lasting. They form the foundation on which TRF will continue to drive economies and improve lives. Since its inception, TRF has financed more than 1 950 projects, delivering over USD 520 million in capital. Their impact has included:

- 290 businesses.
- 14 440 housing units.
- 16 610 charter school slots.
- 29 470 jobs.
- 5 million square feet of commercial space.
- 1 million MWh of clean energy – enough to power over 100 000 homes for a year.

Case study 28. Italy: FinPiemonte and FinLombarda

Overview of the financing tool

FinPiemonte and FinLombarda are two examples of regional public/private financing organisations in which the regions are major shareholders. These financing organisations support economic development in the region and fund urban renewal.

FinPiemonte

FinPiemonte (Istituto Finanziario Regionale Piemontese) is the Piedmont regional development agency. It was set up in 1977 as a public-private partnership between the Piedmont Region, as the major shareholder (62.2%), and other local actors including:

- Financial institutions and banks having their headquarters in the region (21.2%).
- Industrial associations (10.6%).
- Piedmont chambers of commerce (2.8%).
- The province and city of Turin (2.7%).
- The province and city of d'Asti (0.5%).
- The province and city of Cuneo (0.1%).

Today with capital of EUR 33 8 million, Finpiemonte invests in infrastructures (incubators), as well as in financial tools, such as bank guarantees, grants, shares and enterprises (in 2005, EUR 121 million were invested in these different tools).

It acts as the leading regional public/private financing organisation. The breadth of Finpiemonte's interests is noteworthy. It includes:

- **Site investment and management including:**
  - Industrial estates.
  - Science parks.
  - Logistics platforms.
- **Urban renewal:**
  - Restoration of historic buildings and centres.
  - Reuse of industrial buildings.
  - Affordable housing.
  - Reconstruction of performance venues.
  - Parking facilities.
- **SME Finance:**
  - Joint venture finance.
  - Surety loans and guarantees.
  - Real estate leasing.
- **Environmental Improvements:**
  - Waste treatment.
  - Tourism promotion.
  - Renewable energy.
  - Water resources.
  - Environmental enhancement.
- **Innovation and Training:**
  - Technology parks.
  - Incubators.
  - New business promotion.
  - Diffusion of technology and innovation.
  - Centres of excellence.
  - Compliance with regional regulations.
- **Support for inward investors:**
  - Industrial relocation.

FinPiemonte serves as a good example of a regional financial institution that is jointly owned by public and private sectors but diversifies its portfolio of actions to cover a portfolio of investments, guarantees, loans, and other financial assistance in such a way as to ensure ongoing revenues and to mitigate risk. It also serves to provide financial support for the diverse needs of SMEs including equity participation, loans, and guarantees to balance sheets, as well as support with technology and innovation activity, premises and lease financing.

FinPiemonte has been actively supporting local economy for 20 years. Since its creation it has focused around two strategic lines:

i) Implementation of complex investment projects (Science Parks, incubators) including:

The Turin Wireless project, established in 2001, is a national pilot initiative for prompting the development of the Turin area in the field of ICT. The initiative plans to double the number of researchers in the wireless sector, while generating at least fifty new companies by 2011. The project is based on an investment of roughly EUR 130 million (approximately GBP 83 million) over five years from public and private funding.

The Turin Incubator, established in 1999, alongside the Polytechnic of Turin, the Province of Turin, Chamber of Commerce to foster the creation and development of new companies.

Tecnorete Piemonte, established in 2001 as a not-for-profit consortium with university and private sector representation to promote scientific and technological parks through initiatives aiming at fostering research, innovation, technology transfer, education and start-up of new firms. Nowadays there are seven parks belonging to Tecnorete.

ii) High value added services such as consultancy and the management of funds from the region. Through its information centre, Piemonteinforma, it helps with set-up, financial assistance, institutional relationships, information on the entrepreneurial structure of Piedmont, engineering and legal information.

FinLombarda

Established in 1971 as a joint venture between the Lombardy Region and other shareholders from the private sector, FinLombarda is today the financial services agency of the Lombardy Region. Its mission is to provide financial and legal assistance and financial management services to the Lombardy Region in planning and implementing economic development programmes. It works closely with the manufacturing and financial sectors, local governments and international organisations. Finlombarda serves as an advisor to the Region of Lombardy in planning new subsidised instruments and is a manager/granter of numerous subsidised financial tools for SMEs. Finlombarda plays a privileged role in the public sector to act as an instrumental entity of the Region of Lombardy while being authorised to do so with private tools and authorised by the Bank of Italy to dispense credit.

Finlombarda manages regional financial subsidies in the form of mid-term financing, participating loans, leasing, guarantees, and contributions with interest for

investments made by SMEs in Lombardy. In the field of financial innovation, Finlombarda works with specific tools, assuming minority shares in the capital of SMEs and granting participating loans. Finlombarda works in the area of corporate finance with consulting services for procuring appropriate financing sources for investment and development programmes of smaller businesses and to support internationalisation projects through the use of EU subsidies of which Finlombarda is an accredited financial institution. In the area of cooperating with other countries, with special emphasis on soon-to-be member states of the European Union, Finlombarda works on EU projects as a consultant to foreign local authorities, especially in the area of activating and managing tools to access credit for local businesses and institution building in financing and business services sectors.

In 2001 Finlombarda activated risk capital instruments as a strategic method of intervention, with the creation of a dedicated management company; Finlombarda Gestioni SGR S.p.A. Finlombarda Gestioni is a management company authorised by the Bank of Italy to institute and promote investment trusts. Its participants Finlombarda (73.54%), along with the Chamber of Commerce of Milan (25.71%) and the Consorzio Politecnico Innovazione (0.75%), and its mission is to support competitiveness and innovation policies through innovative financial tools.

Finlombarda Gestioni manages two funds - Next and Euromed.

- **Next fund**: Next, a fund of funds and co-investment fund, specialises in Early Stage Venture Capital and is oriented in particular towards innovation, R&D and new technologies with the aim of developing a Venture Capital market in the Lombardy Region. The objective of the Next fund is to create, in Lombardy, one of the most important regional venture capital markets in Europe. Next can invest in both closed-end venture capital funds and co-invest directly in companies with at least another qualified operator (up to EUR 500 000 or EUR 750 000 for firms located in disadvantaged areas). The Region of Lombardy is a key player in this project. With the Regional Law no. 25, 5 September 2000, it constituted a guarantee fund of EUR 20 million managed by Finlombarda for the easement of capital account losses connected to the shares of the fund of funds issued by investors.

- **Euromed fund** (*Fondo Comune di Investimento Mobiliare di tipo Chiuso*): EUROMED is a EUR 60 million private equity fund which aims to increase the volume of direct foreign investment in SMEs in Algeria, Egypt, Morocco, Tunisia and other non-EU Mediterranean countries. The fund uses a network of north Africa-based managers to identify local

enterprises which European-based companies can develop into joint ventures. The EIB makes its contribution through its Facility for Euro-Mediterranean Investment and Partnership (FEMIP), which was launched in 2002 to provide loans, investment capital and technical assistance grants to help Mediterranean partner countries respond to the challenges of economic and social modernisation and enhanced regional integration. FEMIP encourages the development of the private sector by acquiring equity and quasi-equity stakes in private companies.

Case study 29. Germany, Stuttgart: Regional Investment Bank, L-Bank

Overview of the financing tool

Staatsbank für Baden-Württemberg (L-Bank) is the development bank of Baden-Württemberg and is owned by the State. The bank has total assets of more than EUR 43 billion and is incorporated in Karlsruhe and Stuttgart. It supports the Federal State in the fulfilment of its public duties, particularly in the fields of structural, economic and social policy and as such supports local economic development. Its general aims are to create competition between market participants, new energy for innovation, and wealth for all parts of the population, social equilibrium and similar living conditions in all regions of Baden-Württemberg.

L-Bank finances small and medium-sized companies, export and the creation of living space. L-Bank is increasingly positioning itself as the key institution to provide financial support to SMEs in the State of Baden-Württemberg with the aim of offsetting size-induced disadvantages and strengthening the competitiveness of SMEs. It supports entrepreneurs starting their own business or taking over existing businesses and established companies by offering loans at reduced interest rates and advances, sureties and guarantees for financing capital spending and also working capital. Consulting and financing services are provided for medium-sized companies that are exploring export opportunities. In addition, L-Bank offers Globaldarlehen (global loans) to private sector banks, which they in turn can 'parcel out' to individual borrowers for the benefit of SMEs in the region.

L-Bank also offers finance for housing construction and the management of family support schemes. L-Bank emphasises the development of residential housing and supporting families with children to buy their own property and since 1972, has supported every fourth housing unit in Baden-Württemberg.

How the city uses the financing tool

L-Bank's strategy is mainly focused on the three segments: economic development, housing and infrastructure within the State of Baden-Württemberg. The institution also serves as a conduit for development and social programmes for the State of Baden-Württemberg.

The bank is to support the Federal State in the performance of its public functions, as well as to finance and implement measures in the interests of the federal state, in particular in the following areas.

Housing and housing schemes

Against a backdrop of substantial cutbacks in public housing support, L-Bank pursues the goal of facilitating access to the housing market. In particular, it believes large families should be able to acquire residential property, despite changes in the underlying policy framework. Meanwhile, the modernisation of older housing stock is of increasing importance, both for ecological reasons and to preserve the value of such property. L-Bank provides reduced-rate loans for the construction and purchase of owner-occupied houses and apartments as well as residential rental property. The reduced rates are financed through contributions from the budget of the State as well as from the bank's own funds. The '1 000 Homes for Families' programme also supports families who would otherwise have no access to preferential reduced rate loans. In co-operation with KfW Förderbank (KfW Promotion Bank), L-Bank helps to finance initiatives to modernise existing residential properties and to increase their energy efficiency, contributing to the reduction in CO^2 emissions and energy costs as well as providing a stimulus for innovative environmental technologies.

Economic development

Special attention is paid to small and medium-size companies and businesses' economic development. In 2005, financing commitments increased by 21.7% to EUR 10.82 billion (2004: EUR 8.88 billion). Growth was due principally to increased activity in the infrastructure financing, business start-up, and SME finance sectors. The bank also achieved a small increase in commitments to the housing construction sector.

Provision of venture capital

In the field of start-ups and SME finance, L-Bank provides support for start-up entrepreneurs, SMEs and agricultural businesses. The purpose of such finance is to assure a balanced SME sector structure and to create a level playing field in terms of competition in Baden- Württemberg. This in turn contributes to the creation and preservation of jobs. L-Bank supports enterprises with a wide range of financial instruments such as reduced-rate loans, grants, stand-by arrangements, guarantees and products to strengthen the capital base. L-Bank achieves this in partnership with the banking sector in Baden-Württemberg, as loans are disbursed via the house bank; that is, a customer must approach L-Bank via his or her prime relationship bank.

Promotion of technical advancement

The bank is participating in a number of technology and industry parks. These business sites are designed to promote synergies between know-how generated at local universities and interested business partners. L-Bank's long-term investments do not only promote regional business but should also prove profitable for the bank in the case of divestment. The bank does not intend to acquire 100% stakes in similar sites going forward but would rather attempt to co-share risks with the respective local authority.

Improvement of the infrastructure and conditions for attracting business

The cornerstone of a competitive business location is a well-developed and efficient infrastructure. In this field, L-Bank assists projects for improving Baden-Württemberg's infrastructure and seeks to reduce the burden on local authorities. L-Bank concentrates its resources mainly on large-scale investment projects undertaken by local authorities in the state.

Programme of loans

In October 2005, L-Bank – in cooperation with KfW Förderbank – introduced a programme of loans for local authority infrastructure projects which met with lively interest. Reduced-rate loans are granted to local authorities and non-profit organisations under its 'Local Authority Investment,' 'Local Authority Direct' and 'Social Investment' schemes. The loans allowed local authorities to build new schools, old age care homes and other local institutions. The new programme

enables highly effective interaction with financial support schemes for urban housing development. This combination makes a significant contribution to improving the urban housing situation in regeneration and redevelopment areas, thus ensuring the positive development of towns and communities throughout the Federal State. The funds are largely provided by the state government through its Community Investment Fund. Such financial support can be supplemented by infrastructure loans to close any funding gaps.

Business competitiveness

Reinforcement of the competitiveness of business enterprises domiciled in Baden-Württemberg. L-Bank's subsidiaries and the other companies in which it has stakes help Baden-Württemberg to succeed in the competitive business economy. They create particularly good conditions for spin-offs from universities and technology-oriented companies by catering to the dynamic development patterns of such companies and their specific requirements. L-Bank uses its own properties to provide assistance to SMEs in addressing new markets and environmental issues, and to accommodate foreign students.

Promotion of the family and students, arts and sciences

Performance of development functions within the scope of its mandate on behalf of the free federal state of Saxony. In its capacity as the State Bank for Baden-Württemberg, L-Bank administers many other financial aid programmes, and checks that grants made available have been put to proper use. Most of the funds are provided by the State Government and disbursed – with top-up funding from the EU and the Federal Government – to support local authority, commercial and private projects. These projects, including programmes to teach German to pre-school children, are supported by, among others, the European Social Fund and the State Foundation of Baden-Württemberg. More than 40 such programmes were processed in 2005.

L-Bank continues to promote the building of new houses, as well as the modernisation of existing dwellings by housing associations and individuals. In order to supplement public funds for the building, purchase or modernisation of dwellings, the bank has launched an additional programme for families with two or more children who receive funds with attractive interest rates. While housing promotion still accounts for just short of 40% of L-Bank's total business volume (down from 50% in 2003), its importance is set to further decrease in line with the decreasing availability of public funds.

Decision making processes

The bank is supervised by the Federal State. The supervisory function is exercised by the Ministry of Finance in consultation, with the ministry having competence for the matter concerned. The supervision is such as to ensure that the bank performs its functions lawfully and in the interests of the federal state. The supervisory authority is empowered to give directions to this effect. The bank is to observe the principles and aims of the state development policy and the federal state government can stipulate individual functions of the bank by an ordinance having the force of law.

The bank's supervisory board consisting of 15 members (and three advisory members), establishes guidelines for the bank's business activity and supervises the conduct of its affairs. It can at any time demand information concerning any aspect of the bank's activities.

Critical success factors

To be successful, L-Bank needs to develop long-term access to the international capital markets at optimum rates. To do so it needs to build up a deep and loyal global investor base, developing constructive relationships with intermediaries, as well as monitoring economic and technical developments to identify appropriate borrowing opportunities and instruments.

The success of L-Bank is based partially on both the maintenance obligation and the guarantee obligation of the State of Baden-Württemberg. In addition, L-Bank benefits from an explicit and unconditional guarantee of its owner for its liabilities incurred on or after 1 December 1998. As a result, its issues are widely recognised as being zero risk weighted (at present confirmed by the following countries: Germany, Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Estonia, Finland, France, Italy, Latvia, Luxembourg, Malta, the Netherlands and Sweden), as well as enjoying ratings of AA+/AAA from the major rating agencies.

Value added by the financing tool

Business volume has been generated in the area of start-up and SME business financing through a co-operation agreement with Kreditanstalt für Wiederaufbau (KfW, rated Aaa/P-1). L-Bank is seeking to exploit further cooperation opportunities with KfW.

Case study 30: UK, East Midlands: Blueprint Fund

Overview of the financing tool

Blueprint (formerly known as the East Midlands Property Investment Fund (EMPIF)) is a proposal for a 50/50 public/private partnership to hold investment property and develop land and property in the East Midlands. Launched in 2005, Blueprint is a limited partnership between the East Midlands Development Agency (EMDA (25%)), English Partnerships, the UK Government's National Regeneration Agency (25%) and Morley Fund Management's and Igloo Regeneration Fund (50%). It is a for-profit organisation which uses its funds to finance the redevelopment of land and property in six Priority Urban Areas in the East Midlands.

Investment, ownership, risk and profit are shared equally between public and private sector. The structure of Blueprint therefore confers advantage by bringing together, in partnership, significant resources and high level skills from influential public and private sector organisations.

The Blueprint's overall goal is to facilitate, through regenerative property development, the delivery of EMDA and English Partnerships' core objectives (creation of a flourishing region and sustainable communities), whilst generating an acceptable return to investing parties. It aims to generate social, economic and environmental benefits within a commercial framework by stimulating and delivering sustainable and well designed development, with a focus on knowledge based and scientific industries. The high level objectives of Blueprint are to:

- Provide focused investment in the East Midlands high growth, high yield regeneration priority areas.

- Lever significant levels of third party finance into development opportunities resulting in an acceleration of delivery on Urban Regeneration Company (URC) master planned areas.

The financial structure of the fund permits a long term view with performance judged according to likely outcomes over the whole 10 year life of the vehicle. The focus of activity is those areas of need where the market is failing or at best is struggling to deliver optimum regeneration solutions or where there is a need to accelerate change.

How is the investment tool used?

Blueprint will have an initial portfolio of mixed-use regeneration sites in Leicester, Derby and Nottingham with a completed development value of over GBP 500 million. Further sites will be added as the fund recycles its capital to regenerate the region's urban priority areas which also include Corby, Northampton and Lincoln. The partnership has bought around GBP 35 million of properties from EMDA and English Partnerships, and will also own a substantial portfolio of small business units throughout the region, which Innes England have been retained to manage. Blueprint will be working closely with the regional and local authorities to improve the provision of premises for small and medium-sized enterprises in order to assist the region's goal of becoming one of Europe's top 20 regions.

Blueprint's first project will be an extension to the Nottingham Science Park with Architects Egret West. The 12-acre site is situated next to the famous Nottingham Tennis Centre and opposite Nottingham University and comprises the second phase of the Nottingham Science Park. It has been over two decades since the first phase of the science park was constructed. The next phase constitutes an integral part of Nottingham City's strategic plan for the future, of Nottingham as one of the UK's science cities, as announced by the then Chancellor Gordon Brown in March 2005. Focused upon providing new accommodation for high-tech businesses, the new scheme will be particularly relevant to companies spinning out from both of Nottingham's highly regarded universities.

Blueprint started this process by instigating a design competition for the 12-acre park. This aimed to select a productive yet original master plan which would challenge the traditional approach to the science park environment, deliver a modern approach to the use of the site and the architecture of the buildings, and capture the outstanding attributes of the environmental setting. Through design, Blueprint are aiming to create sustainable space, that works not only with regard to aesthetics, but also offers usefulness and practicality ensuring those working inside the buildings experience an environment that evokes passion and encourages innovation.

Decision making processes

The Blueprint board comprises representatives from EMDA (chairman), English Partnerships and Igloo. Blueprint has adopted a Socially Responsible Investment Policy (SRI). The policy sets out a range of performance criteria against which schemes are screened and assessed.

The criteria are arranged according to three themes:

i) Regeneration – projects must contribute to the social, physical and economic renewal of urban neighbourhoods.

ii) Environmental Sustainability – patterns of resource use must not compromise the sustainability of environmental systems.

iii) Urban Design – design of buildings and public realm should be distinctive, functional and urban in character.

Critical success factors

Blueprint shares profit, risk and investment equally between its public and private sector partners. It is a powerful development vehicle which enhances the amount of money and skills available to revitalise failing neighbourhoods and rebuild local economies.

Value added of the financing tool

Blueprint is currently working on a range of projects with an estimated completion value of more than GBP 500 million. It has an existing portfolio, purchased from EMDA and EP, of around GBP 30 million worth of land and buildings. The buildings are located throughout the East Midlands. The land is in three (Derby, Leicester, Nottingham) of the six (the others are Corby, Northampton and Lincoln) urban priority areas within the Urban Action Plan for the East Midlands. Current projects include the extension to the Nottingham Science Park which will provide new accommodation for high-tech businesses, Leicester's St George's area and Wolsey Island, and the Derby Town Centre.

Case study 31. India: Tamil Nadu Urban Development Fund

Overview

In India the move towards local government borrowing from capital markets is a recent phenomena and embryonic in most states. The Tamil Nadu Urban Development Fund (TNUDF) represents India's first experimentation into innovative market based financing of urban infrastructure.

Tamil Nadu is one of the most urbanised states of India with an urban population of 27.5 million, about 44% of the state population; average annual growth rate of urban population between 1991 and 2001 was 4.2% which placed extra strain on urban infrastructure in the region. With this population pressure in mind, Tamil Nadu pioneered a series of innovative approaches to finance its urban infrastructure: funds mobilisation through a unique private/public financial intermediary model; capital market access using customised credit enhancements; and ingenious pooled financing of a project portfolio of smaller local bodies were the most notable instruments are used. The private/public financial intermediary model is known as the Tamil Nadu Urban Development Fund.

The fund's objectives are to

- Fund urban infrastructure projects, which improve the living standards of the urban population.
- Facilitate private sector participation in infrastructure through joint venture and public -private partnership.
- Operate a complementary window, the Grant Fund, to ensure urban infrastructure can be accessed by the poor.
- Improve the technical, managerial and financial management of urban local bodies, equipping them for qualitative maintenance of civic infrastructure and to access debt finance from markets.

The TNUDF replaced the MUDF in 2001 (Municipal Urban Development Fund), which was criticised for excessive reliance on public funds.

How is the investment tool used?

