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EUROSTAT

Directorate D Government Finance Statistics (GFS)

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Subject: Consultation regarding the statistical recording of the assets of the Public Private Partnerships (PPP) contract for the execution, maintenance and operation of the motorway A-7 between Crevillente y Murcia

**Ref.: Your letter of 31 July 2019
Discussion held during the EDP visit on 27-29 November 2019**

Dear Mr Cristóbal,

Following your letter under reference, Eurostat would like to provide you with its opinion on the appropriate interpretation of a number of provisions of the above-mentioned PPP contract, as requested by the Spanish statistical authorities.

The accounting issue

The issue for which an opinion is being sought is a determination of the correct accounting treatment of the classification of the assets in the above-mentioned PPP contract. In particular, the following provisions of the contract are being consulted:

- The duration of the contract, taking into account the investment made by the private partner;
- The interpretation of the indicator based on the level of traffic as one of the indicators reducing the availability payments to the private partner;
- Possible ICO's¹ participation in the financing of the investment.

Documentation provided

- Background note
- Report of the *Technical Committee of National Accounts* on the treatment of the PPP contract under consultation
- The Specific Administrative Rules of the contract
- The Technical Prescriptions of the contract

¹ *Instituto de Crédito Oficial* – a public entity classified in S.12 (*Financial corporation sector*)

Description of the case

The Ministry of Public works and Transport is planning to launch several PPP contracts related to the enlargement of heavy congested tranches of motorways and their subsequent operation and maintenance. All PPP contracts will be tendered and governed under the same terms. The *Technical Committee on National Accounts* has analysed one of such PPP contracts, i.e. A-7 motorway between Crevillente and Murcia.

The estimated value of the PPP contract amounts to 311 million euro. The initial investment by the private partner is estimated to be around 215 million euro and the replacement investment, to be undertaken over the operating period of the contract, is expected to amount to 11 million euro.

Subject of the contract:

- Area 1 relates to the establishment and reform works for the implementation of the three sections of the motorway;
- Area 2 comprises restoration and major repairs of the motorway;
- Area 3 covers activities related to the conservation, maintenance and operation of the infrastructure.

The duration of the contract is 15 years, including approximately 2 years for the construction. The possibility of the extending the duration is not foreseen in the contract. The government will not make any payments during the construction period (24 months for sections 1 and 2 and 26 months for section 3).

Payment mechanism

The private partner's remuneration is determined on the basis of the availability of the infrastructure sections covered by the contract. The private partner will receive monthly payments, linked to the availability of the motorway to the user, and to its maintenance. The monthly availability fee can be amended downwards, depending on certain correction factors, such as demand, road safety, service and conditions of the motorway.

The formula ensures that the payment to the private partner is proportional to the percentage of the road actually in service. In addition, the contract defines 12 indicators divided into four types: demand, road safety, service provided and indicators defined by the government. A penalty regime is foreseen in the PPP contract, consisting of a mechanism of availability adjustments and performance deductions.

The data required for the calculation of indicators, is under the responsibility of government (*Directorate General for Roads*). The contract defines, by indicator, the method of measurement, the frequency of measurement and the corrections to be applied. The weight of each indicator is also laid down in the contract, and includes rules for the calculation of unavailability and poor service deductions. Unavailability of the whole asset or poor quality (calculated on the basis of the 12 indicators) would lead to a 100 % deduction.

Financial arrangements

The private partner assumes the following financing risks:

- Any delays in funding;
- Whether the European Investment Bank (EIB) will participate or not in the financing and risks of increasing interest rate on debt;

- Public contributions to the financing of the project are not included in the tender documents, and the possibility of obtaining shareholder loans from the government is specifically excluded. Notwithstanding the above, the contract specifications allow the private partner to obtain a contribution from the ICO, while at the same time excluding the possibility for the ICO to participate directly in the share capital of the private partner.

At the end of the PPP contract, the infrastructure will be returned to the public administration and no payment for the asset is due by the government to the private partner.

Methodological analysis and clarification by Eurostat

Applicable accounting rules

Based on the documents provided, Eurostat carried out its analysis based on *ESA 2010* and the *Manual on Government Deficit and Debt (MGDD 2019)* in particular chapter VI.4 Public-Private Partnerships (PPPs) as well as the *Guide to the Statistical Treatment of PPPs*, published jointly by the EIB and Eurostat in September 2016 (PPP guide), which are relevant for the analysis.

Availability of national accounting analysis

The Spanish *Technical Committee on National Accounts* has concluded that the majority of the risks and rewards concerning the asset would be transferred to the private partner and, accordingly, the conditions to record the asset on the balance sheet of the private partner would be fulfilled.

