MISSION CITIES' POLICY BRIEF
FINANCE AND INVESTMENT POLICY LAB

This policy brief presents policy recommendations on finance and investment formulated by cities participating in the EU Cities Mission (Mission Cities) for EU decision-makers and European national authorities. *These recommendations have arisen from discussions among 13 Mission Cities during the Finance & Investment Policy Lab, facilitated by NetZeroCities.*

NetZeroCities is a consortium consisting of 34 partners from 27 European countries, managing the Mission Platform for the EU Cities Mission "100 Climate-Neutral and Smart Cities by 2030".

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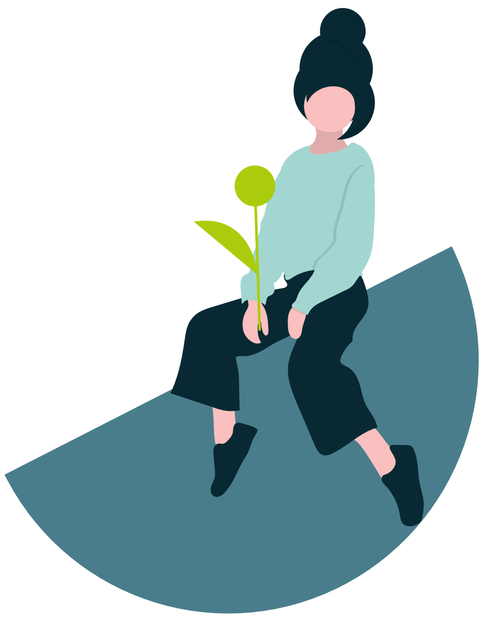
EXECUTIVE SUMMARY

The following Policy Brief addresses EU policymakers who are responsible for finance and investment mechanisms to support city ambitions in achieving climate neutrality by 2030. With a focus on the current EU policy landscape, this Policy Brief raises real-case challenges in navigating funding policies, as faced by Valladolid, Leuven, and The Hague on behalf of Cluster Pilot Cities. **Through collaboration among City Practitioners, this Policy Brief offers finance and investment related policy recommendations to EU policymakers**.

Cities play a crucial role in the transition to climate neutrality and have a unique opportunity to help drive change. At the same time, they are especially impacted by policies in terms of funding the projects that help make climate neutrality a reality. In this respect, regulatory barriers often found at the EU and national level, particularly in terms of finance and investment flows, must be overcome for Mission Cities to achieve their climate neutrality agenda. Therefore, **regulatory and policy barriers faced by Mission Cities should be high on the EU policy agenda and need particular attention within the upcoming EU mandate, after the elections in June 2024**.



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METHODOLOGY

NetZeroCities Policy Labs at the EU level convene city practitioners from Mission Cities and EU Thematic Policy Experts in a city-centric design to create collective learning on EU public policy by bringing the evidence from real-case city challenges and formulating policy recommendations for EU decision-makers.

The Brief is based on the presentations and findings from the second Policy Lab, focused on Finance & Investment issues. The session was led by three challenge owner Mission Cities (Valladolid, Leuven and The Hague on behalf of the Dutch Pilot Cities) and ten challenge solver Mission Cities from across Europe who discussed and formulated policy recommendations included below.

CHALLENGE OWNERS

VALLADOLID: HOW CAN EU POLICIES CREATE ENABLING CONDITIONS TO ATTRACT PRIVATE INVESTMENT/FUNDING AND INVOLVE PRIVATE COMPANIES AND CITIZENS IN THE PATHWAY TO CLIMATE NEUTRALITY?

Valladolid is one of the first cities to receive the EU Mission Label following the submission of their Climate City Contract, a recognition by the European Commission of their ambitious strategy to achieve climate neutrality. The city is currently in the implementation phase toward climate neutrality. The challenges faced by Valladolid in terms of accumulating private investment/funding are centred around its Climate City Contract Action Plans which are divided into four key areas. Valladolid has set **energy renovation of buildings and development of district heating networks** as some of its main focuses, owing to the fact that buildings and heating account to a total of 22% of the city's GHG emissions in 2019.

The city of Valladolid is collaborating with projects such as LEGOFIT to achieve positive energy building, as well as URBANEW to promote capacity building of different stakeholders such as local and national authorities in an attempt to increase energy efficiency. Meanwhile, to implement sustainable heating networks, Valladolid seeks to provide at least one positive energy district, in addition to the rehabilitation of housing blocks.