The fund mobilises long term debt for municipal infrastructural investment. By 2001, the fund had grown to INR 2 billion (Indian rupees) with 29% of its capital invested by three leading Indian financial institutions: The Industrial Credit and Investment Corporation of India, The Housing Development Finance Corporation and Infrastructure Leasing and Financial Services.

Decision-making regarding revenue spending/capital investment

Lending policies are approved by the Board of Trustees of the fund. There are also collaborative exercises in project identification, project development and implementation with local urban bodies. TNUDF's lending policies encourage long tenor, fixed rate, market friendly debt financing for eligible civic projects.

Critical success factors for the financial instrument

The TNUDF is supported heavily by a long term loan from the World Bank. Nonetheless, it has succeeded in securing its own high safety credit rating, independent of the World Bank.

What value is added by the financing tool

After just over a year of operation, TNUDF had approved municipal loans worth INR 1.5 billion for infrastructural improvements. Core beneficiaries tend to be smaller municipalities facing a sizeable backlog of essential infrastructure investments. Over 175 projects were sanctioned by March 2002, primarily for roads, bridges, sewers etc. Some of the most significant projects which have been financed by the fund are the Alandur STP (BOT – INR 70 million), the Karur Toll Bridge (BOT – INR 152 million) and the Madurai Toll based Ring Road (BOT – INR 430 million).

5 INTERNATIONAL FINANCIAL INSTITUTIONS

International financial institutions (IFIs) are an increasingly important aspect of the local development finance scene and they are potent partners for local development bringing substantial financial resources and expertise to the local development agenda.

Because IFIs borrow funds on the capital market in large quantities and with an excellent guarantee from the National Governments that support them, they are able to access capital in larger quantities and at a cheaper price than commercial institutions. Equally, because they are not for profit institutions they are able to apply structured financing to a range of policy imperatives without charging commercial rates of return. This provides the IFIs with the resources required to deliver capital at affordable costs, and also to provide technical support, promotion of good practices, and additional grant finance to support some costs.

IFIs are able to lead financial syndicates for larger projects but also to bring commercial financiers into partnership on a range of local and regional investment opportunities. IFIs have mainly focussed on infrastructure and tangible assets in the past, but they are increasingly moving into the fields of local and regional development. This is potentially very significant as it will allow for IFIs to take a patient and innovative approach to fostering local development finance. Below, we cite the cases of:

Theme	Case Study	Example
1. International financial institutions		
	32	World Bank
	33	Inter-American Development Bank (IADB)
	34	Asian Development Bank (ADB)
	35	Islamic Development Bank (IDB)
	36	European Investment Bank (EIB)
	37	European Bank for Reconstruction and Development (EBRD)
	38	Council of Europe Development Bank (CoEDB)
	39	Joint initiatives by the European Commission, the European Investment Bank and the European Bank for Reconstruction and Development

Case study 32: World Bank

Overview

Established in 1944 during a conference of 44 countries in Bretton Woods with the mission of global poverty reduction and the improvement of living standards, the World Bank has become a Group, encompassing five closely associated development institutions: the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), and the International Centre for Settlement of Investment Disputes (ICSID). Each institution plays a different but supportive role. Together they provide low-interest loans, interest-free credit and grants to developing countries for education, health, infrastructure, communications and many other purposes (Table 5.1).

The World Bank operates out of more than 100 offices worldwide. Three-quarters of outstanding loans are managed by country directors located away from the bank's Washington, DC, headquarters. Thirty percent of staff are now based in country offices.

Table 5.1. World Bank regions and new commitments for 2005 financial year

	IBRD USD millions	IDA USD millions	Portfolio of projects USD billions
Latin America and the Caribbean	4 904.4	261.3	19.0
Middle East and North Africa	1 212.1	71.5	5.9
Europe and Central Asia	3 588.6	504.9	15.8
East Asia and Pacific	1 809.8	1 073.5	19.9
South Asia	2 095.9	2 897.4	18.2
Africa	0	3 887.5	16.5

Source: The International Bank for Reconstruction and Development / The World Bank, 2006.

Urban development

The World Bank approved its first loan in the urban sector in 1972. Since then, government and donor supported efforts to address urban development and urban poverty have largely been through low-cost investment projects in shelter and basic services, water supply, sanitation, and urban transport. These were later expanded to include various combinations of components including business support, health, nutrition, education, housing finance, urban sector, municipal development and emergency projects with multiple executing agencies. World Bank loans have proven especially important in supporting local economic development in urban areas of developing countries.

Prototypes of first and second generation urban projects

- Low cost housing (sites and services): large scale direct provision of housing to the poor. These programmes secured land for urban development and strengthening of housing finance institutions; they are now a part of relocation and policy formulation.

- Squatter/slum upgrading to improve the living conditions of the urban poor by providing basic infrastructure and service delivery, granting security of tenure, and bettering environmental circumstances where the poor live.

- Early urban transport projects focused on rail, bus systems development, road construction, street paving and traffic management.

- Municipal and urban lending with competitive access to infrastructure, urban services, capacity building and programmes to change incentive structures for leadership and professionalisation at the city level.

- Metropolitan regions and mega cities where large scale land, environmental and motorisation issues require specialised application of technologies and integrated approaches.

- Urban environmental problems (the brown agenda) that call for comprehensive pollution control, collection and treatment of wastes over a large area.

Current strategy and projects

The World Bank, with its partners, is committed to promoting sustainable cities and towns that fulfil the promise of development for their inhabitants - in particular, by improving the lives of the poor and promoting equity - while contributing to the progress of the country as a whole. For cities and towns, the Urban and Local Government Strategy proposes an agenda for working with both national and local governments to develop sustainable cities, which are first and foremost:

- *"Liveable"* - committed to ensuring that the poor achieve a healthful and dignified living standard; provide systems for adequate housing, secure land tenure, credit, transportation, health care, education, and other services for households; and that address environmental degradation, public safety and cultural heritage preservation for the benefit of all residents.

- *"Competitive"* - providing a supportive framework for productive firms, to promote buoyant, broad-based growth of employment, incomes and investment.

- *"Well governed and managed"* **-** with representation and inclusion of all groups in the urban society; with accountability, integrity, and transparency of government actions in pursuit of shared goals; and with strong capacity of local government to fulfil public responsibilities based on knowledge, skills, resources and procedures that draw on partnerships.

- *"Bankable*" - that is, financially sound and, at least for some cities, creditworthy. Financial health of municipalities requires the adoption of clear and internally consistent systems of local revenues and expenditures, transparent and predictable intergovernmental transfers, generally accepted financial accounting, asset management, and procurement practices, and prudent conditions for municipal borrowing.

The Urban Anchor, through the UNCHS/Habitat, has initiated the "Cities Alliance" to support the strategy's implementation. This partnership aims to mobilise USD 25 million over the next three years to support city development strategies and scaled-up programmes of services for the poor.

Projects and policies

Urban development projects include all active projects with an urban development theme classification, such as access to urban services for the poor, municipal finance, municipal governance and institution building and other urban development.

Municipal Fund

Established in May 2003, the Municipal Fund[1] is a joint initiative of the World Bank and the International Finance Corporation (IFC)[2]. They give creditworthy local and state entities the opportunity to invest in infrastructure projects without taking sovereign guarantees.

This is a novel approach to development infrastructure, as traditionally the World Bank has invested in municipalities through government guarantees, as required by its charter. The International Finance Corporation, however, has invested in a wide range of sub-sovereign infrastructure projects but always through private sector sponsorship.

By bringing together the World Bank public policy experience and IFC's credit culture and market expertise, the Municipal Fund intends to fill a gap in a potentially large market where the opportunities for impact are immense.

The Municipal Fund supports investments made by states, municipalities, and municipally controlled entities in sectors such as water, wastewater, electricity, district heating, solid waste, and urban transport. Public-private projects such as leasing, management contracts and concessions, are supported either through financial support or through private concessions/special purpose vehicles controlled by sub-sovereign institutions.

Financial products

- *Loans*: a variety of lending instruments, including senior, subordinated, and convertible loans, as well as a selection of loan types: fixed rate or variable rate. Loans are provided in major currencies as well as in local currency in selected markets. Loans are issued at market rates and have maturities of 8 to 12 years.

- *Guarantees*: loan and bond guarantees to broaden clients' access to capital markets, including local capital markets. Credit enhancement structures help clients attract new sources of financing in their currency of choice, reduce borrowing costs, and extend maturities beyond what lenders would otherwise provide.

- *Equity/Quasi-Equity*: To provide enterprises with long-term capital, the Municipal Fund can invest in project companies, financial institutions, or other entities. Quasi-equity products include convertible debentures, subordinated loans, income warrants, and other hybrid instruments.

Investment criteria include:

- Degree of decentralisation in the country.
- Degree of municipal/state level control.
- Financial situation of borrowing entity.
  - Predictability of cash flows to repay debt.
  - Tariff reform for utility projects.
- Potential for local currency financing.
- Essentiality of investments.
- Degree of commercialisation.
  - Commercial budgeting.
  - Corporate structure.
  - Independence of operations.
- Regulatory framework.
- Capital market component.
- Appropriate private sector involvement.
- Absence of direct or implied liabilities for the sovereign.

Case study 33. Inter-American Development Bank (IADB)

Overview

The Inter-American Development Bank (IADB) is the oldest and largest of the regional development banks. Established in 1959, it is the main source of multilateral financing for economic, social and institutional development projects as well as trade and regional integration programmes in Latin America and the Caribbean.

The IADB has 47 member countries: 28 in the Western Hemisphere, 16 in Europe, as well as Israel, Japan and Korea. The Latin American and Caribbean countries hold half the shares in the institution.

In 2006, the IADB approved USD 145 billion in loans and guarantees for projects in such areas as energy, agriculture, transportation and communications, environment, poverty reduction, public health, economic and social reform, government modernisation, urban development, education, science and technology, competitiveness and trade, tourism and small enterprises.

Initiative

The Multilateral Investment Fund (MIF) is an independent fund administered by the IADB. Established in 1993, it plays an essential role in the IADB's efforts to reduce poverty and promote economic growth through private sector development and investment in Latin America and the Caribbean. At year-end 2006, the MIF's net approvals exceeded USD 1.2 billion for 997 projects. Including counterpart funding from its partners, MIF projects have put some USD 2.2 billion to work.

In 2006 IADB launched several initiatives to update its products and windows with the objective of better serving its member countries. Among them:

- A *New Lending Framework*. The IADB modernised its approach to both investment and policy-based loans as part of a package of measures instituted by the Board of Governors and the Board of Executive Directors that constituted a new lending framework for 2004-08 and the adoption of more flexible lending instruments. Among the new lending tools and approaches now being offered by the IADB are performance-driven loans, conditional lines of credit for investment projects, programmatic policy-based loans and loans using the sector-wide approach.
- The *performance-driven loan* is disbursed in tranches once its investment objectives, measured by outcome targets as the lending programme progresses, are achieved and the IADB has verified the borrower's expenditures to achieve the outcomes. This instrument creates a stronger incentive for, and managing of, results during the design and implementation of the programme, and it also opens the way to increasingly rely on country project management systems. The IADB has approved three performance-driven loans, all for health sector projects, in Colombia, Honduras and Nicaragua.

- The *conditional line of credit* for investment projects carries the advantage of enabling the borrower to finance similar investments in a sector with a strong track record in quick succession, without having to pay a commitment fee for the unused portion of the credit line. The IADB has approved two conditional lines of credit to Brazil, one for USD 3 billion for a programme to support micro, small and medium-sized enterprises, with an initial loan of USD 1 billion charged against the line of credit, and a second line for USD 100 million for road improvements in the state of Minas Gerais, Brazil, with an initial loan of USD 50 million.
- A *programmatic policy-based loan* allows for phased support to a multiyear programme of policy reforms and institutional change, with a clearly defined overarching objective, through the approval of a series of operations that are each disbursed in a single tranche. This approach may be able to better capture the medium to long-term nature of many significant policy reform efforts while allowing for greater flexibility as the IADB engages in an ongoing policy dialogue with the borrower. The IADB has approved the first stage of three such operations.
- The *sector wide approach* enables the IADB to join with other donors and agencies to support a government-led programme in a coordinated manner that is targeted to a specific sector. The different stakeholders share a joint review process, use common indicators to measure achievement and may share a pooled account and utilise national fiduciary procedures. The IADB has used the sector wide approach in loans to Brazil and El Salvador, both in the social sectors.

Lending without sovereign guarantees

In April 2006, the Board of Governors took the historic decision to expand the number of sectors that the IADB may fund through operations without sovereign guarantees, both in the private sector and in the case of sub-national entities. The latter offer a wealth of potential clients, given the need for financing for infrastructure projects and basic services, either on their own or in partnership with private businesses. The guidelines approved allow the IADB to lend directly to companies active in all sectors, including oil and gas, agribusiness, mining, manufacturing, tourism, technology and services.

Urban development

In response to the decentralisation of government functions that gained momentum in the early 1980s, the IADB has expanded lending for the development of municipalities and other sub-national governments, such as departments, provinces, states or regions. The IADB initial approach to sub-national lending focused on expanding the capacity of local governments in order to provide services to a growing urban population (Table 5.2).

A key concern of projects belonging to this generation was the efficient allocation of investment resources and the proper operation and maintenance of infrastructure. Bank loans thus emphasised project preparation and appraisal, devoting the bulk of the institutional development resources in improving the execution of project-related activities (cost-benefit analysis, transparent and competitive bidding procedures for contracting civil works) and to ensure proper operation and maintenance of infrastructures and municipal facilities. In the 1990s the IADB expanded the range of services eligible for financing with municipal and sub-national development loans. It began to assist in mobilising private sector financing for sub-national governments and placed greater emphasis on strengthening institutional capacity at the local level. Bank interventions included support for second-tier financial institutions that rediscount loans from private banks and the refinement of government-sponsored municipal funds to prepare them for issuing debt instruments in local capital markets. Through the Private Sector lending window the IADB provided syndicated loans and guarantees for private companies investing in municipal infrastructure, most frequently in sanitation, transportation and energy distribution.

Table 5.2. IADB urban lending by sector 1961–2002
(1996 USD million)

Sector	Amount lent	%	Number of loans	%
Housing	3 028.3	11.9	65	17.1
Settlement upgrading	1 476.4	5.8	20	5.3
Integrated urban development	1 429.5	5.6	13	3.4
Urban heritage conservation	137.1	0.5	4	1.1
Municipal development	6 040.7	23.7	69	18.2
Urban transportation	1 139.7	4.5	14	3.7
Environment	1 681.3	6.6	14	3.7
Sanitation	10 574.4	41.5	181	47.6
Total urban lending	**25 507.4**	**100.0**	**380**	**100.0**
Total Bank lending	**175 312.6**		**3 100**	

Source: IBD Annex, 2002.

Programmes

IADB runs the six following programmes:

Integrated urban development programmes

In response to demands made by municipalities and higher tier governments, the IADB financed integrated urban development projects to consolidate peripheral urban areas and rehabilitate inner city areas. In the 1970s and 1980s, projects focused on the poorly structured growth areas in the urban fringes; in the 1990s the focus shifted to central areas, fuelled by the growing interest of local and national governments to preserve historic centres.

Urban rehabilitation

The IADB has financed a variety of urban rehabilitation projects ranging from investments designed to address the needs of specific neighbourhoods (like the Belgrano area of Buenos Aires, or the newly urbanised area of southern Bogota) to an area affected by an earthquake in Peru. These operations focused on coordinating investments in a given territory in order to increase access to sanitation, housing, employment, health, and education, particularly for low-income residents. A key feature of successful implementation mechanisms is their ability to efficiently distribute benefits and risks among public and private actors.

Urban heritage conservation and development

An active programme of loans and technical assistance has been developed to meet the demand for programmes for restoration and preservation of their heritage by many national and local governments. The IADB sponsored projects support a variety of instruments. They include the establishment of municipal conservation funds open to public and private philanthropic donations; direct subsidies to assist owners and developers to shoulder the extra costs of rehabilitating heritage; and the promotion of joint public-private investments to preserve and develop urban heritage assets with commercial potential or high social demand. To determine the eligibility of projects, the IADB applies criteria based on successful international experience and its own policies and operational guidelines.

The IADB finances projects that comply with the following requirements:

- Set up conservation models capable of flourishing in the long term and becoming self-sustaining.
- Are fully supported by the beneficiary communities and the owners of the heritage properties.
- Open channels for participation by private philanthropies as an alternative to public financing through subsidies. Encourage public-private cooperation in the execution and financing of conservation.
- Improve the regulatory environment and public functions involving conservation.
- Prevent irreversible loss of heritage properties.

Urban transportation

One of the objectives of the IADB assistance to cities has been to support the planning and financing of urban transportation systems and infrastructure, seeking to expand service coverage and effectiveness and to make it more accessible for the low-income population. Emphasis is placed on the appropriate operation and maintenance of existing systems and on encouraging the participation of the private sector in the financing and operation of the systems. For that purpose, the IADB finances a wide variety of interventions, including the rationalisation, restructuring, and rehabilitation of existing urban transportation systems, the expansion of streets and urban transportation systems, and passengers and freight terminals and complementary equipment.

Water, sanitation and urban environmental management

The IADB projects place emphasis on rehabilitating existing water supply distribution networks; setting adequate rates; planning capital investment; establishing micro metering systems, efficient collection and accounting of tariffs; and strengthening the managerial capacity of companies. Given that water supply expansion is only possible to the degree that aquifers are protected and managed, these environmental components are gaining importance in the IADB projects. Privatisation of public utilities has expanded capacity and improved service in many

cities. The IADB is supporting these efforts with loans for the utilities through its private sector window and technical assistance financed by the Multilateral Investment Fund to develop efficient regulatory and supervisory frameworks. In the last decade, the IADB has moved into urban environmental management, protection, and remediation issues. Flood control, disaster mitigation, resettlement of vulnerable populations, reforestation, waste water treatment, industrial effluent reduction, and strengthened urban environmental management are often components of IADB operations. The current portfolio of loans has projects to clean up bays, rivers, and lakes near cities or to protect green areas and forests surrounding cities.

Technical cooperation, research and publications

The IADB has an active technical cooperation programme to facilitate the preparation of urban development loans and support institutional development and innovation in borrowing member countries. Funds for these operations come from the net income of the Fund for Special Operations and from trust funds established by non-borrowing member countries and administered by the IADB. More than 100 operations, amounting to over USD 16 million, in support of urban development in the region were executed between 1994 and 2001.

Case study 34. Asian Development Bank (ADB)

Overview

Established in 1966, the Asian Development Bank (ADB) is an international development finance institution whose vision is to make the Asian and Pacific region free of poverty. ADB has 59 members (as of 31 December 2001), of which 43 are in the region. ADB is rated triple-A by Moody's and Standard & Poor's. In pursuing its objectives, ADB provides different forms of financial assistance to its developing member countries (DMCs). The main instruments are loans, technical assistance, grants, guarantees, and equity investments, which are met through various funding resources. Such funding resources are ADB's ordinary capital resources (OCR).

In 2005, ADB approved 72 loans (64 projects) for USD 5.8 billion, 10 equity investments for USD 217.1 million, 2 guarantees for USD 68.4 million, 51 grant-financed projects for USD 1.2 billion, and 299 technical assistance operations for USD 198.7 million for ADB operations of USD 7.4 billion. Around 10% of ADB lending goes towards urban development projects (Table 5.3).

Chart 5.1 shows the countries which benefited most from ADB funding in 2005.

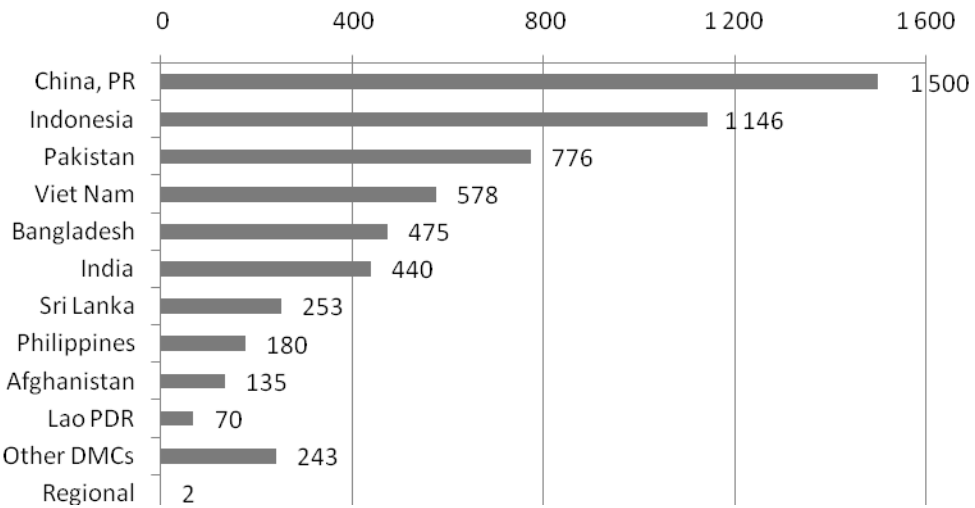
Table 5.3. ADB operations, 2004-05

	2004[a]	2005	Change
		(USD million)	%
Lending	5 239.0	5 796.8	10.6
Public	4 946.5	5 260.8	6.4
OCR[b]	3 704.5	3 885.2	4.9
ADF[b]	1 242.0	1 375.6	10.8
Private	292.5	536.0	83.2
Equity and guarantee	174.4	285.5	63.7
Grant-financed projects	104.4	1 151.4	1 002.9
Technical assistance	195.1	198.7	1.8
Total	5 712.9	7 432.4	30.0

Notes:
a. Adjusted to reflect terminated loan and changes in technical assistance.
b. Ordinary Capital Resources (OCR); Asian Development Fund (ADF).