Notwithstanding the above-mentioned conclusion of the committee, some aspects of the contract lead the Spanish statistical authorities to consult Eurostat, given that:

1. The *duration of the contract* is 15 years, i.e. 2 years will be needed for the construction of three sections of the motorway and the remaining 13 years for maintenance and operation of the asset.
2. The *payment mechanism* is 100 % availability-based. Yet, one of the deductions stated in the contract (among others) is linked to traffic. In case that the actual use of the motorway would be under the forecasted traffic, automatic deductions should apply. Thus, once the asset enters into service, the actual use of the motorway for the following years will have to be assessed. Although the deduction could amount up to 25 % of the availability payment, this would only happen if there would be no traffic (zero vehicles). For an actual use lower than expected, ranging from 0 to 50 %, the deduction percentage would be allocated between 0 to 40 %. For example, a 30 % lower actual traffic than foreseen would lead to a deduction of a 6 % of the availability payments. For an actual use, lower than forecast, ranging from 50-100 %, the deduction percentage would oscillate between 40-100%. For example, if an actual use would be under 60 % of the estimate, it would lead to a 13 % deduction of the availability payments.
3. At this moment, the *financing sources* of the private partner are still unknown. The partner is likely to raise funds from the EIB, but not exclusively. ICO might contribute to the financing of the investment through:
 - a. Forming a part of the bank consortium, which would provide funds to the private partner. In such a case, ICO would lend the money under the same conditions as the rest of the banks;

- b. Granting a loan to the partner, based on the same conditions, as any other commercial bank would offer.

The possible participation of ICO would be only for financing of the investment. ICO shall never take part in the equity or the own funds of the private partner.

Analysis

Eurostat has carefully analysed the information provided. Particular attention was devoted to the three specific provisions of the contract, as asked by the Spanish statistical authorities.

Duration of the contract

As regards the duration of the contract, Eurostat takes note that the duration is limited to 15 year, i.e. 2 years will be devoted to the construction and the remaining 13 years are intended for the maintenance and operations of the asset. Eurostat also takes note that government will make no payments to the private partner during the construction period.

Firstly, Eurostat would like to recall that the MGDD clearly says that *PPPs imply a long-term relationship in the framework of specific contracts, where the obligations and rights of each partner are clearly specified. In practice, most PPPs contracts cover at least 20 years. The duration of a PPP contract normally depends on the nature of the assets (on the length of their expected depreciation) but there might be cases with a duration below 15 years or, even, 10 years. In such cases, a specific analysis should be undertaken in order to assess whether such contracts could actually be considered as PPPs in the sense used in this chapter.* In this context, it is to be underlined that the duration of the great majority of PPP contracts in the Member States is equal or above to 30 years.

Moreover, according to the PPP Guide, *Eurostat expects a PPP contract to cover a meaningful part of the asset's economic life.*

As discussed during the EDP visit end-November 2019, the economic life of motorways in Spain is estimated to be about 55 years. Therefore, Eurostat's opinion is that 15 years does not cover the majority of the economic life of the motorway and the contract cannot be considered a PPP.

Payment mechanism

Eurostat understands that the payment mechanism is 100% based on an availability of the assets. No demand-based payments are considered in the contract. Nevertheless, one of the deductions is based on traffic (demand), which means that in the case that the actual use of the motorway is under the level of the forecasted traffic, automatic deductions would be applied.

Firstly, Eurostat observes that the application of deductions, based on demand, is asymmetrical. While the government is entitled to reduce payments if the use of the assets is lower than anticipated, the private partner is not entitled to receive an increase of payments if the use of the assets is higher than anticipated (although more traffic would cause more expenditure to the private partner for the maintenance and reparation of the motorway).

As indicated in the PPP guide, *Eurostat's view is that provisions that reduce Operational Payments (that are 100% availability-based) to reflect a lower level of use of the asset than anticipated do influence the statistical treatment and this is an issue of high importance.*

Given that the payment mechanism is 100 % availability-based and not at all linked to the demand, the deductions based on demand would limit the transfer of rewards to the private partner.

Financial arrangements

Eurostat takes note, that at this moment, the funding sources of the private partner are unknown and a possibility of ICO's participation in the financing of the project exist in the contract.

According to the PPP guide, *financing by a public entity classified outside the general government sector (e.g. a national public bank classified as a public corporation) is considered to be government financing if the public entity is considered by Eurostat to be acting on behalf of or on an express or implied instruction of government in connection with the project.*

Therefore, the Spanish statistical authorities would have to analyse the conditions under which ICO would participate in the financing of the project, and in particular, whether it is acting as any other private bank would act from a commercial point of view.

Conclusions

Eurostat's view has been expressed in the previous section. On the basis of the above considerations and analysis, Eurostat is of the opinion that the contract does not cover a meaningful part of the economic life of the assets and therefore the project cannot be considered as a PPP as defined in national accounts. Notwithstanding the above, Eurostat also notes that there are or might be issues concerning the payment mechanism and financial arrangements.

Procedure

This view of Eurostat is based on the information provided by the Spanish statistical authorities. If this information turns out to be incomplete, 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.

Yours sincerely,

(eSigned)

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Director