As for promoting **local energy communities**, namely another key area for Valladolid, the city is working on energy communities for private and corporate environments, ranging for over 1.000 small and medium businesses. The alignment of regional and local priorities is also done through active collaboration with EREN (Ente Regional de la Energía) along with a few other projects.

Another key focus is also the adaptation of **sustainable mobility to workplaces**, accounting for the concern of transportation as a sector which contributes 19% of GHG emissions in Valladolid. This is done by the city through engagement with small businesses for decarbonisation plans, with support from projects such as The Interreg Project, ADAPT CLIMA, and CENCYL.

However, despite Valladolid's efforts, a few challenges remain:

- Financial feasibility for action plans as local investment is not enough to achieve total investment.

- A need for more innovative ways to engage with key stakeholders (private companies, citizens, home and building owners) for commitment to invest in climate neutrality.

LEUVEN: HOW CAN WE RAISE AN INVESTMENT FUND BY LEVERAGING ON EUROPEAN MONEY, TAKING A GUARANTEE/FIRST LOSS/MONEY BACK POSITION?

The city of Leuven is also working on Action Plans based on its Climate City Contract—encompassing a total of 86 innovative breakthrough projects which could be mapped out into five emission domains, namely renewable energy, built environment, transport and mobility, circular economy and waste, as well as green infrastructure and nature-based solutions. The funding of these projects and the strategic questions that come with it (fund size, legal structure, assets, return, etc.) is what is currently being worked on.

In this regard, investment readiness, or the question as to how to actualise the city's projects into a pipeline with deal flow, poses a challenge for Leuven considering that not all projects are generating returns. Energy-related portfolio is particularly a revenue driver, but the city is still tackling issues of managing funds for its diverse set of projects.

Thus, Leuven is setting up a potential fund structure which focuses on dividing its categories of sub-funds into different initiatives. The city of Leuven is also opting for various efforts to raise investment funds, whether by issuing obligation bonds, or attracting money from the European Investment Bank (EIB), banks, or investors.

On that note, the remaining barrier still faced by Leuven is as follows:

- The need for EU-level policies that help with leveraging money while also taking into account warranties and first loss position.

DUTCH PILOT CITIES: HOW CAN WE ATTRACT FINANCING FOR PROJECTS, TOO SMALL FOR EIB STANDARDS, THAT ARE NOT CONSIDERED "INNOVATIVE" AND HOW TO CREATE MULTI-BENEFIT BUSINESS CASES AT THE DISTRICT LEVEL?

Dutch cities have been implementing a joint pilot project (Dutch 100CNSC Cities Pilot), as part of the Pilot Cities Programme, on creating a District Investment Platform in each city, to close the financial gap to invest in natural gas-free districts. However, the cities are faced with a financial gap between public resources and investments, in which only 10-20% of the required investments are accumulated thus far. For instance, the current budget for energy transition, sustainable mobility, and circular economy of the City of The Hague doesn't by far reach the necessary investments in the action plan.

The installation of sustainable heating grids is one of Dutch/The Hague's solutions for energy transition, and it requires the financing of not only the city but also of private partners. Currently, the risk of market failure due to high upfront costs and revenue risks stand as a barrier for private partners and are passed on to the local government. On the other hand, many of these projects do not necessarily meet the "innovative" criteria for EIB investments either[1]. The financing in the acceleration of heat grids is ultimately a complex process as it involves many different partners and combined plannings, while they are crucial in upscaling and accelerating the heat transition.

In dealing with this challenge, Dutch cities are learning from the process of nature-based solutions with multi-benefit business cases and positive energy districts which brings about the integration of different systems and infrastructures. This de-risks the projects and attracts more investors and financiers to trust and invest in the system, though not as a whole.

Even so, the Dutch cities still face the following challenges:

[1] EU funding is directed to innovation, as in line with its European Innovation Agenda focused on reducing GHG emissions through deep-tech innovations.

- Most private investors are more inclined to short-term returns on their investments.

-The bankability of district projects is too small and therefore they do not qualify for EIB investments or big private investors. The cities are still in search of how to combine projects with the same risk profile to overcome this barrier.