Source: ADB, 2005.

Chart 5.1. Top borrowers, 2005
USD millions



Note: China, PR – China, People's Republic of; Lao PDR - Lao People's Democratic Republic; Other DMCs - Other Developing Member Countries.

Source: ADB, 2005.

Of the 64 public and private sector projects and programmes approved in 2005, 16 (25%) were categorised as targeted interventions and 48 (75%) as general interventions. By theme, sustainable economic growth was most prevalent and was associated with 53 projects. By sector, transport and communications received the largest share of lending (30%).

Asian Development Fund

Established in 1973, the Asian Development Fund (ADF) is the oldest and largest of the bank's existing special funds whose resources consist mainly of contributions mobilised under periodic replenishments from the ADB members. ADF is designed to provide loans on concessional terms to those DMCs with a low per capita gross national product (GNP) and limited debt-repayment capacity. Activities supported by the ADF promote reduction in poverty and improvements in the quality of life in the poorer countries of the Region. Twenty-six members of the ADB are providing direct contributions to ADF.

Urban development

Since the late 1960s, about 200 urban projects have been funded (in the amount of approximately USD 10 billion) and implemented by ADB throughout the region. Of the total lending, around 10% was for urban projects. Much of ADB's lending during the period focused on urban water supply, sanitation, and wastewater management.

ADB's approach to urban development is guided by the following key documents:

- Long-Term Strategic Framework (2001-15) outlines sustainable economic growth, inclusive social development, and governance for effective policies and institutions, which applies to urban areas.

- Enhanced Poverty Reduction Strategy (2004) says "ADB is committed to poverty reduction and will lend its weight and influence to achieve it".

- Urban Sector Strategy (1999) results from the need to strengthen ADB's leadership role in urban development in the region by expanding the level and impact of development assistance provided to DMCs to improve the plight of urban areas. In 2005, ADB reviewed the strategy to determine

how appropriate and effective it is in guiding the urban development agenda.

- ADB's stated commitments in assisting DMCs achieve the Millennium Development Goals, e.g., Goal 1 on eradicating extreme poverty, and Goal 7 on ensuring environmental sustainability.

Urban development is an important cross-cutting sector for ADB's operations in urban areas, which includes a wide range of sectoral activities:

- Urban water supply.
- Solid waste, sewerage and wastewater management.
- Urban roads, bridges, transport and clean air.
- Urban environment.
- Flood protection and drainage schemes.
- Slums and squatter area improvement.
- Housing and land-use management.
- Energy efficiency.
- Urban governance and financing.
- Urban institutional strengthening and capacity building.

ADB supports integrated urban development approach, and investments for better urban governance, gender equality, private sector participation and capacity building to achieve poverty reduction and sustainable development in urban areas.

Case study 35. The Islamic Development Bank(IDB)

Overview

The Islamic Development Bank (IDB) was founded in 1973 and is a Multilateral Development Bank (MDB), established to foster the economic development and social progress of its member countries and Muslim communities in non-member countries in accordance with the principles of Shari'ah (Islamic Law).

The present membership of the IDB consists of 56 countries. The basic condition for membership is that the prospective member country should be a member of the Organisation of the Islamic Conference, pay its contribution to the capital of the IDB and be willing to accept such terms and conditions as may be decided upon by the IDB Board of Governors.

The functions of the IDB are to participate in equity capital and grant loans for productive projects and enterprises besides providing financial assistance to member countries in other forms for economic and social development. These loans are the means by which the IDB may finance urban development. The IDB is also required to establish a fund for assistance to Muslim communities in non-member countries.

How the financing tool is used

The IDB extends financing to its member countries for infrastructural projects such as roads, canals, dams, schools, hospitals, housing etc. both in the public and private sectors, which have an impact on the economic and social development of the member countries concerned. Such loans, in conformity with Shariah law, are interest-free and the IDB recovers its administrative expenses by levying a service fee.

Through a range of financing instruments, the IDB finances a variety of projects in the agricultural, industrial, agro-industrial and infrastructural sectors. The IDB also finances small and medium-scale enterprises (SMEs), micro-finance schemes etc. The instruments fall under following categories:

Loan financing

Loans are extended mostly to governments or to public institutions having the government guarantee and provide long-term financing for development projects in basic infrastructure and agriculture.

Technical assistance

The purpose of this assistance is to finance the acquisition of technical expertise to prepare or implement a particular project, or for the purpose of formulating policies, or for providing institutional support or human resources development and training.

Leasing

IDB procures the assets that constitute similar and independent items, such as machinery and equipment needed for lines of production in case of factory financing, power generation plants, or ships, etc. Then it leases them to the beneficiary for a specific period of time.

Instalment sale

IDB purchases the machinery/equipment needed for a certain project then re-sells it to the beneficiary adding a mark-up which is mutually agreed upon between the IDB and the beneficiary.

Istisna'a

This mode is applied in the financing of the manufacturing of goods and equipment, as well as in the financing of construction works.

Lines of financing

IDB extends lines of financing to the National Development Financing Institutions (NDFIs) or Islamic Banks (IBs) to promote the growth of small and medium scale enterprises, particularly in the industrial sector.

Equity participation

IDB participates in the capital share of productive industrial and agro-industrial projects that are economically and financially viable.

Murabaha

This mode of financing is used in the financing of foreign trade, both 'imports' and 'exports'. The IDB purchases the commodity requested and re-sells it to the beneficiary. In case of import financing, the period of financing is up to 30 months, while, in case of export financing, it may extend up to 120 months.

Profit sharing

Sharing is a form of partnership which involves the pooling of funds between the IDB and another party for the financing of a project, each partner obtaining a percentage of the net profit accruing from the venture. The profit accruing to (or loss incurred by) each partner is proportional to its share in the venture. This mode might be suitable for projects expected to have a high financial rate of return.

Decision-making regarding revenue spending/capital investment

A project or programme is deemed viable if it aims to create a critical mass of beneficiaries-cum-consumers that will, in the long run, support and sustain the local economy. In addition, any intervention by IDB must occur in areas or sectors that benefit or uplift a greater majority of people. The IDB has outlined three thematic priority areas for loans, the third of which is clearly relevant to urban economic development. They are:

i) Agriculture.

ii) Human development.

iii) Infrastructure.

Given the dynamism and competitiveness of the operating environment in the middle-income and high-income countries in which the IDB often invests, the Operations Department continuously assesses the market conditions in these countries with a view to enhancing its niche and strategic position

Case study 36. European Investment Bank (EIB)

Overview

Instituted by the Treaty of Rome and created in 1958, the European Investment Bank (EIB) is the European Union's financing institution. It contributes to European integration and the economic development of the less-favoured regions. The EIB mission is to contribute to integration, the balanced development of the common market and to economic and social cohesion by drawing on the capital market and its own resources. Its aim is not to make a profit but, through the assistance it provides, to facilitate the implementation of public and/or private investments and attract other investments for the projects that it supports. In this way it plays an important role in local economic development. Although the projects the EIB funds can cover a wide range of subjects, they must be geared towards one of the following objectives:

- Development of the European Union's less-favoured regions.
- Modernisation of businesses and creation of new activities which cannot be entirely covered by national funding resources.
- Aid for investment in infrastructures of Community interest which, as a result of their scope or nature, cannot be funded by one Member State alone.

Funding local economic development clearly falls within the scope of all three of these objectives. In 1994 the European Investment Fund (EIF) was set up to support the development of high-growth small and medium-sized enterprises (SMEs) and/or those active in new technologies. The EIB is the majority shareholder and operator of the EIF. In 2000 the EIB Group was created, consisting of the EIB and the EIF. Within the Group, the EIB grants medium and long-term bank loans, while the EIF specialises in venture-capital operations and providing guarantee for SMEs.

The European Investment Bank is composed of the Member States which subscribe to its capital. Since 1 May 2004, with the accession to the European Union of the ten new Central and East European Member States and the increase in Spain's subscription, this capital has stood at EUR 163.7 billion.

In 2005 the EIB provided EUR 47.4 billion in support, with the following geographical breakdown:

- EUR 42.3 billion (89% of the total) in the present Member States.
- EUR 2.2 billion (1.3% of the total) in the Mediterranean countries.
- EUR 1.4 billion (4% of the total) in the Western Balkans.
- EUR 756 million in Latin America and Asia.
- EUR 537 million in the African, Caribbean and Pacific countries (ACP States).
- EUR 60 million in Russia.
- EUR 156 million in South Africa.

In its corporate operational plan, the EIB sets out its medium-term policy and identifies its operational priorities in light of its objectives as laid down by its governors. For the 2006-08 period, lending activity is geared towards six priorities:

i) Economic and social cohesion in the enlarged EU (84% of loans).

ii) Implementation of the Innovation 2010 Initiative (i2i).

iii) Development of trans-European and access networks.

iv) Support for EU development and cooperation policies in partner countries.

v) Protection and improvement of the environment, including renewable forms of energy.

vi) Support for small and medium-sized enterprises, as well as mid-cap companies of intermediate size.

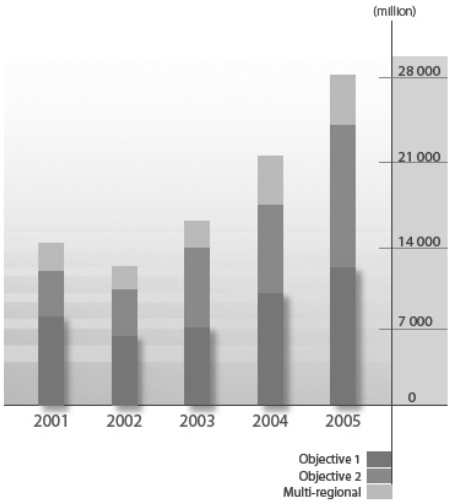
In addition to its main priorities, the EIB operational plan for 2006-08 mentions one priority which remains topical: support for human capital, notably in the health field.

Achieving economic and social cohesion

The development of the less-favoured regions is the European Investment Bank's main priority, and as such the EIB presents a more useful funding tool for cities and towns in the newer EU member states as opposed to cities such as London, Paris or Frankfurt. In 2005 it granted EUR 34 billion for projects in European Union regions receiving support from the Structural Funds, in particular under Objective 1 and Objective 2 (Chart 5.2).

Chart 5.2. Regional development in the EU

Individual loans in 2005: EUR 28.1 bn



Source: European Investment Bank, 2005.

Table 5.4. Regional development in the EU

Breakdown of individual loans by sector (2005), (million)

	Amount	Total %
Energy	2 885	10
Communications	12 857	46
Water and sanitation	1 530	5
Urban development	2 193	8
Industry, agriculture	2 824	10
Health, education	2 423	9
Other services	3 376	12
Total individual loans	28 088	100
Global loans	5 900	

Source: EIB Group's 2005 Annual Report, 2005.

The EIB is involved in programming Structural Fund assistance and also part-finances priority regional development programmes[1]. The main projects funded, as shown in Table 5.4 are:

- Communications infrastructures fostering the growth and creation of activities.
- Environmental protection projects.
- Improving the quality of life: urban revitalisation, public transport development, and construction and modernisation of health infrastructure.
- Extension, modernisation and establishment of service companies and industrial businesses.
- Adjusting the industrial base to face up to international competition.
- Promotion of human capital (health, education and social services).

The EIB is the main source of external funding in the new Member States. The EIB part-finances specific projects in the public and private sectors. It vets the technical, economic and financial feasibility of the projects and their compliance with Community legislation, in particular on the environment. The EIB supports foreign direct investment (FDI) by European businesses and grants global loans to local commercial banks helping businesses to develop. As a rule it contributes up to 50% of the total cost of the project. Additional non-repayable grants may be provided under Community programmes.

Implementation of the Innovation 2010 Initiative (i2i)

The EIB is involved in implementing the "Lisbon Strategy" defined by the Lisbon European Council in March 2000, aimed at transforming the Community into a knowledge-based economy. Since the launch of the new Innovation 2010 initiative the EIB has already signed loans worth EUR 34.8 billion. The European Investment Fund is also supporting i2i by participating in venture-capital funds. In 2005 loans worth EUR 10.7 billion were signed in the three areas covered by the initiative: innovation, research and development (6.2 billion), education and training (2.3 billion) and information and communications technology (1.9 billion).

Operations under i2i focus on four key areas:

i) Research, development and innovation: The EIB supports public and/or private research programmes and centres of excellence that provide SMEs and mid-cap companies of intermediate size with easier access to research programmes.

ii) Development of innovative SMEs and entrepreneurship: The EIB encourages the use of venture-capital through the EIF.

iii) Human capital formation: The main measures are the computerisation of universities and other higher education establishments and loans for training centres.

iv) Information and communications technology networks: The EIB part-finances broadband and multimedia trans-European networks and the physical or virtual infrastructures for local access to these networks. It also supports the production and distribution of European audiovisual works. The "i2i audiovisual" initiative is coordinated with the Commission's MEDIA Plus programme[2].

Development of trans-European networks

The EIB also provides major support for funding trans-European networks (TENs). During the period 1993-2005, it lent EUR 69 billion for transport TENs and EUR 9 billion for energy TENs. In 2005, the EIB activities in support of TENs and corridors amounted to EUR 7.7 billion in the EU and EUR 550 million in Romania.

The EIB played an active part in preparing the "European action for growth" approved by the European Council in 2003. This initiative is designed to boost Europe's long-term growth potential by stepping up investment in TENs, as well as in innovation and R&D. To support the European action for growth, the EIB has created a new TEN investment facility with the aim of investing EUR 50 billion in this sector between now and 2010.

Protection and improvement of the environment, including climate change and renewable forms of energy

In 2005, individual loans granted by the EIB to environmental protection projects accounted for a third of all individual loans, namely EUR 19.9 billion within the EU. The EIB is supporting investment in the environment focusing on:

- The urban environment (EUR 6.8 billion).
- Water treatment and pollution reduction (EUR 2.3 billion).
- Preventing climate change (energy efficiency and renewable forms of energy) (EUR 1.1 billion).
- Eco-efficiency and waste management (EUR 738 million).

EIB funding in this area of activity in the present countries of the European Union covers the following sectors:

- The urban environment: urban public transport networks (trams and underground railways) and urban renewal (social housing and protection of architectural heritage).
- Water and sanitation, improving air quality, energy saving and energy substitution.
- Solid and dangerous waste treatment projects.

In 2004, the EIB committed itself to increasing, by 2010, the proportion of its loans allocated to projects involving renewable forms of energy (solar, hydrogen, fuel cells, biofuels, ocean energy, etc.) to 50% of the total loans it grants to new power production projects.

As regards climate change, the EIB has launched three initiatives:

- The funding mechanism for climate change, which, thanks to a lending envelope of EUR 500 million, will support measures to control climate change implemented by European companies participating in the EU emissions trading scheme, in operation since 1 January 2005.

- The technical assistance facility for climate change, with an envelope of EUR 10 million, under which conditional grant assistance (non-repayable) will be provided.

- The pan-European carbon fund, which will involve the exchange of carbon credits, and is currently being finalised in discussions between the EIB and the World Bank.

Support for SMEs, as well as mid-cap companies of intermediate size, and support for human capital, especially in the health sector

The funding of investments in the health and education sectors has been one of the EIB's areas of activity since 1997. Human capital funding is now one of its top priorities, and in 2005 its loans in this field within EU-25 exceeded EUR 4 billion. The EIB provides medium and long-term funding for SMEs through global loans. These are credit lines made available to intermediaries (banks or other financial institutions), which use the product to support limited-size investment projects run, in many cases, by SMEs with fewer than 250 employees. In 2005, global loans in EU-25 reached EUR 9 billion, half of which was for SMEs.

The EIF, for its part, supports SMEs, either directly by providing resources through venture-capital funding, or indirectly by guaranteeing portfolios of loans to SMEs held by financial institutions or public guarantee agencies.

Support for the community's development aid and cooperation policies

The EIB is also active in urban areas of the Western Balkans (Albania, Bosnia and Herzegovina, Croatia, Serbia, Montenegro including Kosovo as defined by Resolution 1244 of the United Nations Security Council, and the Former Yugoslav Republic of Macedonia). Here, it mainly supports reconstruction and technical upgrading of transport, energy and environment infrastructure.

For more than 30 years the EIB has been supporting the economies of the ten Mediterranean partner countries (Algeria, Egypt, Gaza Strip/West Bank, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia and Turkey). It plays an important role in implementing the Euro-Mediterranean Partnership launched under the Barcelona Process in 1995. In 2002 the EIB launched a new initiative in collaboration with the countries concerned: the Facility for Euro-Mediterranean Investment and Partnership (FEMIP).

In 2005 FEMIP loans amounted to EUR 2.2 billion up to 2006 (including EUR 900 million for Turkey). FEMIP is a major development in the EU's financial and economic cooperation in that the Mediterranean partners are more closely involved in implementation. It places emphasis on helping to foster private-sector activity in the region as a way to underpin growth and generate employment opportunities. Financial support is directed towards private-sector projects and also public projects that help to create an enabling environment for the private sector to flourish.

Projects financed under FEMIP can come from any of the eligible sectors:

- *Energy* - power generation, transmission and distribution, gas transmission and distribution, renewable energies;

- *Transport and communication* - airports, air transport, air traffic control, roads and highways, ports, bridges, telecommunications.

- *Environment* - water supply and treatment, waste water collection and treatment, solid waste disposal and treatment, pollution abatement, irrigation.

- *Human and social capital* - construction and equipment of hospitals, clinics and healthcare centres, construction and equipment of schools, technical and vocational colleges, social housing.

- *Industry, tourism and services* - industry and agro-industry, both large and small-scale (SME investments).

In November 2003, in the light of the positive results obtained during the first year of the FEMIP's operation, the Ecofin Council decided to set up a reinforced FEMIP (larger funding envelope and strengthening of the dialogue between the ministers of economic and financial affairs of the European countries and Mediterranean partner countries).

Under the European Union's foreign cooperation and development policies, the European Investment Bank is also active in the 77 ACP States. Signed in June 2000, the Cotonou Agreement lays down the framework for relations between the EU and these countries and enables the EIB to grant refundable financial assistance to support projects. Over the period 2003-07 the EIB will provide the ACP countries with support worth 3.9 billion, broken down as follows: 1.7 billion of loans from its own resources and 2 billion through the investment facility provided for in the

Cotonou Agreement. The projects funded are designed to promote the private sector and, in particular, the development of SMEs, the local savings markets and foreign direct investment.

Case study 37. European Bank for Reconstruction and Development (EBRD)

Overview

Since it was founded in 1990, the European Bank for Reconstruction and Development (EBRD) has played a pioneering role in the development and financing of private infrastructure investment in the countries of Central and Eastern Europe, the Baltics, and the former Soviet Union. The EBRD's mandate to foster the transition towards market-oriented economies and to promote private initiative uniquely positions it to facilitate and support private sector participation in the financing and provision of public infrastructure and services in its countries of operation.

It is owned by 61 member/shareholder countries, the European Community and the European Investment Bank and funded with a subscribed capital totalling EUR 20 billion (EUR 5 billion paid-in and EUR 15 billion callable[3]). The strength of the EBRD capital and its prudent operational and financial policies are reflected in the EBRD's credit rating of AAA from Standard & Poor's and Aaa from Moody's. Voting power is in proportion to the number of shares. Despite its public sector shareholders, it invests mainly in private enterprises, usually together with commercial partners.

Investment projects

EBRD provides project financing for banks, industries and businesses, both new ventures and investments in existing companies. It also works with publicly owned companies, to support privatisation, restructuring of state-owned firms and improvement of municipal services. The EBRD uses its close relationship with governments in the region to promote policies that will bolster the business environment.

Every EBRD investment must have the following characteristics:

- Help move a country closer to a full market economy: the transition impact

- Take risk that supports private investors and does not crowd them out
- Apply sound banking principles

Through its investments, the EBRD promotes:

- Structural and sectoral reforms
- Competition, privatisation and entrepreneurship
- Stronger financial institutions and legal systems
- Infrastructure development needed to support the private sector
- Adoption of strong corporate governance, including environmental sensitivity

Functioning as a catalyst of change, the EBRD:

- Promotes co-financing and foreign direct investment
- Mobilises domestic capital
- Provides technical assistance

How the EBRD finances its loan operations

The EBRD finances project lending and operational needs by borrowing funds on the international capital markets. The bank does not directly utilise shareholders' capital to finance its loans. Instead, the AAA/Aaa rating enables the EBRD to borrow funds in the international markets by issuing bonds and other debt instruments at highly cost-effective market rates. By raising funds on competitive terms, EBRD can structure loans which best match the requirements of its clients in its countries of operation.

The EBRD manages its liabilities such that it does not incur foreign exchange or interest rate risk in its funding operations. It interacts with all major capital market participants on a daily basis in order to ascertain which market, currency or structure of debt can provide the EBRD with the most efficient cost of financing.

