EUROPEAN COMMISSION
EUROSTAT

Directorate D: Government Finance Statistics (GFS) and quality

Luxembourg, 14 May 2014
ESTAT/D-2/LN/LFO/LPU/mhd D(2014)1626075

Mr Jean-Marc Delporte
Chairman
National Accounts Institute
City Atrium C
Rue du Progrès 50
B-1210 Brussels

Subject: Recording in national accounts/EDP of Public-Private-Partnerships for the construction and renovation of schools in Belgium (Flanders)

Ref: Your letter T/ICN/2010/009156 dated 23 July 2010
Our letter ESTAT c-4(2010)570083 dated l7 August 2010
Your letter T/ICN/2010/010564 dated l0 September 2010
Our letter ESTAT/c-4/FL/JV/MW/eb(2010)901153 dated 15 November 2010
Your letter T/ICN/2012/011584 dated 21 December 2012
Our letter ESTAT/D-2/FL/LFO/JD/mhd D(2013)328850 dated 5 March 2013
Your letter T/ICN/2013/007980 received on 27 August 2013
Our letter ESTAT/D-2/FL/LFO/LPU/lj D(2013)3319227 dated 25 September 2013
Your letter T/ICN/2014/002250 dated 10 March 2014

Dear Mr Delporte,

Thank you for your letter dated 10 March 2014 and for the accompanying documents by the Flemish Government providing general information on the restructuring envisaged for the Public-Private-Partnership (PPP) project for the construction, renovation, financing and maintenance of schools in Flanders and answering to the questions raised by Eurostat on the letter from 25 September 2013.

This case has been bilaterally discussed between the Belgian Statistical authorities and Eurostat since 2010 and the original project has been subject to substantial changes during the past years. Eurostat made its first analysis on the basis of the documents provided in 2010[1] and no updates of these documents have been provided to Eurostat since then. Please note that PPP projects can only be assessed on the basis of the final relevant documentation. In this context, Eurostat would like to ask the Belgian Statistical Authorities to provide the last version of such documents.

[1] Master Agreement, Statute of the SPV, finance documentation, etc.

Commission européenne, 2920 Luxembourg, LUXEMBOURG - Tel. +352 43011
Office: BECH F4/933 - Tel. direct line +352 4301-36850 - Fax +352 4301-35199

http://epp.eurostat.ec.europa.eu
laurs.norlund@ec.europa.eu

Notwithstanding the above, please find below Eurostat's preliminary view on the recording in national accounts of the above mentioned PPP project on the basis of the latest information provided by the Belgian Statistical authorities.

1. THE ACCOUNTING ISSUE FOR WHICH A CLARIFICATION IS REQUESTED

The main issue is to determine the sector classification of the Special Purpose Vehicle (SPV) involved in the PPP project and the recording in national accounts of the infrastructure assets built or renovated (and the associated debt).

Following Eurostat's letter of the 25 September 2013, the Flemish Region has again restructured the PPP project and the National Accounts Institute after providing its own analysis, has requested Eurostat's view on this issue.

Description of the case

To recall, the Flemish Community (the grantor) is undertaking a programme of building and renovation of schools through a PPP scheme. The total value of future capital expenditure is estimated at EUR 1.5 billion.

a) Description of the Special Purpose Vehicle, the PPP contract and the assets to be built

The arrangement involves a specially created SPV (DBFM Scholen van Morgen) which was set up in June 2010. It is owned by a private partner (Fscholen NV[2]) and a joint investment vehicle of the Flemish Community (School Invest NV)[3]. The majority of the capital of the SPV (75% of the shares - 1 share) is held by the private partner, while the Flemish Community holds 25% of the shares + 1 share.

The SPV (the operator) will be responsible for the design, building, financing and maintenance of the schools. The construction phase was initially foreseen to last around 6 or 7 years. At the end of the contracts for the individual schools, after the term of 30 years, the ownership of the school buildings will be transferred from the SPV to government without any payment.

During the operating phase, the SPV will be remunerated by government through quarterly payments based on the availability of the schools, according to criteria specified in the contracts. The remuneration system foresees deductions and penalties for non-fulfilment by the SPV of availability standards set up in the accounts.

The SPV has appointed a subsidiary of the private partner as a Delegate Developer which will, on a contractual basis, be fully in charge of the programme management of the PPP.

