EUROPEAN COMMISSION
EUROSTAT

Directorate D: Government Finance Statistics (GFS)

23 December 2019

Decision of Eurostat on government deficit and debt

The statistical treatment of Energy Performance Contracts

1. Introduction

Under an Energy Performance Contract (EPC), the owner of a facility engages a contractor to design and deliver energy efficiency measures. EPCs usually require the contractor to perform all necessary works to implement the identified efficiency measures. Such works may involve investment (capital expenditure) in construction works and/or equipment, the provision of the necessary funding and the delivery of related services. EPCs therefore contain at the same time elements of rental, service, leasing, purchase and loan arrangements, which makes its nature complex.

This note provides Eurostat's decision on the statistical treatment of such EPCs, which involve investment measures (construction and/ or equipment), and which are concluded between a government entity and a private EPC-contractor (including public entities classified in the nonfinancial corporations sector in national accounts). The main issue to be determined is the allocation of the investment expenditure (gross fixed capital formation in national accounts) related to construction works and/ or equipment, i.e., whether the related impact on net lending/ net borrowing and debt should appear in the general government sector or in the nonfinancial corporations sector.

EPCs which have as their objective solely the provision of management measures like planning, optimization, maintenance of equipment etc., without any investment (capital expenditure) in equipment addition or renewal, are outside the scope of this decision.

A consultation of the CMFB on this issue took place in October 2018. This is included in annex.

2. The issue

In the context of an EPC, the EPC-contractor normally finances and carries out an initial capital investment in order to improve the energy efficiency of an existing facility. Energy efficiency measures can concern new and/or upgraded equipment as well as other improvements. The capital investment undertaken can be in removable assets and/or non-removable assets.

The remuneration of the EPC-contractor is linked to the energy savings achieved through the upgraded equipment and structures and through the other measures carried out. The capital expenditure undertaken by the EPC-contractor is repaid from the revenues it realizes over the duration of the EPC contract. Furthermore, the EPC-contractor decides which assets are to be installed and when they should be replaced or changed during the term of the contract. In the case where the necessary savings were not achieved as expected, over the term of the contract, the EPC-contractor has to cover the gap and incurs losses. After the contract ends, all benefits related to the cost savings are borne by the government entity.

In general, ESA 2010 7.17 provides for assets (which, in principle, includes construction works and equipment provided under EPC contracts) to be recorded on the balance sheet of its economic owner. "*The economic owner is the institutional unit entitled to claim the benefits associated with the use of the asset by virtue of accepting the associated risks.*" (ESA 2010 7.17). This means that the allocation of the risks and rewards (related to the holding or use of the asset over a period of time) is an essential feature in deciding on the balance sheet treatment of assets. At the same time, ESA 2010 3.131 provides that improvements to existing fixed assets should be recorded as acquisition of new fixed assets of the same kind. In particular, non-removable assets are considered to be such improvements to existing fixed assets.

An EPC involves usually a set of energy efficiency measures (construction work/ equipment) that consists of removable and non-removable assets. Given the fact that it is quite common for EPCs to be the object of a large number of contracts for relatively small amounts, the issue is which practical solution would be feasible for the recording. In particular, whether the individual measures provided by the EPC-contractor could be considered collectively, i.e. as a coherent set of measures to be recorded in its entirety on the balance sheet of the entity that is bearing the majority of the risk and rewards or whether the measures should be considered individually. In case of the latter, it would appear that, for statistical purposes, the individual equipment installed would have to be analysed on a contract by contract basis and an individual assessment, on what would constitute removable or non-removable items (as well as precise information on the accounting value of each separate item), would have to be undertaken in order to record the non-removable parts together with the already existing asset. This exercise could be very time consuming and the information might not always be available.