EBRD's securities are sold to investors, such as central banks, pension funds, insurance companies and asset managers around the world.

It is EBRD's Treasury department that is responsible for funding the bank in the international capital markets and managing liquid assets held in anticipation of disbursements and overall asset and liability management. The Treasury ensures that the bank has a stable source of income at all times.

Case study 38. Council of Europe Development Bank (CoEDB)

Overview

Set up in 1956, the Council of Europe Development Bank CoEDB is the oldest multilateral financial institution in Europe. Formerly known as "Council of Europe Social Development Fund", the bank adopted its new name in November 1999.

The CoEDB is administered under the supreme authority of the Council of Europe but is legally and financially autonomous. The CoEDB has 38 member states, including 14 central and eastern European countries. The CoEDB extends long-term loans and guarantees to its member states, to local authorities and to public or private financial institutions in order to finance social projects.

The CoEDB mission is:

- To contribute to strengthening social integration, in particular by providing aid to refugees and migrants, increasing the amount of available social housing, improving living conditions in urban and rural areas and fostering job creation and preservation.

- To participate in responsible management of the environment, through preventative action and aid to regions hit by natural or ecological disasters; the construction or rehabilitation of infrastructures for water supply and the treatment of liquid and solid waste; the production of clean and renewable energies; and the protection and rehabilitation of historic heritage,

- To provide support for developing human capital through projects in the education and health sectors.

The first part of this mission statement is clearly particularly relevant to the funding of local economic development. By the end of 2005, the CoEDB had a

subscribed capital of EUR 3 294 million shared between 38 member states and reserves totalling almost EUR 1 236 million.

Financing investment

The CoEDB does not receive any aid, subsidy or budgetary contribution from the member states to finance its activities. The necessary resources are raised on the international capital markets in the form of borrowings[4]. For its borrowing activity, the CoEDB has been rated by Moody's since 1988, by Standard & Poor's since 1989 and by Fitch Ratings since 1996. It enjoys the maximum AAA rating with all three agencies on its principal long-term debt and A1+/P1 on its short-term debt.

Case study 39. Joint initiatives by the European Commission, the European Investment Bank and the European Bank for Reconstruction and Development

Overview

With the enlargement of the European Union to include new Member States, virtually all regions in these countries are covered by the top priority Convergence Objective for aid provided under the EU Structural Funds. The European Commission has joined forces with the European Investment Bank and the European Bank for Reconstruction and Development (EBRD) to develop a new technical assistance initiative designed to improve the preparation of projects proposed for financing by EU funds and help the Member States to use the grant finances provided by the Union more rapidly and more effectively.

Three new initiatives were officially launched in May 2006 (JASPERS, JEREMIE and JESSICA). The initiative JESSICA (Joint European Support for Sustainable Investment in City Areas) is most relevant to cities.

- JASPERS (Joint Assistance in Supporting Projects in European Regions) aims to improve the preparation of major projects to be co-financed by the Cohesion Fund and the European Regional Development Fund (ERDF), in particular in the new Member States, during the next period 2007-13. It foresees using the technical and financial expertise of the banks to strengthen the capacity of national and regional authorities, helping them to deliver high-quality project proposals which will make efficient use of EU funds and mobilise additional sources of funding.

- JEREMIE (Joint European Resources for Micro to Medium Enterprises) aims to improve access to finance for small and medium enterprises (SMEs), and in particular the supply of micro credit, venture capital, loans or guarantees and other forms of innovative financing. It is aimed especially at micro to medium-sized enterprises. JEREMIE means that SMEs in all regions will be able to benefit from tailored financial engineering products. It is a direct response to the challenge of continuous economic adjustment, and in this context the JEREMIE Memorandum of Understanding organises the joint approach between the Commission and the EIF.

- JESSICA (Joint European Support for Sustainable Investment in City Areas) aims to promote sustainable investment, and growth and jobs, in Europe's urban areas. It plans to spend EUR 308 billion[5] over the next six years across the EU, mainly in Eastern Europe, for urban development and renewal, or social housing where appropriate, with the loans and the expertise of the banks for urban development and renewal, including social housing. The banks have also committed themselves to a more streamlined approach to lending in this field of urban development, making it more user-friendly for end-users.

How JESSICA works

JESSICA will offer the managing authorities of Structural Funds programmes the possibility to take advantage of outside expertise and to have greater access to loan capital for the purpose of promoting urban development, including loans for social housing where appropriate. Where a managing authority wishes to participate under the JESSICA framework, it would contribute resources from the programme, while the EIB, other international financial institutions, private banks and investors would contribute additional loan or equity capital as appropriate. Since projects will not be supported through grants, programme contributions to urban development funds will be revolving and will help to enhance the sustainability of the investment effort. The programme contributions will be used to finance loans provided by the urban development funds to the final beneficiaries, backed by guarantee schemes established by the funds and the participating banks themselves. No State guarantee for these loans is involved; hence they would not aggravate public finance and debt.

Notes

[1] www.ifc.org/municipalfund

[2] IFC promotes economic development by providing equity, long-term loans, structured finance and risk management products, and advisory services to sustainable projects in developing countries without accepting government guarantees. In the year up to June 2004, IFC committed USD 4.8 billion for 217 projects in 65 countries.

[1] In January 2000 the Bank signed a partnership agreement with the European Commission giving the EIB a greater say in the technical and financial assessment of projects.

[2] MEDIA is the EU support programme for the European audiovisual industry. From 2001-06, more than half a billion Euros were injected into 8 000 projects from over 30 countries. The new MEDIA 2007 programme (2007-13) is the fourth multi-annual programme since 1991 and has a budget of EUR 755 million (http://ec.europa.eu/information_society/media/overview/2007/index_en.htm).

[3] The powers of the EBRD are vested in the Board of Governors to which each member appoints a governor, generally the minister of finance. The Board of Governors delegates most powers to the Board of Directors, which is responsible for the EBRD's strategic direction. The President is elected by the Board of Governors and is the legal representative of the EBRD. Under the guidance of the Board of Directors, the President manages the work of the Bank.

[4] In 2005, the Bank borrowed a total amount of EUR 2.6.billion, broken down into 14 funding operations, with maturities of 1 year or more, including six reopenings of existing issues. This amount, superior to the funding volume in 2004 meets two main objectives: to cover lending needs, similar to those in 2004, and to meet the Bank's repayment of maturing debt, which in 2005 was noticeably more important than in 2004. 81% of the funds raised in 2005 came from the American dollar market. The average maturity of issues launched during this financial year is of 5 years.

[5] Macdonald, Stuart (2007), "Grow money grow", www.regeneratelive.co.uk/story.asp?sectioncode=697&storycode=3081829&c=1&encCode=00000000012a90e3.

6 FOUNDATIONS AND NGOs

Foundations and NGOs are an important and growing source of financial resources for local development. Because they are private and not for profit they are often able to innovate and to be patient. This allows for the growth of specialist intermediaries that can take forwards local development supported by charitable resources. Such resources have played an important part in building up local community development corporations in the USA, and other locally based groups around the world.

Local development is becoming more popular as an instrument of philanthropic giving because it provides access to jobs and other income earning activities which can help make attempts to tackle poverty more likely to succeed.

Case studies of five initiatives are cited here:

Theme	Case Study	Example
1.	**Foundations and NGOs**	
	40	Ford Foundation
	41	Local Initiatives Support Corporation
	42	Open Society Institute and the Soros Foundations Network
	43	Gatsby Foundation
	44	Annie E Casey foundation

Case study 40. Ford Foundation

Overview

Founded in 1936 by Edsel Ford and two Ford Motor Company executives, the Ford Foundation is an independent, non-profit, grant-making organisation, which for

more than fifty years has worked to strengthen democratic values, reduce poverty and injustice, promote international cooperation, and advance human achievement. Headquartered in New York, the Foundation also makes grants to approximately 50 other countries through offices in Africa, Asia, Latin America and Russia. Table 6.1 shows a breakdown of grants made by each of the foundation's programme areas in 2005.

Table 6.1. Worldwide Ford Foundation offices

International Office	Year Created	2005 Grants (USD millions)
New York Headquarters	1936	324.6
Cairo	1959	17.7
Lagos	1960	8.9
Rio de Janeiro	1962	10.7
Mexico City	1962	13.5
Santiago	1963	10.8
Nairobi	1963	12.5
Johannesburg	1993	15.9
Moscow	1996	10.8
Total grants expenditure		**425.4**

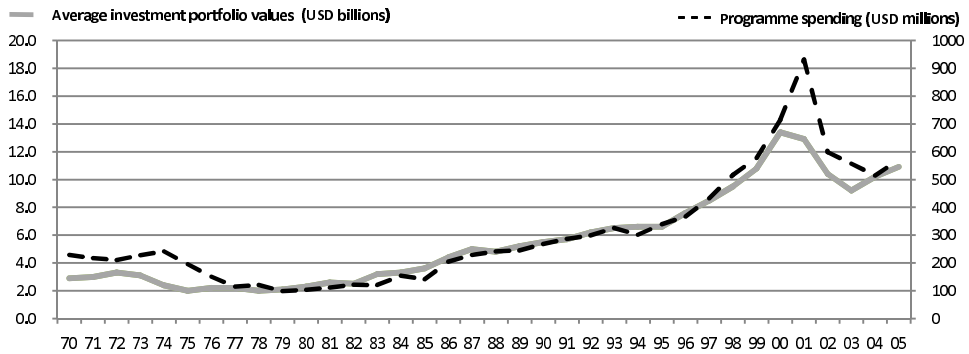
Source: Ford Foundation, Annual Report, 2005.

Investment

Since its inception, the Foundation has provided more than USD 12 billion in grants, projects and loans. Each year Ford receives about 40 000 proposals and makes some 2 000 grants. Requests range from a few thousand US dollars to millions of US dollars and are accepted in categories such as planning grants, project support, general support and endowments.

The level of programme spending by the foundation is related to the value of the endowment. Chart 6.1 shows this relationship, starting in 1970, and indicates how, in recent years, programme spending has exceeded the growth in investment portfolio values.

Chart 6.1. Average investment portfolio values



Source: Ford Foundation, Annual Report, 2005.

Grant making is focused into three complementary programme areas, the first of which is especially relevant to supporting local economic development:

- Asset Building and Community Development,
- Peace and Social Justice,
- Knowledge, Creativity and Freedom.

Table 6.2 shows the programme approvals in 2005.

Table 6.2. Programme approvals in 2005

USD millions

Asset building & community development	142.1[a]
Peace & social justice	205.2[a]
Knowledge, creativity & freedom	161.6[a]
Foundation-wide actions[b]	22.1
Programme-related investments	22.0
Total programme approvals	553

Notes:
a. These totals include USD 25.4 million in Programwide Actions, including USD 2.2 million in Asset Building &Community Development, USD 19.8 million in Peace & Social Justice, and USD 3.4 million in Knowledge, Creativity & Freedom.
b. Includes USD 1.1 million in Good Neighbor Grants.

Asset Building and community development

The Asset Building & Community Development programme is a recognised leader in the field and provides support for efforts to build human, social, financial and environmental assets that enable people and their communities to expand opportunities and participate more effectively in their societies. The Asset Building and Community Development Programme is divided into two parts: Economic Development and Community and Resource Development.

Economic development

The Economic Development unit aims to make durable economic improvements in the lives of the disadvantaged. The unit coordinates efforts in two fields:

i) *Development finance and economic security*: by supporting organisations that help businesses to create employment opportunities and help low-income people to acquire, develop and maintain savings, investments, businesses, homes, land and other assets.

ii) *Work-force development:* supporting organisations that help to improve the ways low-income people develop marketable job skills and acquire and retain reliable employment that provides liveable wages.

The Economic Development unit administers programme-related investments (PRI's) for the foundation's programmes. PRI's are usually loans, although they may also be loan guarantees or equity investments. The primary purpose of these investments is to help meet the credit needs of organisations in low-income communities that lack capital to finance important projects. The distinguishing feature of PRIs is that, unlike grants, they are recoverable.

PRIs help recipients close credit gaps, leverage additional financing from other public and private sources, and accumulate assets. In this way, they help build strong, sustainable development organisations. Examples of such investments are reported in Table 6.3.

In all these units, grant making also helps to establish and fortify organisations and institutions that support asset building and the expansion of livelihood options through research, practical innovation, training, policy analysis and advocacy. Grant making aims to help low-income people and communities build the financial, human, social and natural assets they need to overcome poverty and injustice.

Table 6.3. Ford Foundation's programmes, United States and worldwide

Investment	USD m	Description
Community Foundation Land Trust	2.0	To enhance the trust's ability to acquire land and make housing affordable to low-income residents of the Los Angeles Metropolitan Area.
Council for Adult and Experiential Learning	2.0	To provide working capital to extend workplace tuition benefits for front-line workers.
Friends of WWB, India	2.0	To provide partial capitalisation of a loan fund to build the capacity of microfinance institutions in India to provide financial services to poor women.
Independent Press Association	1.5	To provide working capital for the Independent Press Development Fund.
National Community Capital Association	3.0	To develop a national financing programme to improve the quality and availability of financing for manufactured housing throughout the United States.
New Hampshire Community Loan Fund	3.0	To increase the capitalisation of a revolving loan fund to respond to the rising demand for financing of resident-owned manufactured housing communities.
New York City Affordable Housing Acquisition Fund, LLC	4.0	To help capitalise a guarantee fund for the development of low-income housing in New York City.
Savings and Credit Cooperative (Fortalecer)	1.5	To capitalise a loan and guarantee fund to promote the development of microfinance institutions serving the low-income rural population of Peru.
Structured Employment Economic Development Corporation	3.0	To provide partial capitalisation to the Borrower's Community Partnership Loan Fund to finance loans to non-profit organisations and small businesses.
Total Programme-Related Investments	22.0	

Case study 41. Local Initiatives Support Corporation

Overview

Since the 1960s in the United States, community development corporations (CDCs) have been working to achieve economic and social revival of low income areas. Operating as non-profits within the civil society, CDCs undertake housing and commercial development projects. They start their own businesses and, increasingly, provide capital to other businesses in their target areas. CDCs raise funds from

government, foundations, corporations, and religious institutions and, in turn, invest the money back into their communities.

In support of CDCs, since 1980, a brigade of professional support groups has grown up to assist them. Known as intermediaries, these organisations operate both on a national and local level. Intermediaries provide two basic types of support – funding for community development initiatives and technical assistance and training. Intermediaries connect CDCs with powerful corporations, banks and other institutional resources. They develop standard financing and production models to help CDCs achieve efficiencies of scale.

Local Initiatives Support Corporation (LISC)

One of the most prominent US intermediaries is the Local Initiatives Support Corporation (LISC). Launched in 1979 with USD 10 million from the Ford Foundation and six corporate sponsors, LISC provides loans, grants, equity investments and technical assistance to its large network of community development groups in cities and rural areas nationwide. Since its creation, unlike other intermediaries, LISC was committed not only to housing production but to a broad concept of community development and, thanks to the work of its first president, Mitchell Sviridoff, LISC's assets grew quickly.

During these years, LISC has spawned several subsidiary organisations. In 1986 LISC started the Local Initiatives Managed Assets Corporation as a secondary market for housing and economic development loans to its affiliated groups. Created in 1987, LISC's National Equity Fund (NEF) organises limited partnerships to purchase equity in housing developments that qualify investors for Low Income Housing Tax Credit. The Retail Initiative, begun in 1992, manages a commercial equity fund and helps CDCs plan large scale retail developments. In 2000 LISC provided start-up capital for the Community Development Trust, the first real estate investment trust created solely for the purpose of acquiring community development assets.

Investment Projects

LISC operates in six strategic areas:

Housing

This strategy, which includes financing, technical assistance and educational resources to CDCs, has resulted in the creation or preservation of more than 160 000

affordable homes and apartments. Affordable housing covers a range of issues, from homeownership to preservation to working with public housing agencies. LISC runs a variety of national programmes to address these issues. Through its subsidiary organisations, LISC run the following programmes:

i) *Low Income Housing Tax Credits*, run by LISC's affiliate, National Equity Fund, Inc. (NEF), which is the US's largest non-profit syndicator of the credits, provides equity capital for multifamily housing projects. Since its foundation in 1987, NEF has been involved in developing 1 400 affordable housing developments in 250 urban communities and rural areas, investing nearly USD 5 billion.

ii) *Public housing*, run by the Housing Authority Resource Centre (HARC), was started by LISC in1998, to create relationships between local housing authorities and other community developers, and CDCs, both nationally and in neighbourhoods across the country. By providing access to best practices, information, and training, LISC has helped connect these worlds to develop creative and collaborative solutions to local problems. HARC teams with local LISC offices and NEF to build the development capacity of local housing authorities that are considering public housing redevelopment, new housing development, and commercial revitalisation and identifies financing and partnership structures that will leverage public resources with private investment.

iii) *Housing preservation.* LISC established the Affordable Housing Preservation Initiative in 2001 to strengthen efforts toward the preservation of affordable rental apartments whose uses were in jeopardy because of expiring federal subsidies, and to promote preservation-oriented public policies. Since then, LISC has helped non-profit community development corporations acquire and preserve housing developments, build partnerships with housing authorities and other organisations, and advocate for government policies that can reduce the loss of affordable homes and apartments. To date, LISC has committed USD 56.1 million to support the preservation of 15 000 affordable homes in urban, suburban, and rural communities.

iv) *Vacant properties.* LISC Vacant Properties Initiative (VPI) helps communities intervene in the cycle of property abandonment to stabilise and revitalise neighbourhoods. VPI provides practitioners and policymakers with models, research, and technical assistance to support efforts to improve systems, policies, and practices that can help prevent

abandonment and return vacant properties to productive use. In 2003 LISC VIP co-founded the National Vacant Properties Campaign with other US organisations with the aim to elevate the issue of vacant properties among policy makers, and build the knowledge base by developing a national network of vacant property practitioners and experts via annual forums, workshops, and list serves.

Rural

In order to expand its reach beyond urban areas to include rural communities, LISC launched Rural LISC in 1995. Rural LISC, recognising that rural communities' needs are not focused on agriculture alone, provides a wide range of services to rural community developers. Currently, Rural LISC provides nearly 100 partner CDC's across the country with training, technical assistance, information and financial support to address the problems rural communities face.

Economic development and safety

LISC helps CDCs develop retail and commercial facilities, train and place neighbourhood residents in jobs, and organise anti-crime efforts, all of which are essential for healthy neighbourhoods. Through the Centre for Commercial Revitalization (CCR), established in 2003 in order to stimulate development and renewal of neighbourhood business districts, LISC currently manages a network of more than 35 local community business district revitalisation programmes in 16 cities across the country. Furthermore, LISC's New Markets Support Company helps community organisations attract new businesses to underserved neighbourhoods through use of federal New Markets Tax Credits. The credits are designed as incentives for investors to support projects in communities that have a demonstrated need for additional business development. Helping troubled neighbourhoods to address issues of persistent crime, disorder and fear is the LISC's Community Safety Initiative (CSI) mission. CSI builds formal long-term partnerships between police and CDCs by linking innovative policing with strategic economic development. These unconventional allies attract the kind of social and financial investments that make communities safer and more vibrant. Since its inception, nearly a decade ago, CSI has made great strides in reducing crime and strengthening neighbourhoods in more than a dozen communities in nine cities.

Education, children and youth

Through years of work on community development, LISC came to see child care as critical to community revitalisation. LISC leaders realised that affordable child care is necessary for parents to find and maintain employment. In 1995, LISC created the National Child Care Initiative, a pilot project that would ultimately become Community Investment Collaborative for Kids (CICK). Initially, the National Child Care Initiative focused on supporting community development corporations working to improve the quality and supply of child care. It quickly became evident however, that increasing the supply of child care requires a particular set of skills and knowledge, and a different group of partners than traditional community development projects. Therefore, the focus of the National Child Care Initiative was broadened to include diverse groups such as child care providers and policy makers.

The initial pilot programme officially became CICK in 1998. CICK creates state and local collaborations that secure funds for and provide technical assistance to child care providers to build and renovate child care facilities. Through public policy development and advocacy, CICK works to develop new sources of capital subsidy for facilities. Once a dedicated funding stream is available, CICK works to enable child care providers to use these funds. CICK's current activities involve financing centre, and family-based child care facilities, training providers on how to access capital resources, and providing technical assistance to organisations seeking to develop new child care facilities. CICK works closely with providers through all phases of construction.

Since 1994, CICK has secured nearly USD 19 million in planning and developing more than 120 new facilities serving 11 000 children in lower-income urban and rural neighbourhoods nationwide. That investment has generated an additional USD 90 million in public and private resources for these projects. In 2003, LISC founded the Educational Facilities Financing Centre (EFFC) to intensify its efforts in the area of educational facilities financing. The EFFC supports quality public charter and alternative schools in low-income neighbourhoods as part of LISC's mission of helping community organisations transform distressed neighbourhoods into healthy ones. LISC uses a three-pronged strategy to help bridge the facilities finance gap faced by charter and alternative public schools. This strategy consists of financing individual schools through its network of 33 local offices, supporting the development of local educational facilities funds and non-profit charter school networks through its EFFC investments, and fostering public policy initiatives in the facilities finance arena.

