Eurostat clarification

CLARIFICATION ON THE APPLICATION OF A GUIDE TO THE STATISTICAL TREATMENT OF PPPS: RESPONSES TO FREQUENTLY ASKED QUESTIONS

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1. This Eurostat clarification supplements *A Guide to the Statistical Treatment of PPPs*, published on 29 September 2016 (the Guide)[1].
2. It consolidates Eurostat's responses to questions on the interpretation and application of the Guide that have been raised by national statistical authorities and PPP stakeholders since its publication. Some of these have been general in nature, while others have been raised in the context of a specific PPP project or PPP programme. In publishing these responses, Eurostat's intention is to promote further transparency and consistency in the statistical treatment of PPPs across EU Member States. There is no intention at this stage to produce an updated version of the Guide, but this note may be updated (or supplemented by similar notes) from time to time to include responses to further queries.
3. EPEC has assisted in the preparation of this note by providing Eurostat with information and expertise concerning the relevant PPP provisions and structures. The comments expressed in this note are, however, those of Eurostat alone and do not reflect the views of EPEC or the EIB.
4. The views expressed by Eurostat in this note constitute official Eurostat guidance, but readers should not rely on them as constituting Eurostat's advice for a specific project or programme. Final decisions on the statistical treatment of specific projects or programmes remain with national statistical authorities and, ultimately, Eurostat.
5. This note should be read alongside the Guide and terms and expressions used in this note have the meanings given to them in the Guide. The scope and limitations of the Guide[2] apply also to this note.

[1] http://ec.europa.eu/eurostat/documents/1015035/7204121/epec-eurostat-statistical-guide-en.pdf

[2] See pages 10 to 12 of the Guide

Price movements during the Construction Phase

1. **Question:** Theme 5.4 of the Guide states that provisions for indexation of the Operational Payments during the Operational Phase have no impact on the assessment of the statistical treatment of a PPP. In this regard, the Guide recognises that the Authority taking the risk of movements in price during the Operational Phase is neutral to the statistical treatment. Can Eurostat clarify if this principle extends to movements in the construction price during the Construction Phase?

   Eurostat response: *The Authority can take or share the risk of movements in construction prices and not for other construction risks such as delay, choice of material, quantity of materials, construction defects, etc. during the Construction Phase without any impact on the statistical treatment of a PPP.*

   The mechanism by which the Authority takes or shares this risk must allow for objective verification of the construction price movements (for example by reference to an index or indices generally recognised in the relevant jurisdiction or sector). It must isolate changes in the cost of construction resulting from movements in construction prices from changes in the cost of construction due to other construction risks which must be allocated to the Partner (such as design, delay, choice and quantity of materials etc.).

   The way in which the Authority bears, fully or partly, the financial consequences of the movements in construction prices (for example, payments during or at the end of the construction phase or compensation in one payment through adjustment to future Operational Payments) has no impact on the statistical treatment.

Assessing a contract change

2. **Question:** An Authority is proposing a change to a PPP contract that was signed in 2012 (before the Guide was published). The contract was assessed as off- balance sheet under 2012 rules. The change involves altering the original design and construction of the asset and the Authority is proposing to pay for the alteration works through a capital payment to the Partner. Will this change have any impact on the original statistical treatment?

   Eurostat response: *The Guide says that, when a contract is changed, it is necessary to assess whether the change itself affects the original statistical treatment. This requires an assessment of the change itself under the rules that exist at the time of the change. If the change itself alters the statistical treatment, the original assessment must be revised.*[3]

   Assessing the change under the Guide, the capital payment for the alteration works is government financing. Government financing of any amount has an influence on the statistical treatment (MODERATE, HIGH, VERY HIGH or even automatically ON BALANCE SHEET).

   *The capital payment for the alteration works must be aggregated with government financing already committed to the PPP. If the capital payment brings the **aggregate amount of government financing** to 50% or more of the capital expenditure incurred in the construction (and alteration) of the asset, then the PPP must now be recorded ON BALANCE SHEET for government.*

   *If, on the other hand, the capital payment for the alteration brings the **aggregate of***

[3] See pages 16 to 17 of the Guide

***government financing** to 10% or less (a MODERATE issue), between 10% and one third (a HIGH issue) or between one third and 50% (a VERY HIGH issue), then the PPP will remain off balance sheet for government.*

While Eurostat will not reassess the entire contract under the Guide in this scenario, it is important to note that the capital payment for the alteration works (leading to MODERATE, HIGH or VERY HIGH government financing) will be assessed in combination with any other changes that the Authority has made to the contract since publication of the Guide. If the combination of these changes falls outside the thresholds contained in Chapter 4 of the Guide4 then the PPP will be reassessed as ON BALANCE SHEET for government. Similarly, the impact of any subsequent change to the contract would be assessed in combination with the government financing introduced by the capital payment for the alteration works.

