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# Pilot Action 1 Summary report

***P9 IRENA***

## SUMMARY OF THE PROPOSED FINANCIAL INSTRUMENT

The aim of this Pilot Action (PA) was to provide an objective and independent assessment of the possibility of implementing an innovative financial instrument for the improvement of EE and use of RES by the end-users, Croatian entrepreneurs, and craftsmen. The Ex-Ante assessment was performed at the level of Istrian County. Although the Istrian County is by all relevant indicators the second most developed county in the Republic of Croatia, the analysis of market needs and investment preferences of Istrian entrepreneurs, showed very low interest in investing in the improvement of Energy Efficiency (EE) and use of Renewable Energy Source (RES).

Low interest is further reduced when only a classic financial instrument or a favourable loan is offered. Therefore, for the purposes of this PA, an innovative financial instrument has been created which represents a hybrid of a classic financial instrument and EU grants, i.e. a hybrid model which, in addition to a loan with low-interest rates, includes the payment of grants as "rewards"/incentives to entrepreneurs to contribute to achieving EU energy and environmental goals. Namely, as shown by the results of statistical analysis of the use of EU financial instruments and grants, and the results of conducted surveys, the right measures or trigger that would encourage increased investment of SMEs in improving EE and use of RES in the Istrian County are grants combined with financial instrument/loan.

A reasonable percentage of the grant (up to a maximum of 30,0% of the total eligible project costs) in this hybrid model will significantly increase the use and absorption of financial instruments, which will directly result in increasing the number and amount of investments, achieving local energy goals and relevant energy and environmental objectives at EU level. In the proposed hybrid form of the FI, the grant element will have a share of at least 10.00% and at most 30.00%, depending on the size of the firm and the type of project. The loan amount will range between HRK 52.500 - HRK 3.375.000. After a grace period up to 24-month repayments takes place on a monthly, quarterly, or semi-annual rate. The loan will be repaid within 12 years. Interest rate equals 0,05% - 0,75% depending on the size of the beneficiary. The source of funding the pure financial instrument (in this proposal, the loan) will be in the program InvestEU (after termination of the use EFSI), while the sources of the grant will be the grants from ERDF and a combination of national and regional(local) funds.

## VALUE ADDED OF THE FINANCIAL INSTRUMENT

Usually, the leverage effect of an FI is considered as the added value of the FI, but in the case of IFI intended exclusively to improve energy efficiency and use of RES, the value added can also come from positive effects on improving the availability of capital for SMEs and micro-entrepreneurs, increase in investments in energy efficiency and use of renewable energy sources, contributions to the realization of SEAP/SECAPs and the contribution to the achievement of energy, climate and environmental objectives of the EU. In terms of quality, the proposed innovative financial instrument can result with an increase in the number of investments, the amount of investment in the sector, reducing CO<sub>2</sub> emissions, reducing energy losses, increasing the share of renewable energy resources, the realization of energy action plans, increasing the absorption capacity of the Republic of Croatia in terms of using EU assistance (grants and financial instruments), new jobs, reducing unemployment, increasing employment, reducing the SMEs operating costs, increasing the competitiveness of SMEs, etc. In order to effectively measure and analyze quantitative indicators of the added value of an innovative financial instrument, optimal indicators were identified and listed in the Ex-Ante assessment, such as number of approved projects/investments, number of implemented project/investments, number and surface area of facilities that have increased energy efficiency, the total amount of investments, energy consumption in the observed period, the amount of CO<sub>2</sub> and other emissions of harmful gases, etc. Regarding the calculated leverage effect of the IFI, during the analysis, in the observed period the debt ratio of Istrian firms averaged 0,63, the own financing ratio was 0,37, the financing ratio was 1,71, and the value of the debt factor was 6,29. Since the level of corporate debt should never approach 100%, the low absorption capacity of financial instruments among Istrian firms had to be considered. At that point, the grant element has an important role, namely the grant is partially neutralizing the increase of the leverage of beneficiaries due to the loan component. Based on the appropriate methodology the net leverage effect of the innovative financial instrument is 74,15%. Possible private resources can further increase leverage. Financing from commercial bank resources can contribute to a higher level of leverage. As an important value driver after the leverage effect can be also the multiplicative characteristic of the loan element as the loan element assures a higher impact on the Istrian economy than the initial total volume of the loans.