Organisational and professional development

In addition to helping CDCs finance their projects, LISC helps make the groups more efficient and productive through training programmes and learning opportunities for their staff and leadership. LISC also uses a federally funded national service programme to place volunteers at CDCs, where they perform service and gain community development experience that prepares them for careers in the field. LISC created the Organizational Development Initiative (ODI) in 1996 to provide training, tools and technical assistance for improving the day-to-day operations and management of LISC's partner CDCs. Since its inception, ODI has trained more than 2 000 CDC staff and board members, and conducted comprehensive organisational assessments of over 100 organisations.

In 1994 LISC began its sponsorship of an AmeriCorps programme as an additional strategy to help CDCs help themselves. LISC AmeriCorps is part of the National Service Network, administered by the Corporation for National and Community Service. Members help promote volunteerism and civic engagement by encouraging neighbours to take active roles in helping to transform their communities. LISC AmeriCorps members help to develop affordable housing and provide home ownership counselling to prospective first-time low-income homebuyers. They also participate in community building activities in neighbourhoods and with residents to form crime watches, neighbourhood groups, tenants associations and collaborations between local service providers. Members work with youths to provide opportunities to participate in sports, other recreation programmes and after school activities that include tutoring, homework assistance and reading enrichment for underachieving students. Since its inception, the programme has enrolled more than 1 000 members in 15 cities from Boston to Los Angeles.

Policy

LISC maintains an active public policy presence at the federal, state and local levels. The objectives of LISC's policy initiatives are established through careful collaboration with its local offices and LISC's Public Policy Advisory Committee. LISC's policy office assists local programme offices, along with rural and urban CDCs, with the advocacy process, while working with other national and state organisations on wide-ranging community development issues.

Since 1980, LISC has marshalled more than USD 7.1 billion from 3 100 investors, lenders and donors. In over 300 urban neighbourhoods and rural communities nationwide, it has accomplished the following outcomes:

- 196 000 affordable homes and apartments.
- 27 million square feet of retail and community space.
- 72 000 jobs.
- 1 150 businesses assisted.
- 53 supermarkets, farmers markets and mercados developed.
- 120 child care facilities supported for 11 000 children.
- 136 playing fields renovated for 120 000 children.
- 70 schools financed for 25 000 youths.

Partnerships

Neighbourhood revitalisation is, by necessity, a collaborative process, requiring the participation of individuals, private enterprises, government agencies, civic associations and other organisations. The business of community development is simply too complex for any one organisation to master independently. Since 1980, LISC has been privileged to develop partnerships with a number of national organisations whose commitment to community development has been influential, unshakeable and invaluable. Partnerships with the groups listed below have enabled LISC to share resources, expertise and strategies on issues such as disposing of vacant properties, bringing Internet access to underserved communities, and establishing data banks of best community development practices, to name a few. All have served to advance the industry. None would have been feasible through the efforts of any single company or effort. Approximately one-third of LISC funding comes from foundation grants; one-third from corporate grants, especially from the financial services sector; and one-third from government agencies.

The US Department of Housing and Urban development (HUD) affirmed CDCs' growing importance in the 1999 State of the Cities report. "Today's successful revitalisation initiatives operate on a smaller scale than the large federal programmes of the past," the report noted. "They focus on the neighbourhood level and are much more local and more personal. [HUD] continues to refashion federal programmes to support and encourage the work of community-based organisations" (State of the Cities 1999: 45-46). HUD is also apparently putting its money where its

mouth is. The percentage of federal housing dollars flowing to CDCs and allied non-profit housing groups grew from 16% in 1990 to 37% in 1995 (Walker and Weinheimer, 1999).

LISC has made important contributions to the civil society – and to better governance in the United States. Their chief contribution has been to pioneer an innovative approach to fighting poverty – stressing local action, flexibility, alliances with public and private sector institutions, and interventions on multiple fronts to attack distress. LISC's community-based approach, considered so novel when it began in the 1980s Great Society era, is now widely viewed as the nation's best strategy for revitalising poor areas. In no small measure, this is because the community development strategy has adapted with changing times and draws wide political support from across the conservative to liberal spectrum.

Case study 42. Open Society Institute and the Soros Foundations Network

Overview

Starting in 1984, investor and philanthropist George Soros established a network of foundations in Central and Eastern Europe and the former Soviet Union to help countries make the transition from communism. Today this network encompasses more than 60 countries, including the United States[1].

The Open Society Institute (OSI) was created in 1993 to support the Soros Foundations. It is a private operating and grant-making organisation aiming to shape public policy to promote democratic governance, human rights, and economic, legal, and social reform. On a local level, OSI implements a range of initiatives to support the rule of law, education, public health, and independent media. At the same time, OSI works to build alliances across borders and continents on issues such as combating corruption and rights abuses.

OSI and the Soros foundations have given away more than USD 5 billion to build open and democratic societies, including USD 369 million in 2005. The Open Society Institute in New York[2] and the Open Society Institute–Budapest[3] each administer a number of initiatives and assist the other organisations and foundations in the Soros foundations network with administrative, financial, and technical support.

OSI initiatives

OSI initiatives cover a range of activities aimed at building free and open societies, including grant-making, to strengthen civil society; economic reform; education at all levels; human rights; legal reform and public administration; media and communications; public health; and arts and culture. Currently there are more than 30 initiatives running. Many Open Society Institute initiatives are established with predetermined life cycles and funding levels. Over the years, several of them have been either closed down completely or spun off as entities that are no longer affiliated with OSI.

The Local Government and Public Service Reform Initiative

The Local Government and Public Service Reform Initiative (LGI) is an international development and grant-giving organisation within the Soros/Open Society network of foundations. Its mission is to promote democratic and effective government in Central and Eastern Europe and the former Soviet Union by supporting research and operational activities in the fields of decentralisation, public policy formation, and the reform of public administration systems.

LGI seeks to fulfil its mission by developing sustainable regional networks of institutions and professionals, supporting comparative and regionally applicable policy studies tackling local government issues, and delivering technical assistance to implementing agencies. It also provides assistance to Soros foundations in countries throughout the region, develops curricula and organisation of training programmes, and publishes books, studies, and discussion papers on decentralisation, public administration, and good governance. LGI has also begun to support policy centres and think tanks in the region. Since 1999 LGI has focused more of its efforts on in-house policy analysis and research projects, with the intention of becoming a fully-fledged think tank in the next few years.

LGI develops and funds in-depth policy studies, particularly those that are regional and comparative in scope. Activities in this field fall into several policy areas:

- Public administration and legislative reform.

- Government and governance issues of ethnic and multicultural policies; corruption, transparency, and ethics in public administration; public participation in government; and development of civil society.

- Municipal fiscal issues assisting transition economies carrying out reform of intergovernmental fiscal relations; improved financial good governance and increased financial autonomy of sub-national governmental units.

- Public service management in urban services and social policy.

- Local economic and regional development, urban development.

LGI works closely with other international organisations, including the Council of Europe, the Department for International Development, USAID, UNDP, and the World Bank. Under these cooperation agreements, LGI co-funds larger regional initiatives aimed at supporting reforms at the sub-national level. The Local Government Information Network (LOGIN) and Fiscal Decentralisation Initiatives (FDI) are two examples of this cooperation.

Case study 43. The Gatsby Foundation

Overview

The Gatsby Foundation is an endowed grant-making trust founded over 30 years ago with general charitable objectives. The Foundation's capital - its expendable endowment - has all been provided by the founder. The Trustees make grants by using the income and occasionally by drawing on the capital. They do not raise money from the public or elsewhere. The Foundation makes grants for charitable activity which it hopes may make life better for people, especially those who are disadvantaged**.**

Grants are made in a number of fields of interest, which for 2007 financial year:

- Science and Engineering Education.

- Plant Science.

- Cognitive Neuroscience.

- Mental Health.

- Disadvantaged Children.

- Local Economic Renewal: to support innovative approaches to enterprise generation and address barriers to social exclusion which underlie chronic economic failure in specific communities.

- Developing Countries: to promote environmentally sustainable development and poverty alleviation through selected programmes aimed at supporting basic agriculture and other enterprises in selected African countries.

- Arts.

Initiatives

In terms of Local Economic Development, the most relevant field which the Gatsby Foundation finances is Local Economic Renewal. The fund has an interest in locally led approaches to regeneration where the underlying theme is one of enterprise generation and support. In this context, they are particularly keen to explore the potential roles of Higher Education (HE) and Further Education (FE) institutions as catalytic agents of change.

For example, in the 2005-06 financial year, the Gatsby Foundation made grants to the following institutions:

- The Combined Universities of Cornwall were given GBP 155 000 towards the development and implementation of an Agri-Food Innovation Service, and to support a programme of SMEs for the Environmental Sector.

- The Impetus Trust was given GBP 100 000 towards the development of the charity.

- The Rich Mix Cultural Foundation was given GBP 150 000 towards the enterprise of the cultural centre.

- The Institute of Manufacturing and the Manchester College of Arts and Technology were both given grants of less than GBP 50 000.

Decision making processes

The Trustees make grants for charitable activity which they hope may make life better for people, especially those who are disadvantaged. The Trustees have chosen to concentrate their support in a limited number of fields of activity. These fields are adapted over time with the help of outside experts and through interaction with the organisations whose work has been helped by the Foundation.

Within their chosen fields the Trustees make grants for projects which they judge to have particular merit. Many of their grants are for projects which the Foundation has helped to initiate. It is the policy of the Trustees to rigorously evaluate programmes and projects and to carefully assess when the evaluations should most usefully take place. Generally the Trustees do not make grants to individuals.

Case study 44. The Annie E Casey Foundation

Overview

The Annie E. Casey Foundation was founded in 1948 and aims "to foster public policies, human-service reforms, and community supports that more effectively meet the needs of today's vulnerable children and families." In order to meet this aim, the Foundation makes grants that help states, cities, and neighbourhoods to fashion more innovative, cost-effective responses to these needs. Located in Baltimore, Maryland, the foundation is the 15th largest private foundation in the United States with assets of more than USD 3 billion. It ranks 19th in the nation for charitable giving.

Initiatives

The Annie E Casey Foundation uses its resources to forge collaborations among institutions, agencies, decision makers, and community leaders so they can work together to transform underprivileged neighbourhoods. The foundation funds research, technical assistance, and multi-site demonstrations that help service and support systems like public schools, juvenile justice agencies, and child welfare systems. It also directly delivers exemplary services, identifies and measures what works, and shares lessons learned with local communities. The Annie E Casey Foundation therefore has a variety of different action areas:

- *Transforming Neighbourhoods*: Building on Casey's history of system and community change investments in multiple communities and neighbourhoods, the foundation seeks to demonstrate that improving the quality of the places in which America's most vulnerable children and families live can make measurable and sustained improvements in their ability to survive and thrive.

- *Building Economic Success*: By investing in new models, best practices, evaluation, and policy research, Casey's goal is to promote specific strategies that enable parents to get jobs and advance in the workforce, increase their income, and build and protect a base of assets sufficient to secure a better future for their families.

- Using Data and Evaluation.

- Ensuring Racial and Ethnic Equity.

- Providing Direct Services.

- Reforming Public Systems.

- Providing Strategic Consulting.

- Strengthening Families.

The "transforming neighbourhoods" action strand is particularly relevant to the financing of local economic development. In this strand the foundation focuses on several key aspirations and approaches:

- Ensuring that children and families can connect to opportunities that help them succeed and be self-sufficient.

- Strengthening grassroots engagement and participation in local transformation activities as well as broader civic enterprises.

- Changing the futures for large numbers of at-risk children by helping their parents succeed in the present. We know that children do well when their families do well and that families do better when they live in supportive neighbourhoods and communities.

Examples of initiatives adopted include:

Making Connections

Making Connections is the flagship initiative of the Annie E. Casey Foundation's strategy to help children succeed based on the belief that the best way to improve outcomes for vulnerable children living in underprivileged neighbourhoods is to strengthen their families' connections to economic opportunity, positive social networks, and effective services and supports. Launched in 1999*, Making Connections* is a decade-long effort to demonstrate this theory in disinvested communities across the country, and in full partnership with residents, community-based organisations, local government and businesses, social service agencies, community foundations, and other funders.

Making Connections advances a two-generation approach. Sites are working to connect parents to good jobs and asset building opportunities and to ensure that their young children benefit from better health care, quality early childhood services, and more intensive support in the early school years.

Neighbourhood Development

Casey's neighbourhood development initiative advocates a more comprehensive, responsive approach to community redevelopment. Its approach focuses on people rather than buildings and on making redevelopment work to improve conditions for low-income families and children that are impacted by these activities. Casey's attention to responsible relocation and redevelopment efforts include not only the processes, practices, and policies of redevelopment, but, moreover, improving opportunities and outcomes for residents of targeted neighbourhoods, cities, and regions.

Strategies include:

- *Promoting responsible relocation* -- minimise the adverse impact of relocation on low-income families while providing services and supports to maximise better social and economic outcomes.
- *Promoting responsible redevelopment* -- increase the chances of residents experiencing positive results by creating diverse, mixed-income, mixed-use neighbourhoods that provide supportive environments for vulnerable families.
- *Promoting expanded access to regional opportunities* -- help connect vulnerable families to better housing, jobs, education, healthcare, and other

opportunities by fostering regional solutions to concentrated poverty and making it practical for residents to move to communities of choice.

- *Promoting partnerships for community development* -- catalyse medical facilities, universities, businesses and other entities with deep community ties to invest in their community's responsible redevelopment in ways where tangible benefits accrue both to low-income communities and to the institutions themselves

Decision making processes

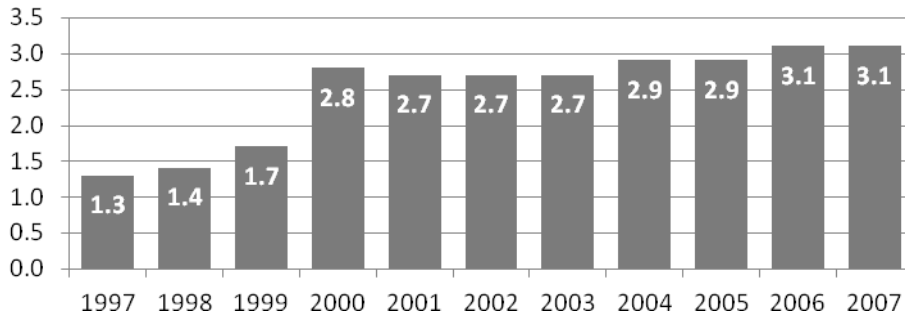
In general, grant making is limited to initiatives in the United States that have significant potential to demonstrate innovative policy, service delivery, and community support for disadvantaged children and families. Most grantees have been invited by the Foundation to participate in these projects. The Foundation's approach to grant making focuses on making multi-year, multi-site commitments that enable it to invest in long-term strategies and partnerships.

In addition, the Foundation has grants programmes specifically aimed at organisations located within Baltimore, and New Haven, Connecticut.

Initiatives

The Annie E Casey Foundation's assets have grown considerably in recent years (Chart 6.2), and as such, the value added to local economies has correspondingly grown as more money is available for the foundation's initiatives.

Chart 6.2. Ford Foundation total qualifying assets
(USD billions)



Note: These are projected numbers for 2006 & 2007. Actual results will differ.

Source: www.aecf.org/AboutUs/FinancialInformation.aspx, 2007.

Notes

[1] Soros foundations are autonomous institutions established in particular countries or regions to initiate and support open society activities. The priorities and specific activities of each Soros foundation are determined by a local board of directors and staff in consultation with George Soros and Open Society Institute boards and advisors. In addition to support from the Open Society Institute, many of the foundations receive funding from other sources.

[2] The initiatives administered by OSI in New York include the Economic and Business Development Programme, the Open Society Justice Initiative, the Public Health Program, the Scholarship Programmes, and the Women's Programme. OSI also operates the Central Eurasia Project/Middle East and North Africa Initiative, the Burma Project/Southeast Asia Initiative, and a number of programs in the United States.

[3] Initiatives based at OSI–Budapest include the Arts and Culture Network Programme, the Education Support Programme, the EU Monitoring and Advocacy Programme, the International Higher Education Support Programme, the Human Rights and Governance Grants Programme, the Local Government and Public Service Reform Initiative, and the Mental Health Initiative. The Budapest office, together with the CEU Centre for Policy Studies, supports the International Policy Fellowships programme. OSI–Budapest also operates programmes that seek to improve the situation of the Roma in Central and Eastern Europe with a special emphasis on the Decade of Roma Inclusion.

7 COMMERCIAL BANKS AND INVESTORS

Commercial banks and investment institutions are now also playing a key role in financiing local development. Often, this builds upon the success of public-private joint ventures that lead the banks inot recognsing valid new markets or niches where they were previously inactive. Pension funds have begun to play particular role in urban redevelopment and SME financing.

Catalan Banks have played a major role in financing the re-development of Barcelona. In New York City the financial services sector has been an important investor in community development successes, and fast growing smaller companies in Australia and New Zealand are seeing their growth supported by public and private venture capital programmes. In cities and regions across Europe, municipal pension funds are now significant investors in small capable firms and urban regeneration, banks are providing patient capital for disadvantaged entrepreneurs, social housing in poor neighbourhoods is regularly financed through private debentures, bonds, and EIB lending, community development organisations are starting to leverage bank lending for capitalisation projects, and businesses of all kinds are working together, and with the public sector, to invest in an improved public realm and quality of place.

We now know that investment opportunities that are principally localised and can be competitive for commercial finance when compared against other opportunities in business stocks and shares, government bonds, or other traditional investment instruments. However, there are credibility and profitability gaps, issues of scale and risk, and matters of cost and confidence, that have to be addressed if localities are to attract private investment over the long term.

It is noteworthy then that several institutions have decided to develop some specialised offer in terms of local and regional development finance. Below we citie some examples of indivdual banks working in this field and also some collaborations between a number of finanial institutions where risks an costs are shared.

Theme	Case Study	Region	Example
1. Commercial Banks and Investors			
	45	USA	New York City Investment Fund
	46	UK	Barclays Bank
	47	Italy	Lombardy Bank Foundation - Fondazione Cariplo
	48	Italy	Compagnia di San Paolo
	49	USA	California Public Employees Retirement System (CalPERS)

Case study 45. USA: New York City Investment Fund

Overview of the financing tool

One of the US's few corporate civic investment funds; the New York City Investment Fund has raised USD 100 million in capital under management since its establishment in 1996 under the auspices of the non-profit New York City Partnership & Chamber of Commerce.

How the financing tool is used

Over USD 100 million has been invested in over 70 projects. These projects have helped to create more than 2 750 jobs in New York City.

Decision making processes

The fund has built a network of experts from the investment and corporate communities who help identify and support New York City's most promising entrepreneurs in both the for-profit and not-for-profit sectors. Its investments typically range in size from USD 1 million to USD 3 million. The fund provides equity or debt, structured to meet the needs of the project. It will invest at any stage of business development, but typically seeks to exit in about five years. To date, the fund has invested in over seventy projects. The fund also established the Financial Recovery Fund and raised over USD 12 million (including a USD 1 million

contribution from the Civic Capital Corporation) to provide recoverable grants to small businesses impacted by the events of September 11.

The capital of the fund comprises three different funding sources:

i) About one third of the fund's assets are owned by a limited liability company, with investors who have effectively made an interest free, unsecured loan to the fund for a period of forty-five years.

ii) Another third of the assets are held by the Civic Capital Corporation, a public charity established to administer tax exempt contributions that have been donated to the fund. These investments are restricted to investment in eligible charitable activities such as economic development. These generally include: 1) projects located in economically disadvantaged areas, that employ local residents and contribute to the revitalisation of those areas; and 2) projects that support the health, education or research activities of the city's non-profit institutions. The fund has been recognised by regulators as an eligible intermediary under the Community Reinvestment Act (CRA)[1] and most of the charitable investments are CRA-related activities.

iii) The balance of assets are held by the New York Small Business Venture Fund I, II and III, certified capital companies that were organised to participate in a State programme that provides tax credits to insurance companies that invest in eligible activities. These funds are primarily for early stage venture capital investments.

The fund carries out its investment activity through industry Sector Groups. More than 200 top industry experts, drawn from the fund's investor network and other sources, volunteer their time and institutional resources to develop the fund's investment strategies, conduct due diligence and monitor portfolio projects. Sectors include: Communications; Health Care and Sciences; Information Technology; Media and Entertainment; Retail and Tourism.

Value added of the financing tool

The key criterion for investment is that the venture is likely to generate benefits for New York City and its communities. Priorities include job creation, revitalisation of distressed areas and innovative ideas or products that position New York at the cutting edge of growth sector industries. The fund invests in technology companies but only alongside an experienced lead venture capital investor. It is flexible in

terms of how it structures its investments. It provides subordinated debt to leverage other private capital or to maintain maximum ownership for management of minority-owned companies. When investing in a venture capital deal, returns are expected to equal those of other at-risk parties.

Case study 46. UK: Barclays Bank Urban and Regional Development Funds/Unit

Overview

Barclays Bank supports regional economic development through a special unit within Barclays Business Banking called the Urban and Regional Economic Development unit (URED). Established in 2001, the unit works to develop commercially viable products supporting economic development and regeneration by providing loans to SMEs.