At this stage, 165 schools have signed pre-agreements with the SPV. Currently, according to the information available, the number of schools in construction is 4. However, according to the information in your letter dated 10 March, the number of school projects under construction should vary between 70 and 120 at the end of 2014.

2 Joint investment vehicle of BNP Paribas Fortis and AG Real Estate NV, which together won the PPP tender.

3 50%-50% held by AGIOn (agency of the Flemish Government for school infrastructure) and PMV (the Flemish Participation Company). Both entities are classified in the general government sector.

b) Financial arrangements

As regards the financial arrangements of the project, they include a EUR 700 million construction financing facility by banks and a further EUR 1.5 billion senior long term debt liability. The latter will be used during the operational phase in order to refinance the construction facility.

During the past years, the arrangements planned for the senior debt (EUR 1.5 bn of capital expenditure) have undergone the following changes mentioned below.

(i) The first proposal (in 2010) included two types of government guarantees on the liabilities of the SPV: a 100% guarantee on the repayment of the SPV loan liabilities for the full amount of the capital expenditure (EUR 1.5 bn) and a refinancing guarantee for a specific part of the SPV's liabilities after a number of years from the financial close (at the end of the construction phase), in case the SPV would be unable to refinance this borrowing at a given predetermined interest rate.

    The opinion of Eurostat in this case was that the risks relating to any non-servicing of the SPV's loan liabilities was to be fully borne by government. The scope and features of the full debt guarantee granted by the Flemish Community to the SPV for its financing, would lead to a recording of the assets (and associated debt) in the books of general government.

(ii) In the second proposal (in 2012), the full debt guarantee by the Flemish Government was abandoned. Instead, the Flemish Government would provide a direct loan to the SPV of EUR 750 million, which would constitute around 50%[4] of its total debt. The refinancing guarantee by the Flemish Community would also be abandoned and the refinancing would be done by the SPV itself. This new structure would entail an increase of the upstart construction cost and higher risk for the SPV. The increase in the upstart cost would be absorbed by a capital injection in the SPV of around 75-80 million € (of which around 19 mn € would be undertaken by government). If the refinancing would result in a higher financial cost than the initial financing cost, the SPV would be allowed to increase the availability fees to cover this higher cost.

    In this second case, Eurostat stated that through the possibility to increase the availability payments, the risk of future evolutions in the rates would be borne by government and not by the SPV. Thus, the financing and availability risk would be, at least partially, borne by government. Eurostat considered that the refinancing cost risk was part of the general economic risk and should be borne by the SPV, which was not the case under this scheme. Following these arguments, Eurostat's view was to record the assets (and associated debt) in the government books.

(iii) In the third proposal (in August 2013), the Flemish Region would still provide a direct loan to the SPV of EUR 750 mn, but abandons the system in which the SPV would be allowed to increase the availability fees to cover its potentially higher financing cost. As in the previous scheme, the increase of the upstart cost would be

[4] The 750 mn € loan represents 50% of the long term debt. However, the total capital cost is also covered by the equity and this brings the share of the loan to 48% of the total capital cost.

absorbed by a capital injection in the SPV of around EUR 75-80 mn (of which around EUR 19 mn would be undertaken by government). However, to mitigate the increase in the risk for the SPV, a refinancing guarantee (similar to the one in the first scheme of 2010) would be put in place: if the SPV was unable to obtain financing at a reasonable cost between the fifth and tenth year, the Flemish Government would repay the debt to the bank and take over the debt loan of the SPV.

Eurostat considered that through the combination of the direct loan of EUR 750 mn plus the refinancing guarantee on the remaining EUR 750 mn, the financing risk was mainly borne by the Flemish government, as it would be most likely covering the majority of the capital cost of the project.

(iv) In the latest proposal (in March 2014), the Flemish Community plans to replace the previous long term facility covering the EUR 1.5 bn of the capital cost (EUR 750 mn of direct loan by the Flemish Community plus a guarantee on the refinancing required after 5-10 years) by a long term funding solution covering all funding requirements for the total life of the project (30 years). The total capital cost (EUR 1.5 bn) would be structured in two tranches, with the new long-term debt funding solution set as follows:

– One subordinated (junior) tranche will be provided by the Flemish Community. The degree of subordination and the total amount provided are not yet fixed. They will be the outcome of a rating process. The amount provided by the Flemish government could range from EUR 500 mn to EUR 750 mn. It will in any case be limited to a maximum of 48% of the capital cost of the project and provided in the form of a long term loan to be amortized over 30 years.