-Government bonds are overrepresented in pension fund portfolios, leaving opportunities unexplored. The Netherlands does not have a strong national investment institution that can act as a reliable partner for private parties seeking to develop or finance sustainable activities.

-Government funding and support for sustainable projects are fragmented.

-Banks, pension funds, insurers and asset managers will need to redirect their financial flows: phase out funding for non-sustainable activities; increasing financial flows towards sustainable activities (circular business, renewable energy infrastructure)

-In the case of The Hague, the city has extensive knowledge of financial instruments and has developed revolving funds for energy transition and (sustainable) economic development. The city has not yet used opportunities such as advisory and matchmaking services offered under flagship initiatives such as Smart Cities Marketplace.

CURRENT POLICY CONTEXT

The capital needs for cities to implement a successful transition towards climate neutrality is difficult to estimate. The gap between the financing capacity in most cities as compared to the investments for net zero transition required is enormous. This implies that cities will need to rely on the redirection of public and private investment to pay for climate neutrality transitions, maximise synergies of public spending by increasing the positive climate impact of local projects through alignment with the EU Taxonomy and working with stakeholders to align private investments with climate neutrality targets.

Municipal revenue streams generally fall under the following categories but vary in terms of relevance for municipalities across European member states: taxes, revenue from the use of funds and public property, licenses and permits, fines and forfeitures, service fees, and national and regional budget contributions. The utilisation of indirect subsidies from other agencies and levels of government (e.g., EU programmes, national grants) or other sources such as philanthropies or corporate social responsibility programmes are important ways to boost or optimise funding for climate action in cities.

Grants or subsidies are an important source for cities to obtain funds in addition to their existing municipal budget for climate neutrality projects, especially in cases where creating financing plans with suitable risk profiles, business models, and returns on investment proves to be challenging. Most frequently, grants are provided to both the city administration and private actors (citizens & companies) through national governmental institutions (such as development banks, ministries, national and regional authorities) or through European Union institutions (such as EIB, CINEA, DG Regio, EBRD).

The European Union budget provides funding for initiatives that serve the EU policies. The 2021–2027 Multi Financial Framework (MFF), of EUR 1,211 trillion, provides the framework for financing nearly 40 EU spending programs and European Structural and Investment Funds (ESIF) over the seven years with an emphasis on climate action and neutrality. Various financial instruments that are implemented in collaboration with public and private institutions, provide access to EU funding. The three primary instruments are loans, guarantees, and equity (NetZeroCities, 2023).

LIFE - Clean Energy Transition (CET)

The LIFE Clean Energy Transition Programme supports the delivery of EU policies in the field of sustainable energy, particularly the European Green Deal, the Energy Union (2030 energy and climate targets) and the European Union's 2050 long-term decarbonisation strategy. It is a key policy-support programme underpinning measures of the Energy Efficiency Directive (EED), Energy Performance Building Directive (EPBD), Renewable Energy Directive (RED) and related EU policy initiatives by:

•Building a national, regional and local policy framework supporting the clean energy transition.

•Accelerating technology roll-out, digitalisation, new services and business models and enhancement of the related professional skills on the market.

•Attracting private finance for sustainable energy.

•Supporting the development of local and regional investment projects.

•Involving and empowering citizens in the clean energy transition.

In addition, two LIFE-CET initiatives are dedicated to empowering energy agencies (ManagEnergy) and boosting sustainable energy investments in cities (European City Facility).

Sansoni, M. (2024)

Financial Institutions are stepping up to collaboratively support cities in mobilising and gaining access to the climate finance needed to develop sustainability projects. Financing sustainable cities is a complex challenge. In areas like renewable energy, energy efficiency, water, and transportation—where they have made significant progress within their mandates and have developed a greater focus on the financial needs of cities—multilateral and bilateral financial institutions are largely focused on national rather than city-level entities, but they still constitute a significant source of funding for investments pertinent to cities. The macroeconomic level is frequently the target of financial institutions urban sector strategies, which aim to increase city productivity through better financial and governance management, housing and infrastructure accessibility, integrated land-use planning, and private sector development. In some cases, these efforts also include dedicated urban climate initiatives. (NetZeroCities, 2022).