How the financing tool is used

In November 2001, URED established four SME Investment funds covering Cornwall, Merseyside, South Yorkshire and Wales. Barclays provided GBP 84 million to these funds with a further GBP 116 million coming from European Structural Funds and local pension funds. The funds are designed to complement the work of government and regional development agencies.

Barclays have also allocated a further GBP 20 million of equity financing to support the new regional venture capital funds (RCVFs) which will provide smaller amounts of finance to companies than is normally offered by venture capital bodies.

Decision making processes re: funding

The main qualification criteria for receiving funding from one of the investment funds are:

- The loan must be between GBP 30 000 and GBP 7.5 million, to finance an investment project of between GBP 60 000 and GBP 15 million.
- The group comprising the borrowing company must have fewer than 500 employees and net fixed assets less than GBP 50 million.

- However, a subsidiary of a large group will qualify provided that the subsidiary itself employs fewer than 500 employees and is located in an assisted area.

- Loans for speculative property development are excluded.

In addition, in order to qualify for an investment, customers must prove they have already been declined funding from a financial institution.

Critical success factors

European Structural Funds make up more than half of URED's GBP 200 million total. Barclays Bank is therefore essentially acting as an intermediary for the European Investment Bank (EIB) in its programme of assistance to SMEs, and the continued involvement of the EIB is obviously critical for the success of the unit.

Value added by financing tool

The benefit of this scheme for the borrower is the provision of a one-off cashback payment on drawdown of a loan which forms part of a capital investment project.

Case study 47. Italy: Lombardy Bank Foundation- Fondazione Cariplo

Overview of the financing tool

The Fondazione Cassa di Risparmio delle Provincie Lombarde (Lombardy Provinces Savings Bank Foundation), also called Fondazione Cariplo (the Cariplo Foundation), is the direct descendant of the Cassa di Risparmio delle Provincie Lombarde (Lombard Provinces Savings Bank) which, throughout the nineteenth and twentieth centuries, became the largest savings bank in the world. The Cariplo Foundation was formally created in December 1991 as part of the restructuring process resulting from implementation of the Amato-Carli Law to rationalise and privatise Italy's lending institutions. The effect of the law was that savings banks were transformed into for-profit corporations whose shares would be owned by a new non-profit corporation, which adopted the title of 'fondazione' (foundations). When the foundation and Cariplo Spa (the for-profit corporation) split in 1991, the

foundation inherited the mission of operating on a non-profit basis, in the public interest and pro bono in several fields, including art, culture, education, scientific research, healthcare and disadvantage.

The strategic goal of the Cariplo Foundation is to become a leader in social and economic development within the locality it serves. The foundation wants to legitimise itself as a driving force for development but without abdicating its core activities, which have been, and still are, grant-making, proposing and stimulating independent and direct actions based on in-depth analysis and specifically targeting the Lombardy community and the areas where it has traditional links.

Other goals of the Cariplo Foundation include:

- Acting as an organisation which supports the development of local communities, in particular by backing those innovative activities that respond to new, unmet needs or provide novel answers to deep-seated needs, in fields and sectors not catered for by the public administration and private organisations. This is done by avoiding any traditional or outdated models.

- Fostering the formation and consolidation of independent, robust and efficient social entities that can autonomously take care of community needs. The action of the foundation is not geared to solving problems directly but to building the social ability to find solutions.

- Facilitating the resolution of community problems by acting as a catalyst for the parties involved. The foundation can be a true catalyst of local resources, a convener capable of bringing together all parties interested in satisfying a common need, finding solutions and activating responses which take into account the interest of all.

How the financing tool is used

The foundation makes grants in areas aiming to promote the social, cultural and economic fabric of the country, paying particular attention to the Lombardy area and its connected territories.

In relation to scientific research, innovation and technological transfer, the foundation also aims to contribute to the creation of a favourable environment by

supporting synergic actions that establish networks and partnerships and stimulate participation in international projects and the development of human resources.

The Cariplo Foundation makes three major types of grant:

i) Institutional grants that the foundation gives every year to important institutions such as La Scala (the famous opera house).

ii) Foundation programme grants, i.e. competitive grants in the sectors noted above.

iii) Local grant-making in each of the provinces of the Lombardy Region (run by the community foundations which are the subject of this case study).

The four key programme areas of the foundation include:

i) Environment: in this area the foundation focuses on environmental protection through lifestyle and social behaviour education. The foundation supports cultural innovation and the spreading of environmental awareness by triggering virtuous circles in which information, education, awareness and action are mutually reinforced with the contribution of all stakeholders: citizens, governments, businesses, the scientific community, organisations and local communities. The foundation relies heavily on non-profit organisations.

ii) Arts and Culture: this programme area relates to the cultural heritage of the region. The foundation gears its action to promote 'good practices,' which set standards focusing on pilot projects and initiatives aimed at enhancing the value of artwork, which may also include restoration. The foundation's goal is to increase opportunities for artistic expression for people of various backgrounds.

iii) Social services: The foundation takes actions taking care of individuals and of needs that social service agencies fail to perceive. It finds new and more efficient ways of dealing with known and un-met problems and serves those who are at risk of 'falling through the cracks.'

iv) Scientific research and technology transfer: the foundation supports scientific research, technology transfer and the development of applied research findings by backing actions geared towards the creation of networks and partnerships, the participation in international projects, the

development of human capital, the production of better knowledge and improved scientific communication.

Decision making processes

The foundation's corporate governance structure includes the introduction of a 40-member Steering Body comprised of Directors nominated by local governments; the Regional government of Lombardy, the City of Milan, the Lombardy provinces, and by the provinces of Novara and Verbania, together with civil society leaders from the foundation's fields of interest (social assistance, health, scientific research, the arts and culture etc.). The Cariplo Board has responsibilities for developing the overall strategy, electing the president and the executive committee and approving the budget. Procedures to appoint the Board are complicated. Half of the Board are appointed by a number of public institutions that each present three names and the past Board member chooses the new member from amongst these names, whilst the other half of the Board is chosen by civil society organisations.

The Cariplo Foundation, like all other Italian savings banks foundations, is under the supervision of the Treasury. In practice, it also needs to gain the support of the local public administrations in Lombardy (region and counties) who appoint half of the Board, but this is not a formal requirement.

Critical success factors

Critical success factors in developing community foundations include:

- Understanding the community foundation concept: in general, public understanding of the community foundation concept is low in all sectors. To be successful, community foundations and those who support them need to actively promote understanding of the community foundation concept.

- Educating donors and others about endowment: because the advantages of endowment are not widely understood, it is difficult for many to see the logic in giving for the future rather than to meet current needs. In order to be successful, community foundations/support organisations need to educate various audiences about the value of endowment building.

- Community and stakeholder participation: community foundations need broad-based community participation if they are to establish credibility and legitimacy, have the knowledge to meet real needs and obtain resources.

- Representation: most successful steering committees and Boards are representative of the communities they claim to serve.

- Links with the business sector: efficient steering committees have strong links with the business sector, while less efficient ones do not seem to have access to local/other sources of wealth that could be attracted by the concept of a community foundation.

Value added of the financing tool

The Cariplo Foundation is the most important bank foundation in Italy. Since the second half of the 1990s, the foundation has restructured its approach to donations and is trying to be more strategic, complementary and not substitutive of public action, supporting the development of the non-profit sector. In this approach, the support of new initiatives in the field of social housing has been one of its main activities.

The Cariplo Foundation is one of the major donors of the Italian community foundations. It gave more than EUR 12 million in 2004 to the twelve foundations it established, of which 500 000 went towards operating costs and the remainder for re-granting.

It has set an important precedent as the first community foundation in Italy and has established a network of local partners so as to have better relationships with the communities in Lombardy where the foundation operates, and to promote a culture of giving as a way to foster the non-profit sector.

Case study 48. Italy: Compagnia di San Paolo

Overview of the financing tool

Established in Turin in 1563 as a charitable brotherhood, Compagnia di San Paolo is today one of the largest private-law foundations in Europe. In 1992, it was transformed into a foundation as a consequence of the restructuring of the San Paolo Bank Group.

Compagnia di San Paolo has EUR 6.8 billion worth of assets, which it uses to pursue aims of public interest and social use in order to foster the civil, cultural and, most importantly here, economic development of the community in which it operates. It collaborates with many public institutions at local, national and European level and operates in Italy and abroad.

How the financing tool is used

The Compagnia di San Paolo funds scientific, economic and juridical research; education; art and the preservation and valorisation of cultural heritage and activities; health and assistance for socially deprived groups.

Specifically its funding activities include:

- *Research* - Supports basic scientific research and the dissemination of scientific knowledge as well as experimenting with new technologies, particularly in the biomedical field with studies that foster new diagnostic and therapeutic applications. Also supports research on economics; social sciences; international relations; and the institutional activities of outstanding Italian and international centres working in the aforementioned fields.

- *Education* - Promotes the fostering of excellence in university education; the development of autonomy in the school system; and the spread of a culture based on civic spirit and responsibility.

- *Art* - Seeks to preserve and safeguard artistic and cultural heritage by entering into restorative projects, in particular in Turin, Genoa and the south of Italy. Also supports exhibitions of European artwork, historical publications and documentation of various restorations and similar works on the region's artistic treasures.

- *Culture* - Supports cultural events in many areas including music, theatre and cinema, and specific projects related to archives and libraries.

- *Health* - Focuses on technical and scientific health care equipment grants, and research grants. Also supports non-profit associations and the restructuring and modernisation of health service organisations.

- *Welfare* - Provides assistance in the fight against poverty, hardship and marginalisation. Focuses on drug addiction, the disabled, serious illness, the elderly, the homeless and young people at risk.

Decision making processes

The Compagnia defines its objectives through multi-annual and annual programmes, and operates both by making grants to organisations which propose projects in line with its programmes, and in other ways, including the work of its operating units, which work directly in various sectors of the foundation's activities.

Value added of the financing tool

The Compagnia is deeply rooted in Turin, and works mainly in the Piedmont and Liguria regions.

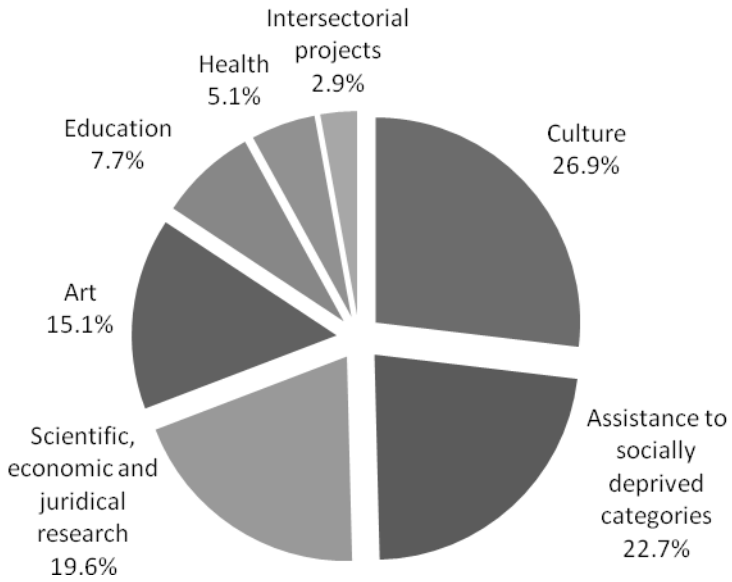
The resources set aside by the Compagnia in 2005 totalled EUR 134.8 million and were allocated to 820 initiatives (see Table 7.1).

Table 7.1. Grants per programmes, 2005

Sector	Grants	%	Amount (EUR millions)	%
Scientific, economic and juridical research	161	19.6	30.0	22.3
Education	63	7.7	16.0	11.9
Art	124	15.1	26.0	19.3
Culture	220	26.9	15.0	11.1
Health	42	5.1	15.0	11.1
Assistance to socially deprived categories	186	22.7	28.0	20.8
Intersectorial projects	24	2.9	4.7	3.5
Total	**820**	**100.0**	**134.7**	**100.0**

Source: Compagnia di San Paolo Annual Report, 2005

Chart 7.1. Grants per programmes, 2005



Source: Compagnia di San Paolo Annual Report, 2005

Housing has recently been included among its priorities in the sector of social policies. The Housing Programme, launched by the Compagnia in November 2006, aims to improve housing opportunities in certain segments of the population, encouraging innovative housing experiences already under way and experimenting with models that are not yet present locally. For the management of the Programme a Technical Evaluation Committee has been set up, consisting of experts drawn from various fields. The initial funding for the Programme amounts to almost EUR 4 million, to which further funding could be added during 2007 and successive years.

Case study 49. USA: CALPERS

A California Urban Investment Partners (CUIP): Pension Fund Urban Regeneration

Overview of the financing tool

The California Public Employees Retirement System (CalPERS) is the largest public pension fund in the USA, and the third largest in the world. Established 75

years ago, the System now manages USD 210 billion of assets and provides pension benefits to over 1.4 million Californian public employees, retirees and their families. As a defined benefit plan, beneficiaries receive a guaranteed pension based on a formula of age, salary and number of years worked.

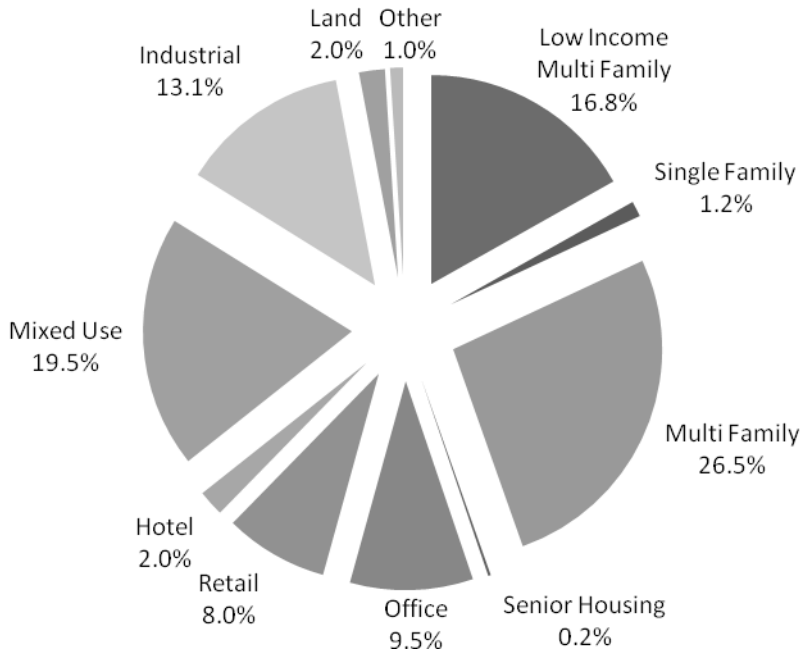
In 1992, the CalPERS Board took a decision to target investment in the State of California as part of its overall investment policies. Two percent of the CalPERS' portfolio was to be invested in California as part of its Economically Targeted Investment Policy (ETI Policy). This policy defines ETI as an investment that has collateral intent to assist in the improvement of both the national and – more importantly in the context of local development finance - regional economies, and the economic wellbeing of the State. Economic stimulation includes job creation, development and savings, business creation, increases or improvement in the stock of affordable housing and the improvement of infrastructure. The 2% target crosses all asset classes including public equity in firms headquartered in California, private equity, fixed-income products, and real estate.

In 1995, CalPERS' decided to specifically target underserved capital markets in real estate investment. With general partner Johnson/MacFarlane Partners, CalPERS formed the California Urban Investment Partners (CUIP). The explicit goal of this USD 51 million investment was to invest in retail properties in underserved urban areas of California. Following the success of the CUIP initiative, CalPERS extended its urban investment sector in 1997 and developed a new targeted real estate programme, the California Urban Real Estate (CURE) programme, as part of its ETI policy. CURE committed an initial USD 375 million towards urban revitalisation with the aim of "creating value through the rehabilitation, repositioning, and development of real estate projects located primarily in the urban neighbourhoods of California's major metropolitan areas."

How the financing tool is used

There are currently thirteen investment partners in the CURE programme, who invest across a range of real estate types, from low to moderate income housing, multi-family low income housing, commercial or residential or both, urban infill, community redevelopment, and the rehabilitation of core properties. The single largest type of investment is multi-family housing (Chart 7.2). In addition, 77% of CURE investment is targeted at Californian Real Estate, and is distributed across the state's urban areas.

Chart 7.2. CURE portfolio diversification



Source: Pension Consulting Alliance (PCA), 2005.

CalPERS also uses the considerable financial power that it wields in order to invest socially in California. It aims to increase social responsibility, fairness and diversity in the Californian economy. For example, CalPERS' urban real estate targets incorporate a responsible contractors' policy - since 2003 CalPERS has required construction and maintenance contractors to provide decent wages and benefits to their workers. The System also invests in and publicises its partnerships with companies owned by women or other minority groups e.g. Johnson/Macfarlane Urban Partners. CalPERS has banned investment in nine companies that do business in Sudan until the Sudanese government halts the ongoing genocide.

Decision making processes

The CalPERS Board of Administration has investment authority and sole fiduciary responsibility for the management of the System's assets. This Board is guided by the CalPERS Investment Committee, management, and more than 150 staff in the Investment Office. There are thirteen members of the Board of

Administration, of which six members are elected. Of these two are elected by and from all CalPERS members and one each is elected by and from:

- All active State members.
- All active CalPERS school members.
- The retired members of CalPERS.
- Active CalPERS public agency members.

Three members of the board are appointed. Of these, two (an elected official of a local government and an official of a life insurer) are selected by the Governor and one is a public representative chosen jointly by the Speaker of the Assembly and the Senate Rules Committee. The remaining four members of the board hold office Ex Officio (by virtue or as a consequence of an office held). Members serve on various Committees that review issues and recommend actions to the full Board. The Board meets monthly in Sacramento and annually in Southern California.

CalPERS is considered to be one of the USA's most transparent pension schemes in terms of the volume and detail of information that it makes public regarding its activities and investments.

Critical success factors

Most pension fund targeted real estate is undertaken in limited partnership, with external real estate developers acting as the general partner. External real estate developers are expected to invest a significant amount of their own capital in the deal, and are often expected to have considerable assets under development.

Some commentators have argued that the sensitivity of the CalPERS board to changing demographics in California has been critical to its successful investments, providing it with an "early mover advantage", particularly in urban real estate markets.

Value added of the financing tool

Revitalisation of California real estate

By March 31st 2005, the CURE programme had a total asset allocation of USD 3.4 billion, and had invested USD 1.2 billion of this. The positive impacts on Californian real estate have been significant. By 2002, 32 000 new homes had been built and 16% of all the housing units CUIP has invested in are affordable housing units (Hebb, 2005). Good examples of positive local effects include a CalPERS partnership with CIM in downtown Los Angeles, which brought a supermarket to the area for the first time in eighty years. Similarly CUIPs is currently engaged in the redevelopment of a mixed use project around one of Oakland's inner city stations. In this project CUIP is working in partnership with the not-for-profit group Oakland Economic Development Corporation, to ensure that community needs are met.

Economic benefits for CalPERS members

Since CURE's inception, the scheme has generated excellent internal rates of return (IRR) of 22.2%, compared to benchmark industry returns of 8.1% (NCREIF 2005). This success has been accredited to the CalPERS' Board of Administration's sensitivity to California's changing demographics, and subsequent increased demand for real estate.

New jobs for California's residents

California's urban communities have the fastest growing labour force in the state. It is estimated that 5 810 construction jobs and 3 505 permanent jobs have resulted from CalPERS' urban investments (Hebb, 2005)

Ken Rosen, Professor of Real Estate and Urban Economics at the University of California, Berkeley's Haas School of Business, has summed up the benefits of the CalPERS scheme in his review of CURE's 2005 report:

> *"This report confirms that careful real estate investments in urban core locations help revitalise these communities while producing excellent risk adjusted returns for investors."*

B California Public Employees Retirement System (CalPERS), California Initiative

Overview of the financing tool

The California Public Employees Retirement System (CalPERS) manages nearly USD 200 billion in assets and provides pension benefits to over 1.4 million Californian public employees, retirees and their families. In May 2001, the CalPERS Investment Committee established the California Initiative Programme.