Type of asset (Chapter 2)

3. **Question:** Could street lighting assets come within Eurostat's definition of a PPP?

   Eurostat response: *Yes, but only if the particular assets which the Partner is required to provide and maintain are "clearly identifiable and specifically designed". In Eurostat's view this would exclude, for example, a project for the provision and maintenance of the street lighting bulbs only, but might include a project for the provision and maintenance of an entire street lighting system (including columns, cables, bulbs, software etc.).*

   To qualify as a PPP, of course, other features of the project would need to comply with the guidelines set out in Chapter 2 (e.g. classification of the parties, economic life of the asset, contract duration, 50% rule on refurbishment etc.)

Revenues received by government from the project (Chapter 2) / Third party revenues from the asset (Theme 5.5)

4. **Question:** What types of "third party revenues" count towards the thresholds specified in Chapter 2 (Revenues received by government) and Theme 5.5 (Third party revenues from the asset)?

   ***Eurostat response:** On this issue, Eurostat draws a distinction between revenues that the Authority receives in connection with services that it delivers from the asset (which do not count towards the thresholds) and, revenues that the Authority receives that are directly linked to the use the asset itself. The following examples help to illustrate this distinction:*

Type of revenue received by the Authority	***Counted in the third party revenue thresholds?***
The Authority (a health authority) receives central government funding to provide health services at a PPP hospital	*No*
The Authority (a health authority) receives fees from patients (directly or via insurance companies) in return for health services that it provides at a PPP hospital	*No*
The Authority (a health authority) receives rent/fees from a private healthcare provider that rents part of the facilities at a	*Yes*

[4] See page 141 of the Guide

Type of revenue received by the Authority	*Counted in the third party revenue thresholds?*
PPP hospital	
The Authority (a health authority) receives rent/fees from a third party that rents retail space (e.g. a catering franchise operator) at a PPP hospital	*Yes*
The Authority (an education authority) receives central government funding to provide education services at a PPP school	*No*
The Authority (an education authority) receives tuition fees from students for education services that it provides at a PPP school	*No*
The Authority (an education authority) receives fees in return for ancillary education services that it provides at a PPP school (e.g. after-school childcare)	*No*
The Authority (an education authority) receives rent/fees from a third party who uses a PPP school facilities to provide after-school childcare services	*Yes*
The Authority (an education authority) receives fees/rent from community groups or individuals for renting the gymnasium at a PPP school	*Yes*
The Authority receives tolls paid by users of a PPP road	*Yes*
A PPP road is within a zone for which users pay a congestion charge to the Authority	*Yes*
The Authority receives fees from users of a car park at a PPP facility	*Yes*
The Authority (a housing authority) receives rent from tenants of PPP houses	*Yes*
Tax revenues are received by a government tax office operating from a PPP building	*No*

5. **Question:** Theme 5.5 states that third party revenues that the Authority is forecast to receive need to be compared against the payments that the Authority is forecast to make to the Partner. In making this comparison, should any costs that the Authority is forecast to incur in connection with those third party revenues (e.g. costs it may incur in providing users with access to a service or to the facilities) be deducted from the revenues that it is forecast to receive?

   Eurostat response: *No, the Authority's costs should not be deducted. It is <u>revenue</u> that the Authority is forecast to receive from third parties (not profit that it is forecast to generate) that needs to be measured against the thresholds specified.*

6. **Question:** On a project where third party revenues are collected by the Partner and shared between the Authority and the Partner, the Authority might receive its share as a direct payment from the Partner or, alternatively, as a reduction in the Operational Payment. Is the statistical treatment the same in both of these cases?

   Eurostat response: *Yes. The assessment of third party revenues received by the Authority would be the same in both cases.*

7. **Question:** Theme 5.5 states that the third party revenues that the Authority is forecast to receive need to be compared against the payments that the Authority is forecast to make to

the Partner. Should any "pass through costs" that the Authority is forecast to pay to the Partner in addition to the Operational Payments (e.g. for utilities) be included or excluded in that comparison?