The EIB is the European Union's bank, where the EU Member States are shareholders, and its role is to fund projects that foster European integration and development. The EIB has been playing a fundamental role in promoting the expansion of European urban investments, raising substantial funds on capital markets and lending on favourable terms to projects that further EU policy objectives. Of the European Investment Bank's EUR 50-70 billion of annual lending, more than 10% is allocated specifically to urban projects and indirect investment in the urban sector exceeds 40% of its overall portfolio. The main instruments of financing are:

•**Investment loans:** Subsidised direct loans targeted for specific projects or programmes.

•**Framework Loans:** Loans provided

directly to a larger municipality (75,000 plus inhabitants).

•**Framework loans via intermediary:** Loans for smaller municipalities are provided through intermediary banks.

•**Equity funds:** Investment in other funds that target urban development, infrastructure or brownfield to generate further investments in the fund.

•**Technical Assistance Grants** (ELENA).

•**Advisory support for cities**.

•**Loan Blending:** EIB also uses blending facilities to blend its loans with grants from public bodies or philanthropic organisations.

(Deska, 2024).

In order to achieve climate neutrality, cities must leverage the substantial funding that could be made available to them through EU funding programmes and financial institutions in the coming years. However, to draw in private sector funding for these initiatives, cities must collaborate with national and international Development Finance Institutions (DFIs), as well as private actors, to implement strategic reforms aimed at removing obstacles related to the city's legal, regulatory, and credit environments. Some of the instruments for private sector financing are Public Private Partnerships, bonds, institutional financing (e.g., from pension funds, insurance companies, sovereign wealth funds, etc.) and Special Purpose Vehicles (SPV).

CHALLENGES AND GAPS

• Many funds are provided by the European Union to finance climate or nature related projects. The main challenge is for cities to access and absorb part of these funds and what instruments are put in place to allow this. Indeed, most of the European funds are managed by Member States and are not directly accessible for cities at the EU level (with some notable exceptions) and even more so for hard investments in the implementation of projects. Therefore, the distribution of these funds to the local level depends on the Member States' priorities and functioning and on the requirement of the fund itself.

• The minimum limit for an EIB direct loan to the city is EUR 100 million which makes it difficult for small to medium-sized cities to access the loan. For loans smaller than EUR 100 million, EIB through ELENA supports banks at the national level to offer loans at attractive conditions or with advisory support at the project stage for smaller loans. This leads to a longer approval time.

• To meet the eligibility criteria and the timelines of the calls for funding, the cities must undergo a cumbersome application preparation process internally which involves investment in time and resources on behalf of the city. Moreover, the myriad of existing funding programmes makes it a complicated path to navigate the search for the best-suited funding.

• Cities are often unaware of all the available funding opportunities available to them. There is no one clear platform that lists all these opportunities and guides them to find the most appropriate initiatives by comparing conditions, eligibility criteria and application deadlines.

• In many countries, there are (national, regional and local) regulations and legislation in place that limit cities' climate finance options. For example, according to the Covenant of Mayors report (2016), some cities are legally constrained from taking debt, affecting their capacity to invest and

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develop projects in the field of climate. Similarly, Energy performance Contracting is regulated in different ways across countries where in some countries they are on balance contracts while in others they are off-balance contracts. This impacts the financial standing of the cities.

• Cities often find it difficult to combine funding from different sources (private, public) or different levels (European, national, regional, local) to finance a project. Cities often lack proper mechanisms and technical capacity and/or are limited by fiscal policies at the national level to help them combine these resources.

• Due to the lack of understanding of the codes of the private sector, cities sometimes find it difficult to propose 'bankable' projects and therefore to engage with the private sector and negotiate the most favourable conditions.

(NetZeroCities, 2022)

POLICY RECOMMENDATIONS

In the policy context outlined above and based on discussing the Mission Cities' challenges and possible solution during the Policy Lab on Finance & Investment, the following policy recommendations were formulated. They are mainly targeting EU decision-makers while also considering the vital role of national governments in creating enabling conditions for cities to transition to climate neutrality.

1) Simplifying regulations at the city level by aligning climate and finance-related policies at the national level with overall EU regulations across all member states.