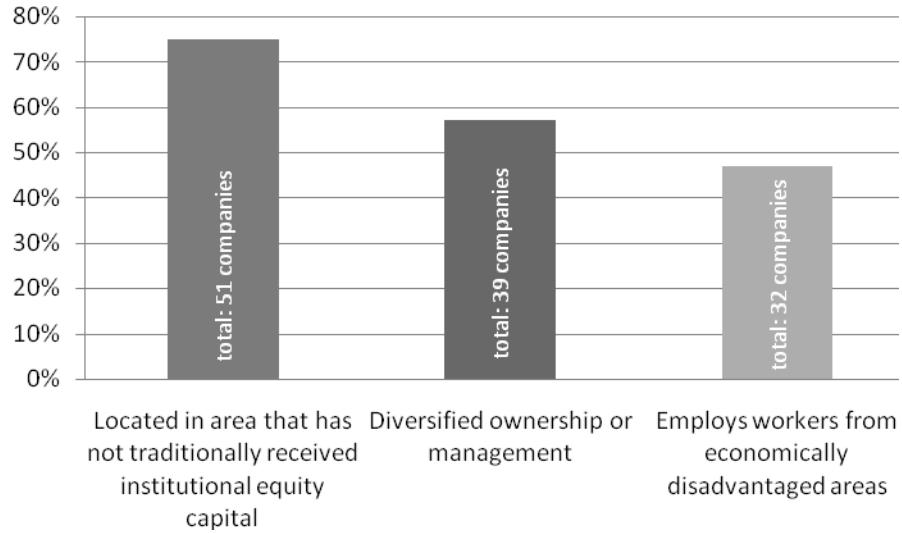
Through the California Initiative, the CalPERS Investment Committee approved USD 475 million of commitments which were allocated to nine private equity funds and earmarked for investment in 'traditionally underserved markets primarily, but not exclusively, located in California.' By 30 June 2006, the programme's original allocation was fully committed and 130 (mostly local) companies had received funding. In October 2006 CalPERS announced a USD 500 million investment vehicle for the second phase of the California Initiative Programme.

The objective of the California Initiative is to discover and invest in opportunities that may have been bypassed or not reviewed by other sources of investment capital. These opportunities should offer attractive risk-adjusted returns corresponding with their asset class. In this way, CalPERS provides an extremely significant amount of funding for economic development across the state.

How the financing tool is used

Nine private equity partners and one fund-of-funds invest in traditionally underserved markets, primarily in California, to discover and take advantage of opportunities that have been overlooked. Since such markets are less efficient than others, the potential for superior performance is greater in the long-run. Three key benchmarks of underserved markets identified include companies that have limited access to capital, companies that employ workers who reside in economically disadvantaged areas, and companies that have female and/or minority management (see Chart 7.3.). Of the 68 California Initiative companies, 65 met at least one of the benchmarks, 39 met at least two, and 18 met all three.

Chart 7.3. Benchmarks reached by proportion of all California Initiative Companies



Source: www.calpers.ca.gov/eip-docs/about/press/news/invest-corp/cal-init-assess.pdf, 2007.

Decision making processes

CalPERS choose Investment managers who decide on the investments. More than 67 firms (funds) responded to CalPERS' search for the California Initiative Programme. Firms were evaluated based on performance track record, operating and investing experience in underserved markets, Californian presence, and alignment of interests with CalPERS. The selection of the 11 firms is contingent upon satisfactory negotiations of terms and conditions.

As outlined above, investment selection is based on the following 'Underserved Market Criteria':

- Is the company located in a region with limited access to investment capital?
- Is there diversification of company ownership and management (either women or ethnic minority)?
- Does the company employ workers from Low and- Moderate Income ("LMI") areas?

Critical success factors

The role of pension funds should not be to create the market that they invest in. They simply provide liquidity to the market and then exit the opportunities after the first stage of risk-taking. Investing in targeted private equity should be a profitable endeavour, following best practices drawn from the California Initiative and other pension funds' experience.

The most important best practice result is that of measuring success first in terms of the risk-adjusted rate of return, and only subsequently on other targets. This allows the fund managers to be sure of meeting their fiduciary responsibilities. This is also the best way to benefit the community, since theory suggests that, by filling capital gaps, the investor should both receive excess returns and support economic development. If the investor does not receive an appropriate return, it is probable that they are not filling a true capital gap (i.e. a gap that an efficient market would have funded), but are instead investing in projects that an efficient market would have left un-funded.

Value added of the financing tool

By bringing equity capital to areas of California that have been bypassed by institutional sources, the California Initiative is directly supporting business development and job creation in these underserved California markets. Furthermore, the deployment of capital investment in these markets has a broad-reaching impact. According to recent economic analyses, the long-term importance of entrepreneurial activity extends beyond job creation. Rather, research suggests that entrepreneurial activity may produce a 'knowledge spill-over' that encourages other entrepreneurs and spurs additional economic activity. Entrepreneurial activity positively impacts upon economic development, and the availability of investment capital positively impacts upon long-term entrepreneurial activity

The California Initiative is also helping to foster economic vitality across California by supporting economic activity in a wide range of locations. In total, California Initiative companies employ workers in over 170 manufacturing, distribution, retail, hospitality, call centre and other service centre operations in California.

The California Initiative is meeting its objective to provide jobs to residents of disadvantaged areas of California. Approximately 40% of California residents employed by California Initiative companies live in economically disadvantaged areas of the state. These approximately 2 000 Californians are employed and

contributing to the rejuvenation of their surrounding communities, in part as a result of California Initiative investments. Improving the economic circumstances of lower-income workers can have a positive impact on their local communities. Consumer spending accounts for between 60% and 70% of spending in the economy. Consumers - particularly lower income consumers - tend to do the majority of spending within a short distance of their homes. The importance of consumer spending, combined with lower-income consumers' tendency to spend in their local neighbourhood, makes improving purchasing power by providing jobs for residents of economically disadvantaged areas of California critical to revitalising those areas.

Through its portfolio companies, the California Initiative is helping to provide health insurance, asset-building programmes such as 401(k) plans, and paid sick and vacation leave to over 30 000 people. Most California Initiative companies are making these benefits available to more than three-quarters of their employees.

Case study 50. USA: New York State Common Retirement Fund

Overview of the financing tool

The New York State Common Retirement Fund is the USA's second largest public pension fund. It manages over USD 140 billion in assets, and provides pension, death and disability benefits to over 965 000 public employees, retirees and their families in New York State. These public employees contribute to either the Police and Fire Retirement System (PFRS) which has almost 36 000 members, or the Employees Retirement System (ERS) which has more than 614 000 members, which are both amalgamated in the Common Retirement Fund.

How the financing tool is used

The Common Fund uses its assets to invest in a number of different programmes, which can be broadly grouped into two different economic development areas for New York State. It invests in programmes focused on the needs of individuals and pensioners e.g. affordable housing programmes, and secondly in helping New York businesses to get started and grow. To date, the fund has committed around USD 400 million of funds towards developing affordable housing, and USD 364 million towards investment in New York businesses.

Investment in New York State businesses

The Instate Investment programme was created in 1999 by former Comptroller Carl McCall in response to legislation proposed by Senate Majority Leader Joseph Bruno and Assembly Speaker Sheldon Silver. This programme aims to provide investment returns consistent with the risk of private equity investment, whilst also expanding the availability of capital for New York businesses. The fund does not invest directly in companies, but through venture capital and private equity funds run by experienced managers. The programme has, thus far, committed USD 364 million to 11 managers located throughout New York State. The capital provided by the fund often becomes the seed capital for start-up businesses, and the Common Fund is often the largest investor.

The fund also provides market-rate loans to small businesses through the New York Business Development Corporation (NYBDC). These loans are guaranteed, removing any associated risk.

Investment in the needs of pensioners and individuals

The Common Retirement Fund has developed programmes to support the rehabilitation and development of affordable housing in New York State. Under 'the Affordable Housing Permanent Loan Programme' the fund purchases permanent mortgage loans at market rate pursuant to agreements with several financial institutions that provide construction financing for affordable properties. The affordable housing programme is run in conjunction with a non-profit organisation called the Community Preservation Corporation. The programme is run state-wide in rural as well as urban areas.

The Common Retirement Fund also invests in the NYS Mortgage Pass-Through programme. In this scheme the fund purchases mortgage "pass through" certificates from Citibank. Pass through certificates are securities backed by residential mortgages that are sold, or passed through, to investors by primary mortgage lenders to generate more funds for mortgage loans.

Decision making processes

The New York State Comptroller, Alan Hevesi, is the sole trustee of the fund as there is no committee, and as such he alone is answerable to retirees. To select the firms that will benefit from the Instate Investment programme, the Common Fund first works in conjunction with its general consultant, Strategic Investment Solution

Inc., to choose external equity managers. The consultant, with input from the fund, conducts an extensive search and recommends a list of finalists. From this shortlist, the Common Retirement Fund selects eleven external equity managers located throughout New York State. The selection of the equity management firms operates on the basis of past performance, investment style, organisational strength, and their fit within the overall equity portfolio structure.

These fund managers then select and vet individual businesses and are provided with 5-6 years to fully invest the committed funds. The sole criterion for selecting investments is that they must have return and risk characteristics at least as good as those of any comparable investments. However, early stage venture capital investments are preferred by the fund, and there is currently a USD 250 million cap on commitments – although this has already been exceeded.

Critical success factors

The role of pension funds should not be to create the market they invest in. They simply provide liquidity to the market and then exit the opportunities after the first stage of risk taking. Investing in targeted private equity should be a profitable endeavour, following best practices drawn from the California Initiative and other pension funds' experience.

Comptroller Hevesi has proposed changes in the statute to help the Instate Investment programme to operate more effectively, including expanding the universe of eligible businesses that can be considered for investment. Current statute emphasises early stage venture capital investments, and the Common Retirement Fund and New York businesses would do better if the programme could consider businesses when they start out and as they grow.

Value added of the financing tool

New economic vitality and more jobs in New York State

To date, the USD 298 million committed to equity managers has resulted in the pension fund investing USD 43.7 million in businesses with a total of USD 200 million in funding to these businesses. The pension fund's willingness to invest has lead to the creation of some entirely new investment funds and the growth of others. Since January 2003, Comptroller Hevesi has doubled the number of companies that have received funds, with nearly two-thirds of the money going to

companies in upstate New York and Long Island. Since that time, the fund has invested USD 32.3 million in individual companies.

Some of the businesses that have received money include:

- *VersaMed* - A USD 3 million investment induced this manufacturer of portable ventilators to relocate from New Jersey to Rockland County, New York State

- *Pacific Pools* - The Common Retirement Fund's investment helped the firm's management finance an acquisition from an international corporate parent retaining jobs in the Capital District of New York and provided the company with resources to continue to grow.

- *Reichert* - The former German owner of this Buffalo manufacturer of ophthalmic equipment disposed of the business because it was no longer core to its long-term business plan. The fund's investment helped finance the purchase of the company by its management; the alternative would likely have been the sale to an out-of-state competitor who would likely have closed the New York facility and moved its jobs out of state.

- *Knovel* - This provider of online services for scientists and engineers is based in Binghamton, New York. It received a USD 2.1 million investment from the Common Retirement Fund, through a fund managed by Credit Suisse First Boston (CSFB), with an option to invest an additional USD 450 000 within a year. The investment helped Knovel, a small business, create new jobs in Upstate New York.

Improving the lives of residents

Since the inception of the Affordable Housing Programme, the fund has purchased over USD 173 million in permanent mortgages, thereby providing stable, long term financing for over 5 880 affordable housing units in New York State. This has enabled moderate income and low income families from across the State to own or rent affordable housing. Comptroller Hevesi increased the system's commitment by USD 100 million in 2004, to bring the fund's total commitment to the programme to USD 400 million. There are plans for the financing of more than 3 000 more affordable units.

Some examples of affordable housing developments facilitated by the fund include:

- The construction of 50 units for seniors who need regular care in Malta, N.Y.
- The transformation of a blighted row of vacant buildings into 38 contemporary style loft apartments in Buffalo.
- A Rockland County home for disabled people upgraded its facilities by tailoring apartments to residents' specific needs.
- A developer in Queensbury, N.Y. built 48 affordable apartments at Highland Springs.

The New York State Mortgage Pass-Through Programme has also provided home ownership opportunities to more than 62 300 residents.

Notes

[1] The Community Reinvestment Act is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighbourhoods, consistent with safe and sound banking operations. It was enacted by the Congress in 1977 (12 U.S.C. 2901). www.ffiec.gov/cra/history.htm.

III. What Principles Should Govern How We Finance Local Development in the Future?

This review of 50 innovative practices in local development finance enables us to understand more clearly what are the key principles around which a long term approach to investment in local economic development could emerge. Through work of of the OECD LEED Programme on local development we have identified ten principles that can help to shape the future investment objectives for local development.

i) Smart finance for smart cities and regions: getting the fiscal relationships with higher tiers of government right

The transition to a knowledge-led service economy has encouraged urban regeneration and re-positioned cities and local economies as central to the economic performance of regions and nations. It has also placed a strong emphasis on continuous re-investment in local economies in order to attract and retain population, businesses, and private investment. To make this sustainable, regional and national governments can re-appraise how well their fiscal systems promote urban investment and how they can be adjusted to invest in localities to promote even greater economic and fiscal performance for wider areas. Governments of all kinds should ask whether they could be getting greater returns by investing more in local economies, and giving localities greater responsibility and flexibility for raising revenue and capital and taking responsibility for investment and oversight.

ii) Promote active private sector leadership in local development finance and investment

Local development finance is, in many ways, a new niche market for commercial financial institutions. It presents new assets and opportunities at a dynamic rate. Commercial financiers need to have close relationships with local government leaders and urban practitioners to understand where the new

opportunities are, and to influence how they are shaped and packaged. The financial sector also needs capable leadership across firms, to increase the rate of innovation in local economic financing, and to share risks and costs where appropriate, especially in new or challenging markets.

iii) Metropolitan finance for metropolitan amenities

Functioning local economies provide many services and assets to their wider sub-regions and metropolitan areas. They provide institutions, identity, and infrastructure for their surrounding areas. The cost of these should be shared amongst those who benefit, both directly and indirectly. For many years, lower tax and cost regimes in the surrounding counties and municipalities of central urban areas have encouraged people to find new houses and places of work outside of the city jurisdiction, with negative economic, social, and environmental consequences. The wider metropolitan region and its commuting workforce benefit from the amenities that the city provides (cultural and sports institutions, health and other services), and from the agglomeration of commercial activities that it hosts. This suburban 'free-loading' does not foster sustainable investment in urban areas. New forms of integrated development and growth management in metropolitan regions should be financed through shared metropolitan finance tools.

New initiatives are emerging to encourage resource sharing across metropolitan areas and to maintain metropolitan assets. These should be encouraged, and a new era of innovation should be promoted.

iv) Capturing and sharing the benefits of growth locally

There is a renewed impetus in local development and urban regeneration. Immigration, life style changes, and the different land use requirements of the new economy, have allowed urban localities to become the sites of increased interest. Private sector returns are now good in urban property markets. However, existing systems of taxes, levies, and fees do not always foster the momentum of urban investment nor create the infrastructure that would allow greater private investment, either because they take too much tax out for other purposes, and do not re-invest directly in nodes of urban growth, or because they leave local governments with little fiscal incentive to encourage growth of the right kind. Capturing and using the value of growth to help foster development is a key mechanism for engaging private investors.

New instruments that enable the local 'recycling' of some element of improved property values should be encouraged, to build long term momentum into urban reinvestment, and to create the conditions for greater private interest. Examples, such as Tax Increment Financing and Development Tariffs, are working successfully in some places. Public sector ownership of land is a key means to capture value from development.

v) Flexibility in public funding to enable private co-investment in local development

The long term goal of much public investment in local development is to attract private co-investment in ways which will build new markets. But pubic finance is often too rigid or cumbersome, to be properly calibrated to attract private co-investment. Public investment can crowd out the private sector. Flexibility and certainty are the key to making public funding more of an incentive to private investment. This means a shift to focus on outcomes and sharing returns, rather than on narrow controls over how public funds are deployed.

vi) A new approach to public assets

Many cities and local economies contain substantial public assets in the form of real estate, facilities, or other amenities. Urban areas in particular were the centres of gravity in the industrial and pre-industrial eras, and their assets have accumulated over time. But in many localities such assets are now owned by a multiplicity of public and quasi public bodies that do not necessarily share a primary objective for the success of the city in the global environment. Urban areas can find that the biggest barriers to re-development are major asset owners in the public sector, often from higher tiers of Government, or from utilities. A new approach to how public assets are managed is required. City Governments, with help from higher tiers and the private sector, should take the lead in fostering active asset auditing and asset management by all parts of the public sector as a logical pre-condition for attracting greater private sector investment.

Too many countries still have systems of 'capital receipts' which means that when local economies realise their assets through sales they do not retain the full value. This creates a powerful disincentive to raise the value of such assets and leaves them in a low investment/low return trajectory. It is central to the task of urban regeneration that improved assets' values be utilised to encourage further investment and regeneration.

vii) Fostering financial innovation in public and private sectors

Financial innovation should be promoted in public and private sectors and continuous experimentation should be fostered and assessed. This requires 'controlled experiments' where rules and formulae are relaxed so that creative solutions can be found. This cannot be left to individual localitieies and tenacious investors alone. The market will grow better and faster if there is some shared effort to promote financial innovation.

An international observatory on local economic financing would be a welcome addition, to reduce the costs and risks of innovation.

viii) Long term market building by the private sector

Evidence shows that local economies and urban areas have many untapped markets and opportunities which will offer good returns if they are addressed patiently by private investors. Government can provide incentives and support. Where all banks are required to address long-term urban markets, for instance in the US through the CRA, or in Italy through bank foundations, this results in new and commercially sustainable market niches for banks to operate in. Building urban markets is a long term process but yields healthy returns. Initiatives to build markets through the right incentive structure are key.

ix) Focus on the quality of the propositions not on the supply of finance

Using special instruments and incentives to build the supply of investment capital is only one side of the coin, diligent work has to be done to stimulate and sustain a continuous level of good quality demand so that the average costs of each deal can be reduced, the scale of the opportunity will grow, and the scope for further investment will be created. Local development leaders and financial institutions should work together to improve the flow of good propositions being developed and to promote 'investment readiness' throughout the professions of urban development.

x) Build capable specialist intermediaries at local and wider levels

Achieving this kind of performance is only really possible with high quality intermediaries (the fund managers, and others, who are really dedicated to making it work). These skills are in short supply. Attention to building up the capacity of the intermediaries is key to making the instruments effective. Venture capital funds

without fund and investment managers do not work. City bond issues do not succeed without specialist advice from investment bankers and brokers. Community Investment Tax Credits without Community Development Financial Institutions are a non-starter, as are Regional Venture Capital Funds without dedicated fund managers.

Combined, these ten principles of local development finance offer a means to promote long term investment into cities which will yield greater value for private investors, cities, regions and national governments alike. Table III.1 demonstrates how the 50 case studies considered in this report led to the development of the principles and how they measure up against them.

Table III.1. 10 principles with the 50 different innovations

	Case study	Smart finance	Active private leadership	Metropolitan finance	Value capture	Flexible in public funding	Public assets management	Financial innovation	Local market building	Quality propositions	Capable intermediaries
1	Philadelphia: Hotel Room Tax	*	*	*	***	*		**			*
2	The EDI Group; Edinburgh	*	**		***	**	**	**	**	**	***
3	Boston Redevelopment Authority	*	**	*	***	**	***	**	**	*	**
4	EIB loan for municipal infrastructure	**	*	*	*	**	*	*	*	**	*
5	BOC- municipal revenue bonds	**	*	*	*	**	**	**	*	*	**
6	Baltimore- Tax Incentives	**	*	*	**	**	***	**	**	**	*
7	Copenhagen: Property Value Taxation	*		*	***	**	*	*			
8	Chicago: Tax Increment Financing	**	**	*	***	**	*	**	**	*	*
9	San Francisco Benefit Association District	*	**	*	***	**	*	**	*		*
10	Glasgow: Public Private Partnerships	**	**	*	*	***	***	**	**		**
11	New York: BID	**	***	*	**	**		***	**	*	**

	Case study	Smart finance	Active private leadership	Metropolitan finance	Value capture	Flexible in public funding	Public assets management	Financial innovation	Local market building	Quality propositions	Capable intermediaries
	Program										
12	Vancouver: Gas Tax	***	*	*	**	*		*	*		
13	London: Congestion Charging	***		***	**			***			*
14	Caisse des Dépôts, France	*	**		*	**	***	**	***	**	**
15	US Federal Reserve	*	***	*	**	*		***	***	***	***
16	Canadian PILOT Funds	***		**	**	*	**	*			
17	SOFIREM	*	**			**	**	**	**	**	**
18	South Africa Urban development Zones	**	***		*	**		**	***		*
19	Green Municipal Fund, Canada	**	**			**	**	*	*	**	*
20	Urban Free Zones, France	***	***			**		*	**		*
21	Real Estate Investment Trusts		***		**		*	*	**	**	*
22	English Cities Fund	*	***		**	*	**	*	***	**	*
23	Enterprise Foundation (USA)	*	**			*		*	***	***	***
24	Australia: Social Enterprise Finance		*			*	*	*	***	***	***
25	New Zealand: Venture Capital Funds		**		*	*		**	***	***	***
26	Australia: Innovation Investment Funds		**		*	*		*	***	***	
27	Greater Philadelphia: Reinvestment Fund	**	**		**	*		**	***	***	***
28	Finpiemonte and Filombarda, Italy	*	*	**	*	***	**	**	**	**	***
29	Stuttgart: Regional Investment Bank	**	*	***	*	**	**	*	*	**	***
30	East Midlands UK: Blueprint Fund	*	**		***	**	***	*	***	*	***
31	Tamil Nadu Urban development Fund	*	*			***	***		**	**	***
32	World Bank	**	***	*	**	*	*	**	**	***	*
33	Inter-American Development Bank	**	***	*	**	*	*	**	**	**	*

	Case study	Smart finance	Active private leadership	Metropolitan finance	Value capture	Flexible in public funding	Public assets management	Financial innovation	Local market building	Quality propositions	Capable intermediaries
34	Asian Development Bank	**	***	*	**	*	*	**	**	**	*
35	Islamic Development Bank	**	***	*	**	*	*	**	**	**	*
36	European Investment Bank	**	***	*	**	*	*	**	**	**	*
37	EBRD	**	***		*	**	*	**	***	**	**
38	CoEDB	*	***	*	*	*	*	**	*	**	***
39	Joint Initiatives by the European Commission, the European Investment Bank and the EBRD	**	**		*	**	***	**	***	***	****
40	Ford Foundation		***		*			**	***	***	***
41	Local Initiatives Support Corporation (US)	*	***		***	*	***	**	***	***	***
42	Open Society Institute & The Soros Foundation's Network		***		*	*	*	*	***	**	**
43	The Gatsby Foundation		***		*			*	***	**	***
44	The Annie E Casey Foundation		***	*	*	*	*	***	***	***	***
45	New York City Investment Fund		***		**			**	***	***	*
46	Barclays Bank Urban and Regional Development Funds		***		**	**	*	***	***	***	**
47	Fondazione Cariplo		***		**			**	***	*	***
48	Compagnia di San Paolo		***		**			**	***	*	*
49	CalPERS California Initiative		***		*	*	**	*	***	***	
50	New York State Retirement Fund		***		*	*	**	*	***	***	

IV. What are the key elements of an Investment Strategy for Local Development?

We observed earlier that the key to making long term progress on local development is the building of collaboration with private sector to make reinvestment more sustainable. Following our review of innovative local development finance initiatives, we can identify now what local development practitioners can do to attract new sources of finance and to shift from an 'expenditure' to an 'investment' based approach to financing local development.