3. The decision

Eurostat considers that EPCs are already a very common phenomenon, following an increasing trend. These are particularly complex contracts due to their very specific characteristics and variety of possible forms and features. However, at the same time, EPCs are contracts involving only small amounts individually. Therefore, as a practical rule, Eurostat considers that the measures provided by an EPC-contractor are, by convention, to be treated collectively as 'EPC assets', and should be recorded on the balance sheet of one of the contractual parties in national accounts.

Furthermore, the decision on which contractual party (EPC-contractor or government) has to record the EPC assets on its balance sheet should be based on the general ESA 2010 principle of which entity ultimately bears the majority of the risks and rewards, i.e., which party is considered to be the economic owner of the EPC assets. This will notably require that the duration of the EPC should be sufficient to cover a meaningful part of the economic life of the EPC assets.

Eurostat would recommend the statistical authorities to carry out the analyses of the risks and rewards associated with the EPC assets according to the structure foreseen in the guide to the "*Statistical Treatment of Energy Efficiency Contracts*". The guide was developed by Eurostat, in cooperation with the European Investment Bank (EPEC), and deals in detail with the statistical treatment of EPC contracts, and in particular with the analysis of the risks and rewards.

Eurostat notes that this decision applies only to EPCs and cannot be extended to other types of contracts involving construction works and/ or the provision of equipment.

Annex

CMFB

COMMITTEE ON MONETARY, FINANCIAL AND BALANCE OF PAYMENTS STATISTICS

CMFB opinion

on the statistical treatment of asset partitioning in Energy Performance Contracts

1. Pursuant to Article 4 of Council Decision 2006/856/EC, the Statistical Authorities of Germany and Hungary (both the National Statistical Institutes and the National Central Banks) requested the CMFB to organise a consultation on the statistical treatment of asset partitioning in Energy Performance Contracts according the European System of Accounts (ESA2010) and the System of National Accounts (SNA2008).
2. CMFB Members were invited to express their opinion on 10 October 2018, with a deadline for the replies by 24 October 2018. Twenty-two (22) national statistical institutes and twenty-one (21) national central banks from the EU Member States returned the questionnaire within the specified deadline. A total of forty-four (44) institutions, including the ECB, expressed their views.
3. The CMFB Members were invited to consider an Energy Performance Contract (EPC) where a government building is improved by a private contractor by adding or substituting non-removable components (like double glazed windows or adding insulation). Should it be possible to consider and hence record these newly installed components as separate assets on the grounds that risks and rewards (economic ownership) for the duration of the EPC lie with the private contractor?
4. The CMFB Member were invited to answer either yes:
5. Exclusively in the context of EPCs, partitioning of non-removable EPC assets should be based by convention on the general ESA 2010 principle of who ultimately bears the risks and rewards (economic ownership). Hence, recording of non-removable EPC-assets separately from the existing assets to which the EPC-assets have been added is possible. This implies that the EPC-assets are not on government balance sheet and at inception they do not have an impact on government debt and deficit (Option 1).
6. Or no:
7. In general ESA2010 and SNA 2008 do not allow for the partitioning of assets. Hence, non-removable EPC-assets should be seen as improvements to existing assets and be recorded as acquisition of new fixed assets of the same kind. This acquisition should be recorded as government investments in government balance sheet, with an impact on government debt and deficit (Option 2).
8. A majority of the Members (29 out of 44) was of the opinion that option 2 was the preferred recording. 14 Members preferred option 1. One Member answered 'no opinion'.

9. Based on the outcome of the consultation, the CMFB expresses the opinion that, in general, ESA2010 and SNA 2008 do not allow for the partitioning of assets. Hence, non-removable EPC-assets should be seen as improvements to existing government assets and be recorded as acquisition of new fixed assets of the same kind. This acquisition should be recorded as government investments in government balance sheet, with an impact on government debt and deficit

10. In addition to the publication of this opinion, all the anonymised answers to the questionnaire will be transmitted to the CMFB Members and will be kept in the records of the CMFB secretariat.

(Signed)

Kirsten Wismer
CMFB Chair

Copenhagen, 31 October 2018