Currently, there is a lack of harmonisation of EU, national and municipal regulations with regards to accessing climate finance that form barriers to climate-neutral investments. Since cities have minimum influence on bureaucratic requirements at higher levels of government, specifically at the national level, there are structural challenges that cities face to implement their action plans. Climate-neutral investments can be facilitated by simplifying municipal regulation and aligning municipal climate policy with EU regulations which should be in line with the national policies as well. Improving the regulatory frameworks to ensure they are transparent, consistent, and predictable, are critical factors for private investment decisions. At the same time, coherent climate policies across the member states would also help in scaling up city-level initiatives at the regional/national level and enable peer-to-peer learning. This alignment should include mechanisms for sharing best practices and financial incentives that encourage local innovations while maintaining consistency with broader regulatory objectives.

2) Leveraging EU-level funding to attract private sector investment for financing climate-neutral projects.

Since NetZeroCities as the Mission Platform engages directly with the cities, the involvement of the national governments have been quite minimal when it comes to alleviating funding and financing challenges that the cities are facing. Hence, a few recommendations on leveraging climate-related funding to create larger finance pools for cities are stated below:

- **Utilise EU Urban Funding Initiatives:** National governments could support cities to tap into dedicated EU funding programs like the European Urban Initiative or European Regional Development Fund, specifically tailored for urban projects. Cities can use these funds to seed initial investments in climate-neutral projects, thereby de-risking the ventures and attracting private investors.

- **Develop Tailored Financial Instruments:** National governments could work with EU institutions to create bespoke financial instruments for city/municipal climate action, such as urban green bonds or city-specific investment funds that focus on achieving climate-neutral goals, that also align with the respective national fiscal policies. These instruments can offer favourable terms to private investors, such as tax incentives or risk-sharing mechanisms.

- **Optimise Utilisation of existing Financial Matchmaking Platforms:** National governments can support in optimising the use of several financial matchmaking platforms like the Smart Cities Marketplace, InvestEU, EUCF, etc that connect cities seeking financing with private investors interested in funding climate-neutral initiatives. Not all platforms are equally serviceable, hence, creating a matrix to support decision-making could help cities to connect with these platforms which in turn could facilitate matchmaking through regular networking events, online databases, and investment showcases that highlight potential returns and environmental impacts.

- **Foster Public-Private Partnerships :** National regulations should promote the development of PPPs specifically designed to support climate-neutral objectives in the cities, where the national governments could also be a shareholder driving the process and ensuring fair terms for all parties. These partnerships can leverage EU funding as a catalyst, encouraging private sector involvement by mitigating initial investment risks and aligning project goals with public sector sustainability targets.

Smart Cities Marketplace is an European Commission initiative to engage with cities of all sizes in attaining sustainable urban environments. The initiative offers solutions, assisting with not only projects but also its financings for cities from its growing investor network. It has over 90 successful European projects in both small and medium-sized towns, as well as big cities such as London, Barcelona and Vienna. Thus far, the initiative has reached a total of €616.3 million in bankable project proposals. Some of the main focuses include mobility, sustainable districts and built environment, energy and ICT infrastructure, transportation, citizen engagement, as well as urban governance.

InvestEU is a programme under the NextGenerationEU and the multiannual EU budget, aimed at supporting sustainable investment, innovation, and job creation in Europe. The programme leverages both private and public funds in mobilising private investments for EU's top policy priorities, such as economic recovery, green growth, employment, and social well-being. From 2021-2027, the programme is expected to mobilise at least €372 billion in additional investment in the EU, as well as private investments through an EU budget guarantee of €26.2 billion. InvestEU consists of three parts, namely the InvestEU Fund, the InvestEU Advisory Hub, and the InvestEU Portal. The InvestEU Fund itself offers support for sustainable infrastructure, research, innovation, and digitisation, social investment and skills, as well as small and medium-sized enterprises (SMEs).

Fi-compass is an advisory service under the European Commission in cooperation with the EIB, focusing on financial instruments under the EU shared management. It provides information resources on financial instruments such as methodological handbooks, factsheets, case study publications, and EC regulatory guidance. Beyond that, fi-compass also offers seminars and networking events. The programme aims to facilitate European Structural and Investment Funds (ESIF) managing authorities, EaSI microfinance providers, as well as other interested parties.

3) Systematic identification of funding gaps in public promotional approaches.