Eurostat response: *In comparing third party revenues received by the Authority against the payments that the Authority makes to the Partner, any "pass through costs" for which the Authority makes payment to the Partner (e.g. reimbursement for utilities or other costs referred to in Theme 5.9) should be excluded.*
For example, if on a monthly basis the Authority pays to the Partner the Operational Payment plus utilities costs, then the third party revenues received by the Authority are compared against (over the life of the project) the monthly Operational Payments only.

Design and construction of the asset (Theme 2)

8. **Question:** Theme 2.5 states that if the Partner pays the Authority a lump sum to cover costs that the Authority has incurred in connection with the preparation of the project before financial close, this does not influence the statistical treatment. Does this statement apply to payments by the Partner to the Authority to cover the following categories of costs:

   - consultant/advisory fees for work carried out for the benefit of the Authority in connection with procuring and signing the PPP contract;
   - bidding costs paid by the Authority to unsuccessful bidders for the project;
   - site investigations;
   - site preparation works?

   Eurostat response: *Payments by the Partner to the Authority to cover these categories of cost - provided that they are clearly identifiable and connected with preparatory work for the PPP in question - would not influence the statistical treatment of the PPP (i.e. these payments would not influence whether the PPP is on or off balance sheet for government).*
   However, a separate issue to consider is whether any such payment from the Partner to the Authority constitutes a loan that the Authority is then repaying through the Operational Payments it makes under the PPP.

   If the payment is to cover costs directly related to the Partner's own design, construction, maintenance and operation obligations (e.g. site investigations) then the payment from the Partner to the Authority is likely to be viewed as a reimbursement by the Partner to the Authority of projects costs that the Authority incurred in advance on the Partner's behalf.

   If, however, the payment is to cover costs that are unrelated to the Partner's own design, construction, maintenance and operation obligations (e.g. the payment is to cover the Authority's own advisory team fees or payment of bid costs to unsuccessful bidders) then the payment from the Partner, which the Authority then uses to meet the costs and repays to the Partner through the Operational Payments, is likely to be viewed by Eurostat as a loan. The loan itself would impact on the government's Maastricht debt criteria, but would not affect the on/off balance sheet position of the PPP itself.

Operation and maintenance of the asset (Theme 3)

9. **Question:** If the Partner sub-contracts its maintenance obligations on a project to a government entity, what impact will this have on the statistical treatment?

Eurostat response: *As the overview of Chapter 3 (pages 28 to 29) explains, the assessment of a PPP's statistical treatment takes account of the risks and rewards taken by <u>all government entities</u>. Any maintenance risk taken by the government entity under the sub-contracting arrangement will therefore be as relevant as if the Authority itself were taking that risk. Under Theme 3.1, the Authority taking responsibility for maintenance is an issue of HIGH importance and so the same will be the case where another government entity is taking maintenance risk under a sub-contracting arrangement.*

The specific arrangements might, when analysed during Step 2 of concluding the statistical treatment assessment (explained in Chapter 4 of the Guide), lead to a re-categorisation of the issue. If the government entity is one of several maintenance sub-contractors and its responsibility is for a minor element of the asset only then it might be appropriate to re-categorise the issue as MODERATE. On the other hand, if the government entity is responsible for 100% of the asset's maintenance and replacement, then this would lead to re-categorisation as an issue that puts the project ON BALANCE SHEET for government.

Changes in law (Theme 8)

10. **Question:** If the contract requires the Authority to fund capital costs of implementing general changes in law (e.g. cost of making physical alterations to the asset) but requires the Partner to fund all other costs of implementing general changes in law (e.g. increased labour costs), is this sufficient to transfer "general operating costs of the business" to the Partner and therefore avoid a MODERATE issue under the Guide?

    Eurostat response: *Yes. Eurostat's view is that there is a distinction between a general change in law that might require capital expenditure on the asset (e.g. a new health and safety law) and a general change in law that might increase operating costs for businesses generally (e.g. a new minimum wage law). The Authority taking the risk of the former does not influence the statistical treatment but the Authority taking the risk of the latter does influence the statistical treatment (as an issue of MODERATE importance).*

Interest rate adjustments (Theme 14.2)

11. **Question:** If the interest rate on a project is EURIBOR plus a margin, would adjusting the Operational Payments for movements in EURIBOR have an influence on the statistical treatment?