– A second tranche, senior to the previous tranche, should be provided by long term institutional investors. This senior debt tranche will be placed in the market as project bonds with a 30 year maturity. The total amount to be provided would range from EUR 750 mn to EUR 1 bn.

With this new funding structure, the refinancing guarantee is dropped. However, the new structure will increase the project cost due to the higher cost of funding and the longer maturity of the tranches. This increase in the cost will be absorbed by an increase in the availability payment by government, modified once at financial close and with no possibility to be increased in the future.

Eurostat's preliminary view on this new structure is provided below.

2. METHODOLOGICAL ANALYSIS

Eurostat's analysis is carried out following ESA2010 and the Manual on Government Deficit and Debt (MGDD), in particular section VI.4 covering public-private partnerships.

First, as regards the classification of the SPV, the updated statute should be provided to Eurostat and analysed on the basis of ESA2010. No conclusions can be drawn at this stage in the absence of the new statute.

As concerns the recording of the assets, the analysis below is done supposing a classification of the SPV outside the general government sector.

According to the above mentioned rules, the assets involved in the PPP can be considered as non-government assets if and only if the private partner if bearing the majority of risks attached to the assets. The MGDD provides guidelines in order to asses which partner is bearing the majority of the risks.

Specific rules apply to cases where government is participating in the financing of the PPP project. In the last scheme presented for the funding, a long-term loan that could add up to EUR 750 mn is to be provided by government. Even if it would (in principle) be limited to a maximum of 48% of the direct capital cost of the project, the conditions in which government financing is provided should be equal in terms of risk[5] and as regards the absorption of possible losses to the conditions in which the remaining financing is provided. This is however not the case in the new funding scheme presented. The government long-term loan is subordinated to the senior tranche provided by institutional investors. As stated in the letter by the Flemish Community, this will enhance the credit quality of the senior tranche of the debt to investment grade (A- rating). In practice, in this contract the subordinated debt has the effect of considerably mitigating the risk (or part of the risk) of the senior debt. This indicates that government is bearing the majority of the risks related to the long-term financing.

Moreover, the considerable increase of the project cost is assumed by government through the foreseen increase in the availability fee.

Finally, it should be noted that further mechanisms by which government could re-assume other risks of the project (such as termination in case of default by the partner or allocation of the assets at the end of the project) are not considered in the current analysis. Only when the final documentation will be available to Eurostat, Eurostat would be in a position to complete this analysis.

3. CONCLUSION

On the basis of the above considerations, it seems that the Flemish Government bears the majority of the financing risk of the project. Eurostat therefore maintains its conclusion of the previous letters that the assets (and associated debt) relating to this PPP scheme for the construction and renovation of schools in Flanders are to be recorded in the balance sheet of the Flemish Community (state government sector S1312).

In addition, Eurostat would like to receive the last version of the following documents (in case of changes as compared to the original documentation provided in 2010):

– the Master Agreement;

– the DBFM Decree and the decision of 2 April 2010;

– the finance documentation;

– the statute of the SPV.

5 One to one or at least very similar.

Moreover, it seems that a number of projects have already started. Eurostat would like to receive a description of the framework in which the on-going projects are being developed (which contracts are applicable) as well as the specific contracts signed for such projects. Finally, Eurostat would like to know whether the contracts already signed could be changed in order to increase the original availability payment.

4. PROCEDURE

This preliminary view of Eurostat is based on the information provided by the Belgian authorities. If this information turns out to be incomplete[6], or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view.

In this context, we would like to remind you that Eurostat is committed to adopt a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009, as amended, and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC. Eurostat is therefore publishing all official methodological advice (ex-ante and ex-post) given to Member States on its website. In case you have objections concerning the publication of this specific case, we would appreciate if you let us know before 27 May 2014.

Yours sincerely,

(eSigned)

Laurs Nørlund
Director

[6] In the absence of final contracts, the advice provided by Eurostat may still be subject to updates. This applies to the statute of the SPV, the DBFM-Decree and the Decision of 2 April 2010, the Master Agreement and the finance documentation, which still have to be adapted to the new framework proposed by the Flemish Region.