## INVOLVEMENT OF STAKEHOLDERS

During the evaluation of the Pilot Action, various important stakeholders were identified together with their relation to the project. In the first phase of the IFI development, several meetings and workshops were organized and surveys and interviews conducted to help to explore the needs of SMEs as main users, and to know also the aspects of the supply side. Local authorities from the Istrian County, representatives of three commercial banks, and Croatian Bank for Reconstruction and Development and the Ministry of Regional Development and EU fund were the main stakeholders that participated during the first phase. As the development of the IFI progressed and reached the point to create an effective and efficient strategy for governing an IFI, two models of implementing structure were proposed. Taking into account the EU and national legislative directives related to defining the institutional framework for the implementation of cohesion policy instruments, model one represents the governance structure according to the established criteria and directives for the implementation of ESI Funds in the programming period 2014-2020, without the need for significant harmonization in regulations, rules, and procedures and it involves the Ministry of Regional Development and European Union Funds as the Managing Authority, the Ministry of Economy, Entrepreneurship and Crafts and the Environmental Protection and Energy Efficiency Fund as intermediary bodies and the Croatian Bank for Reconstruction and Development (HBOR) as the implementing body of the IFI. In addition to creating an IFI that would contribute to increasing investment in EE improvement and the use of RES, the focus of the PA was to find a model that would significantly increase the absorption capacity of the Republic of Croatia from the aspect of community assistance usage (grants and financial instruments), and related socio-economic benefits. Thus, model two could represent an innovative implementation model that implies the creation of a decentralized institutional framework for operational implementation. Certain legislative changes and adjustments are needed for this kind of implementation, mostly related to regulations on bodies in the management and control systems for the use of ESI Funds. The amended regulations would allow the Managing Authority to designate counties as intermediate bodies for the implementation of the IFI, HBOR would remain as the implementing body, and County's energy and/or development agencies would play an important role in the implementation by sharing knowledge and experience throughout the technical support.

## EXPECTED RESULTS OF THE FINANCIAL INSTRUMENT

The results of research and analysis indicate that the use of an innovative financial instrument and its feasible decentralized implementation would significantly contribute to increasing the number and amount of investments of entrepreneurs in craftsmen in EE and RES projects in Istrian County and consequently in the Republic of Croatia. It is conservatively estimated that thanks to the presented model of financing, implementation and management, in the next programming period, only in the Istrian County will be realized 302 investments in EE and RES, with a total investment value of 147.997,00 million Kuna which is approximately 20 million euro. It is foreseen that entrepreneurs in other Croatian counties will show much greater interest in investing in the improvement of EE and the use of RES if they will have at their disposal the proposed financial instrument, implemented according to simplified procedures. In addition to increasing the number and amount of investments in EE improvement and the use of RES as a precondition for reducing CO<sub>2</sub> emissions, reducing energy losses, increasing the share of RES, achieving targets of energy action plans, and finally achieving EU energy and environmental goals, the proposed model would significantly contribute to increasing the absorption capacity of the Republic of Croatia in terms of using EU assistance (grants and financial instruments), new jobs, reducing unemployment, increasing employment, reducing operating costs of SMEs and increase SMEs competitiveness.

## TRANSFERABILITY

The conducted Ex-Ante assessment and the proposed IFI, in terms of transferability should be considered twofold. First, since the conducted assessment was carried out for the territory of the Istrian County, during the development and the elaboration of the IFI, it was considered that the proposed model should also mostly fulfill the needs of other Croatian counties, and in this way the transferability will be assured on the local/regional level. Second, an analysis should be provided if the proposed model is appropriate and applicable in other partner regions or other member states in the EU. The hybrid form of FI consisting of loan and grant component can be an appropriate tool to enhance EE and RES related investments among SMEs. The developed IFI can be a good practice in all foreign member states where the present absorbent capacity of firms regarding a sole loan or credit instruments is limited.