Local development: investment or expenditure?

Rethinking economic strategies

When local leaders establish local economic strategies they could therefore more fully consider some of key factors required to achieve a better likelihood of attracting diverse finance. These include:

- Identify what the underlying market drivers in weaknesses in the local economy and consider what may be required to incentivise sustained interest from commercial investors and financiers. Build interventions where the goal is private sector investment from the start.

  Local development requires the evolution of business groups and organisations who recognise that the performance of their local economies is an important ingredient of their own success, in complementary ways to the wider national or regional business environment in which they operate. However, local development leaders and practitioners do not always recognise the need to build business enthusiasm for local development and to foster mechanisms which bring the internal rate of return of key initiatives together with their external performance in policy terms.

Enlightened private sector investment is a central goal of mature local development, but is not always addressed explicitly.

- Where cost and risk sharing is required between public and private sectors, identify the best organisations arrangements to deliver these, especially considering what role specialist financial intermediaries can play in improving financial skills of local development practitioners and building a consistent and high quality flow of financing propositions.

  The issue of skills gaps were considered in section one. The key task is enlarge the pool of people working in local develop who have commercial and project finance skills. Local development agencies can pay an important role here. They may be able to both attract people with appropriate skill sets to work in their 'business-like' corporate environments, and they may be able to utilise entrepreneurial freedoms that do not exist within municipal structures. The recent growth in the use of local development agencies is partly explained by these opportunities, as our case studies demonstrate.

- Consider how to overcome information and awareness gaps between the demand and supply for finance and work to close the information gaps systematically.

  Many assessments reveal that information gaps are real and they can reinforce frustrations and suspicions between public and private actors at the local levels. Studies that address the difficulties of smaller firms and local not for profit organisations in attracting external finance often identify such information gaps.

- Consider how public assets could be better managed to attract private investment towards the goals of local economic strategies.

  In many OECD countries there is the emergence of a new approach to the management of public assets within a local development framework. Here, land, buildings, infrastructure, logistics, and other amenities are seen as important strategic assets that can perform in financial terms if they are managed well. Consequently, there is there is beginning of a new suite of joint venture and other asset finance arrangements emerging in some countries. In several countries however, local government strategic management of assets to attract investment is still not considered appropriate, or is viewed as risky or untried. There is a lack of confidence on the part of local leaders, higher tiers of government, potential private partners, or all three. An important action here is to effectively assess and

communicate models of innovation and learning that are able to work, as some of our case studies show.

- Identify and undertake detailed preparatory work on the most promising 4-8 propositions in the local strategy in collaboration with financial institutions and advisors and higher tiers of government.

  This is essentially a requirement for greater focus and prioritisation in local development strategies. Too frequently, such strategies do not present a small number of high impact projects in a manner which could attract finance. One reason that hosting international events have become popular catalysts of local development is that they tend to bring forwards a small number of larger bankable propositions that offer external financier a meaningful means to invest locally.

- Audit the existing assets and funding streams that might be utilised to support these projects.

  Limited financial appraisal of the potential of local development projects is a common failing. This issue is identified by several of our case studies and one of the important roles of the International Financial Institutions and Development Banks is to apply this financial appraisal through their technical assistance functions, once engaged. Local development practitioners can establish systematic mechanisms to do this through partnership with the financial community if they organise to do so as strategies and projects are formulated, as our principles suggest.

- Convene meetings with key financial institutions and financial advisors to undertake some preliminary assessments of the best means to develop the interventions to attract external investment.

  In many cases, financial institutions and other investors respond well to opportunities to collaborate with other financiers in the early stages of local development planning. In many cases they are also willing to form consortia or financing syndicates to share the risks and costs of entering new local development finance markets, e.g. with SME growth capital or with structured debt for housing improvements, or PPPs for local infrastructure. There is great potential to foster private sector collaboration if local development leaders will convene such opportunities.

- Produce a business plan and investment plan for each intervention.

The basic task of understanding the potential financial performance of local development projects through detailed business planning is required. This is essential to enable easy and effective appraisal of the likely financial returns available. Performance management also becomes much more critical than is often the norm in the local public sector. Commercial finance can impose external disciplines on project which are important to ensure that financial performance is achieved. Such disciplines are also very important in building a longer term local investment market through the demonstration effect of the projects concerned.

- Develop an overall investment plan for the 4-8 key interventions.

  Putting otherwise disparate projects and interventions together into a portfolio that attract global financing may be a key ingredient to reduce the risks and costs of smaller project. This requires the development of an investment plan for a basket of projects and programmes. Our case studies demonstrate that this is an effective way to attract finance at the right scale to make local development worthwhile for institutional financiers. Detailed work is required to build such a portfolio, but it can pay important dividends for local development practitioners.

- Broker agreement across key public and private sector partners for each business plan.

  Many projects and programmes will require a blend of financing, where public finance may be used to enhance the returns or reduce the costs to private sector investment. Several of our case studies demonstrate such approaches. This frequently requires confidence form local development actors and a regulatory approach that encourage the controlled use of public resources to act as incentives for private investment. But such incentives need not be simply subsidies to private actors. They can operate as guarantees, preparation and feasibility costs, or subordinated investment capital.

Taken together, there interventions would substantially improve the investment readiness of local economic strategies and make it more likely that more external finance will be attracted and appropriate financial tools will be developed or more fully utilised.

Towards a transnational agenda: learning lessons and sharing practices

This review of local development finance innovations enables us to draw some conclusions on the importance of international exchange. The OECD LEED programme regularly reviews local development strategies, partnerships, and agencies in order to foster international exchanges. We have learned that the transferability of local development tools is not always a simple matter.

Local development practitioners from across the OECD are starting from rather different institutional and constitutional positions in both fiscal and financial terms. Financing tools for local development are very different from one place to another, creating a different balance of incentives and tools in each country. For example:

- **Economic development marketing** is often supported by chambers of commerce in countries where there is compulsory or widespread business membership of chambers. But in countries where chambers are less strong there is often a partnership venture created especially to develop marketing approaches. There is also a very wide variety of different arrangements through which higher tiers of government engage in economic development marketing.

- **Value capture financing techniques** in Europe have tended to be linked to planning agreements and the careful and continuous review of local property taxes. In the USA there is more focus on tax increments and designation of zones of impact and benefit (e.g. the TIF model). Elsewhere public ownership and sue of land is often key to land value capture.

- **Tax credits and incentives** are more widely used in some countries that in others, where transfer payments or other forms of public finance might be preferred. In the larger federalised countries there is often more competence to provide tax based mechanisms at the local level, but not always so. States and Provinces, in such countries, carefully regulate local government finance.

- **Guarantee systems** have been widely used in some parts of Europe, especially to address small business lending issues. In other countries these may be supported through bank regulation or through the establishment of special purpose funds.

- **City and Town Centres investment mechanisms** (BIAs, BIDs, SIDs, CIDs, etc) begun in Canada (and spread rapidly thought the USA) have

placed town/city centre investment on a statutory partnership footing, and have been effectively replicated in South Africa, Australia, and UK , despite beginning with a voluntary partnership. In many parts of Europe, especially where there is compulsory membership of chambers of commerce, similar services have been supported by these institutions.

- **Business attraction agreements** which are encouraged with tax abatements to investing firms in one place, are supported with co-financing of specific requirements (e.g. R&D facilities or site preparation) in others. Direct subsidies are now rare.

- **Infrastructure focused debt financing** instruments to meet long term investment requirements are provided by pubic bodies (e.g. through bonds or debentures) in some countries, and through private actors (e.g. through PPPs and Commercial Financing Consortia) in others.

We can summarise these kinds of differences in simple and direct ways. There are different approaches to local development finance across the OECD member countries because:

- Fiscal and financial authority is located at different tiers within prevailing public finance systems.

- Methods for defining, calculating, and appraising public sector debt vary across nations.

- Habits of 'ring-fencing' or 'hypothecating' certain public funds or fiscal revenues for specific purposes are at varying degrees of being established.

- Mechanisms for attracting, appraising, and managing public/private co-investment vary significantly.

- Regimes for encouraging financial institutions to get involved in economic development vary widely.

- Substantial variations in the extent to which public sector assets are subject to limiting controls about their sale, re-use, or participation in a financial transaction.

- The development of inter-governmental agencies, and single and/or free market agreements, between nations have produced very distinctive

outcomes in terms of the pursuit of parallel social and sub-national investment mechanisms.

- Political cultures vary in terms of appraising and accepting risk in relation to public sector investment in wealth creating activity and civic cultures vary in terms of how, and how much, popular support can be garnered for long term debt within more local tiers of public sector.

Despite this multiplicity of differences, we observed above that two basic forms of innovation are continuously emerging.

- There is a continued push by commercial intermediaries and investment institutions to create non-governmental approaches which define and develop new localised investment markets where it is clear that good returns might be made. This partly explains why so many financial intermediaries are becoming interested in local development and why the International Financial Institutions are an important source of support to them.

- Within government at various tiers, there are efforts to innovate with public finance in ways which will make it more supportive of local development, flexible and sensitive to commercial thresholds, and thus leverage private investment more effectively.

This combination of public and private enthusiasm, despite the complexity of the markets involved, provides the basis for a growing programme going forwards. Given that there is renewed appetite in both public and private sectors for financial innovation, it is worth beginning by understanding how local development practitioners across the OECD member nations can overcome rather different local development financial systems in order to learn across borders and boundaries and be able to innovate more effectively.

Given these major differences it may be tempting to conclude that the trans-national learning and transferability of local development financing tools is limited. However, the practical experience suggests otherwise. There are multiple reasons why local development practitioners and their partners in higher tiers of government and in financial institutions need to learn together and to adapt and adopt each other's successful practices. Our review of financing tools would emphasise several:

- Knowledge and understanding of international practices in local development finance are an important backdrop to reviewing local and

national approaches. Understanding the range of tools and approaches adopted elsewhere is not necessarily a step towards copying and transfer of policies. It may also act to reinforce and confirm local choices, or to seek alternative forms of innovation, or indeed improve upon other models.

- Understanding how local development finance tools are used in other countries may be as important as what those tools are. We mentioned above that many local development practitioners have more tools available to them than they use and this provides us with some justification for focussing transnational exchange as a form of capacity building.

- The skills of local development finance are in short supply, as described above, and there is an important transnational role in sharing and developing new skills sets.

- Leadership is a key ingredient in both public and private sector on financial innovation. This is especially sensitive to learning international lessons on what can work.

- Institutions and Intermediaries appear to be critical to how effectively financing tools are developed and delivered. Much of the best practices exchange may well take place at the level of institutions and leadership approaches, rather than individual tools.

- Evaluation of local development finance tools is an essential backdrop to transnational dialogue and exchange. It is important that evaluation address understanding of local development finance systems as well as individual tools and mechanisms.

- Learning, rather than copying, should underpin our approaches here. There is more skills and knowledge transfer in considering why and how an instrument has worked or not, than in simply borrowing it. This is why adaptation is even more important than adoption.

Some useful examples include:

Town Centre and City Centre Management and Investment

Good examples of local development efforts that engages multiple stakeholders and provides potential scope for public and private returns. Business Improvement

Areas were invented in Ontario Canada in the 1960s. They have been widely copied across the world and there are now approximately 50 000 worldwide. These districts offer a mechanism for joint financing and managing improvements to commercial and industrial locations through the agreement by a majority of businesses (either land owners or tenants) to support an additional levy to produce revenues for special services. The additional resources often begin by supporting additional safety and sanitation services to improve the commercial environment and aid marketing, but they can also develop into much more sophisticated investments and initiatives (such as infrastructure improvements and promotional initiatives).

Once a district is established it then has the revenue at its disposal and can capitalise through long-term debt instruments for capital investment, or use it to finance additional services.. Although invented in Canada, BIAs (as BIDs) really took off in the USA (see case study on New York above). In the USA context BIDs found a local fiscal system which was open to local tax increments being development for specific purposes.

However, BIDs are now being introduced into widely varying localities with different local fiscal regimes (often less open to incremental levies), and with variable business partnership mechanisms. BIDs are not workable without a critical mass of businesses that are willing to pay and to being charged a wide range of fees for particular services.

BIDs are good tools for reasonably healthy commercial and industrial centres that are tightly bounded and densely populated by the owner/users. Poorer areas that have many more business operating at 'breakeven' or worse are less able to support a BID. In some such locations BIDs have been attempted and then closed down. They are also less effective for more 'spread out' districts such as areas with a higher diversity of land uses, including residential and public service uses, where it is harder to capture the benefits of targeted improvements in area services and amenities.

In some countries where BIDs are being introduced, their role and scope is being overplayed, and as elsewhere, failure could be a major setback. Equally, in some countries that have a more restrictive local fiscal regime, the version of BIDs introduced may be much less potent that those that are delivering progress in cities like New York. These kinds of situations are critical to successful introduction of such a tool.

Venture Capital for Small Companies

An interesting area of policy exchange**.** In some parts of Europe, regional development banks began this work in the 1970s and 1980s and these efforts were augmented by the establishment of special regional venture capital by several EU countries in 1990s. Countries like Australia and New Zealand have followed suit. In the USA Small Business Investment Companies were established in the in the 1970s to enlarge the venture capital available to early stage smaller companies with growth prospects. The original intention in the USA was to trigger the market to respond, not to apply a permanent subsidy. The idea was that the SBICs would provide a spur to other institutional investors, demonstrating to them that reasonable returns were possible with such smaller firms. This was supported with tax incentives for investors, an approach then copied by venture capital trusts in the UK.

Creating special vehicles to develop small firm venture capital offers many interesting trans-national learning opportunities. The approaches offer different insights:

- US models show how the building of a specialist corporation with tax incentives for investors can work.

- EU models emphasise the use of public and private capital working together under the management of specialist fund managers

- Both models have to pay attention to the building of a flow of investment ready propositions and the attraction of skilled investors. Equally, they have to operate within wider system of SME Finance which will exhibit strengths and weaknesses as well as gaps and wider opportunities. For example, the growth of business angels in some countries play an important role in complementing institutional investors.

This is a good example of the need to examine and assess the whole of system of finance in a particular location or region in order to understand how an apparently attractive initiative actually works.

Attracting private investment into derelict or disadvantaged redevelopment areas

This is a key priority in many OECD countries. Large scale redevelopment of land is a key component of local development in many contexts, but is relatively

expensive without business investment, alongside. Tax incentives have been used in some places to encourage private sector co-investment.

Enterprise Zones were established in Britain in the 1970s and 1980s. These provide national tax incentives for businesses locating into a particular location to promote rapid urban re-development. In the UK, these Zones were time-limited and offered incentives in a very small number of tightly defined locations which had been the beneficiaries of very large scale public investment in infrastructure, and site preparation, with the objective of creating new business locations. The zones have now been copied and adapted over 20 000 times throughout the world to varying degrees of success. Zones worked in a limited but clear way in the UK because they were a means to enhance an existing long-term investment of government. The major problem is that whilst the UK zones were very small and well selected on grounds of need and opportunity, in the USA, zones were often much larger and more numerous. So their purpose was distorted from prioritising a limited number of small area regeneration targets in the UK to a general business subsidy within a wider area in the USA.

In other countries, for example South Africa, the lessons of the UK zones were learned and a smaller number have been designated, but with more sophisticated incentives that address social and employment goals as well physical investment by private sector bodies, There are a multiplicity of other models that have also been developed, but the idea of the targeted use of tax incentives to attract private investment into specific redevelopment areas is now one which is evolving through continuous experimentation across a number of countries.

Conclusions

At the OECD LEED Programme we have been thinking about the financing of local development for some years. One of our key questions has been: *'Is local development investment or expenditure for local government?'*. This is an interesting question because the answers appear to reflect very much the different local finance systems in our Member States. In countries with greater de-centralisation in financial structures there is stronger drive to improve the performance of local economies, and a wider canvass for innovation. In countries with more centralised financial systems, the shift is towards creating envelopes of innovation in which local governments can be more creative and attract greater private sector co-investment.

In our view though, it is important that local development comes to be viewed much more as an investment that local governments and their partners can make. By creating jobs, re-using disused land, and fostering new forms of entrepreneurship and investment, local governments are fostering the factors of growth in their economies and the growth of the tax yield in the municipalities, even if those tax yields are not captured at the local level. This must be of interest to all tiers of government.

Given the pace of innovation in local development finance, there is scope for a much more systematic observatory on the transferability of successful models. The OECD LEED programme will work with international financial institutions and national/local partners to help develop this approach with the aim of encouraging greater confidence and innovation in how local development is supported and how it can become a focus of productive investment.

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Annex A.
Key to case studies

Creating dedicated economic development revenue streams

1. Philadelphia: hotel room tax
2. Edinburgh: The EDI Group
3. Boston: The Boston Redevelopment Authority
4. Warsaw: European Investment Bank (EIB) loan for municipal infrastructure
5. Turin: Buoni Ordinari Comunali (BOC) - municipal revenue bonds
6. Baltimore: tax incentives
7. Copenhagen: property value taxation
8. Chicago: Tax Increment Financing (TIF)
9. San Francisco: Benefit Association Districts (BAD)
10. Glasgow: public-private partnerships
11. New York: Business Improvement District (BID) programme
12. Vancouver: gas tax
13. London: Congestion Charge

National initiatives

14. France: Caisse des dépôts et consignations
15. USA: US Federal Reserve
16. Canada: PILOT scheme

17. France: Société Financière pour Favoriser l'Industrialisation des Régions Minières (SOFIREM)
18. South Africa: Urban development Zones / Empowerment Zones
19. Canada: Green Municipal Fund
20. France: Urban Free Zones
21. Worldwide: real estate investment trusts
22. England: English Cities Fund
23. USA: Enterprise Foundation
24. Australia: social enterprise finance
25. New Zealand: venture capital funds
26. Australia: innovation investment funds

Development agencies, development banks and regional funds

27. USA, Greater Philadelphia: The Reinvestment Fund
28. Italy: Finpiemonte and Filombarda
29. Germany, Stuttgart: Regional Investment Bank, L-Bank
30. UK, East Midlands: Blueprint Fund
31. India: Tamil Nadu Urban Development Fund

International financial institutions

32. World Bank
33. Inter-American Development Bank (IADB)
34. Asian Development Bank (ADB)
35. Islamic Development Bank (IDB)
36. European Investment Bank (EIB)
37. European Bank for Reconstruction and Development (EBRD)
38. Council of Europe Development Bank (CoEDB)
39. Joint initiatives by the European Commission, the European Investment Bank and the European Bank for Reconstruction and Development

Foundations and NGOs

40. Ford Foundation
41. Local Initiatives Support Corporation
42. Open Society Institute and the Soros Foundations Network
43. The Gatsby Foundation
44. The Annie E Casey Foundation

Commercial banks and investment funds

45. USA: New York City Investment Fund
46. UK: Barclays Bank Urban and Regional Development Funds/Unit
47. Italy: Lombardy Bank Foundation - Fondazione Cariplo
48. Italy: Compagnia di San Paolo
49. USA: California Public Employees Retirement System (CalPERS)
50. USA: New York State Common Retirement Fund

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Investment Strategies and Financial Tools for Local Development

An important change is upon us in terms of what is needed to finance local economic development. Global opportunities for cities and localities have led to a renewed impetus for new financial tools. Addressing how public assets can be better used to generate private co-investment (rather than just sold for a once only "current value" price) is now the new mind-set, and thinking about the organisational vehicles needed at local and regional levels to promote financial innovation has moved on. As cities have to help nations respond to shifts in new global value chains, so renewed interest in supporting investment into cities is occurring.

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