    Eurostat response*: Yes, if the adjustment is made outside of the initial hedging process it would have an influence on the statistical treatment. As stated in Theme 14.2, adjusting the Operational Payments for fluctuations in interest rates in this scenario is an issue of HIGH importance in assessing the statistical treatment. This applies whether the adjustment is made for fluctuations in EURIBOR only, margin only or both EURIBOR and margin.*

Government financing (Theme 14.4)

12. **Question:** The Guide states that government financing must be measured against the "capital expenditure to be incurred for the construction of the asset". Should it not instead be measured against the total amount of financing needed for the PPP (which, in addition to construction costs, will include costs such as financing fees, rolled-up interest, adviser fees, bid development costs etc.)?

Eurostat response: *No. The position stated in the Guide is correct: the amount of government financing should be compared against the capital cost of constructing the asset. This would include costs directly linked to the construction, such as design fees, survey costs etc. but not extend to indirect costs such as financing fees, rolled-up interest, bid development costs etc.*

13. ***Question:*** Please explain how to assess the influence of government financing in a situation where some or all of that financing is adjusted by a multiplier (e.g. 2.5 for fully subordinated debt).

Eurostat response: *A multiplier must be applied to the amount of any government loan to reflect the risk exposure of that loan relative to other sources. The risk-adjusted amount of the government loan is then added to any other forms of government financing to the project (e.g. capital contributions), and that total amount is then compared against the capital cost of the asset (see Question 11 above).*

For example: On a project with a construction cost of EUR 100m, the Authority makes a capital contribution of EUR 10m and provides a loan of EUR 5m of subordinated debt. In assessing the impact of the government financing on the statistical treatment of the assets, the total government financing is calculated to be:

EUR 5m x 2.5 (i.e. subordinated debt x 2.5 multiplier) + EUR 10m (i.e. capital contribution) = <u>EUR 22.5m</u>

The total government financing is 22.5% of the capital costs of the asset and is therefore of HIGH importance to the statistical treatment (see page 121 of the Guide).

14. Question: Theme 14.4 (page 120) cross-refers to Theme 14.4.5 in connection with government financing in the form of exemptions for liabilities that the Partner would otherwise incur. However, no Theme 14.4.5 exists. Please clarify.

Eurostat response: *The cross reference to Theme 14.4.5 is an error and should be deleted.*

15. **Question:** If the Authority has an equity share in the Partner, is this assessed as government financing under Theme 14.4 or as Authority influence under Theme 15.1?

Eurostat response: *The Authority's equity share is assessed as both government financing under Theme 14.4 and as Authority influence under Theme 15.1.*

The amount invested in the Partner's shares will counts as government financing. Government financing, depending on the overall amount, will be of MODERATE, HIGH, or VERY HIGH importance or could (if 50% or more) put the project ON BALANCE SHEET for government. In addition, if the Authority's equity share carries a right to a share of the Partner's profit, this will count as the Authority taking reward. The overall level of profit share that the Authority takes from the Partner (if over 10%) will influence the statistical treatment as a separate issue of MODERATE, HIGH or VERY HIGH importance or could (if 50% or more) put the project ON BALANCE SHEET for government.

16. **Question:** Without a *de minimis* threshold for government financing then even a very nominal (e.g. EUR 100) Authority equity shareholding in the Partner will count as a MODERATE issue. Is this Eurostat's intention?

Eurostat response: Yes. There is no *de minimis* allowance for government financing. Government financing (whatever the amount) will always have an influence on the statistical treatment.

17. **Question:** If the Authority receives an EU grant which it pays to the Partner during the Construction Phase, how does this affect the statistical treatment?

    Eurostat response: *The EU grant is not treated as government financing. If the Authority (or government) contributes any financing of the project in addition to the EU grant, then the threshold against which the government financing is measured (for the purposes of Theme 14.4) will be the capital expenditure incurred in the construction of the asset LESS the amount of the EU grant.*

18. **Question:** If the Authority receives an EU grant which it uses to fund the Operational Payments, how does this affect the statistical treatment?

    Eurostat response: *The source of funds that the Authority uses to meet the Operational Payments has no influence on the statistical treatment.*

19. **Question:** A project has a 50/50 refinancing gain sharing provision but because it reached financial close before March 2016 it is off balance sheet for government. If that provision is implemented and the Authority takes its 50% share of the refinancing gain, will the project be reclassified as on balance sheet for government?

    Eurostat response: *No, the Authority taking the 50% share will not in itself lead to a reclassification.*