Cities claimed to face partially tremendous funding gaps from private and public sources. In order to be able to react to evolving cities' needs and create enabling policy conditions for funding cities' climate goals, EU institutions should get involved with cities to close the gap. Therefore, in-depth analysis, offering and creating opportunities for direct exchange, knowledge sharing and needs assessments would be beneficiary to identify funding gaps in public promotional approaches:

• Selection of a sample of relevant cities and identification of relevant funding schemes on different levels (EU, national, regional) for a selected number of climate-related projects.

• In-depth analysis of the demand and supply side for public promotional support (financial and technical) in close collaboration with relevant stakeholders while taking into consideration failures in financial market mechanisms.

• Presentation and discussion of identified funding gaps with relevant stakeholders.

• Feeding ongoing discussions on the next phase of EU Climate Policy (e.g. towards the 2040 objective) with key findings of the funding gap analysis enhancing the importance of municipal climate finance.

4) Utilising policies as a tool to re-evaluating investments from an impact and return perspective:

Cities predominantly highlighted the socio-economic benefits being largely neglected by the investing community despite the positively evolving reporting ecosystem. Creating a space for a holistic assessment framework for evaluating infrastructure projects that consider not only their financial viability but also their broader socioeconomic impacts also help the EU track municipal investments better. This framework can include indicators related to job creation, income generation, social inclusion, and public health and other macro indicators such as contribution to the national GDP.

Promoting to conduct a social cost-benefit analysis including equity considerations as part of project appraisal processes as a part of pre-feasibility/ feasibility studies to quantify and monetise the social and environmental benefits of infrastructure investments to bring transparency to the private sector, multilaterals and DFIs on the progressive returns they are making in a wholistic view over just evaluating the monetary returns. Paying special attention to equity considerations in infrastructure financing decisions would also help climate investments penetrate underserved neighbourhoods, marginalised populations, and areas with high levels of deprivation to promote inclusive and equitable development which otherwise gets overlooked in many scenarios.

Such a move can also provide a framework for private investors or investors to bundle projects in packages with different levels of monetary and socio-economic returns to make a better economic case for them.

5) Focusing on regulatory policies to leverage multiple sources of financing to support equity funds:

A regulatory policy outlining the broad parameters to combine seed funding initiatives with other support measures to attract more private equity funding for infrastructure investments. Designing a mechanism to provide seed funding or co-investment capital from public sources, complemented by additional support from EU financial institutions such as the European Investment Bank (EIB), the EU can catalyse the establishment of equity funds targeting infrastructure assets. This initial public support mitigates early-stage investment risks and enhances the attractiveness of infrastructure investments for private equity investors.

Furthermore, leveraging EU support mechanisms, such as concessional loans, equity co-investments, guarantees, and technical assistance programs, can provide additional financial backing, risk mitigation, and capacity-building support to equity funds, thereby incentivising greater private sector participation in infrastructure financing. Through this combined approach, the EU could create a conducive environment for attracting private equity funding, fostering investment innovation, and accelerating infrastructure development to meet critical societal needs.

CONCLUSION AND REMARKS

Finance and Investment are major levers of change for Mission Cities in their transition to climate neutrality. The variety of projects calls for tailored funding options that relate to cities' needs and provide favourable conditions for the private sector to get involved. Therefore, improving and, where necessary, creating enabling conditions for cities to access funding and financing for their transition to climate neutrality is crucial. **The requests from Mission Cities are based on their own experiences. They can help pave the way for other European cities to make significant progress towards their climate goals.**

NetZeroCities will continue to pursue the aims and recommendations highlighted in this Policy Brief, for example, by engaging with EU policymakers where possible, facilitating exchange with cities and promoting the recommendations at key events/conferences across the EU.

RELATED RESOURCES

NetZeroCities (2022). City climate finance: landscape, barriers and best practices. Deliverable 7.1

Covenant of Mayors for Climate & Energy. (2016). Sustainable energy investment in European local authorities. Report.

Presentations

Sansoni, M. (2024). "LIFE Clean Energy Transition: Opportunities for cities and successful case studies": Presentation at NZC Policy Lab - Finance and Investment, 9 April 2024.

Deska, W. (2024). "EIB Financing and Advisory": Presentation at NZC Policy Lab - Finance and Investment, 9 April 2024

Websites

LIFE Clean Energy Transition sub-programme (viewed on 30.04.2024)

EUCF (Viewed on 30.04.2024)

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