Blending ESIF grants and PPPs - Available options and a worked example

JASPERS-EPEC Seminar "Blending ESI Funds and PPPs"
Brussels, 11 May 2016

Presentation outline

1. Blending: what and why
2. Past blending activities: what needed to be fixed
3. MFF 2014-2020: what has been fixed
4. The PPP project blending cycle
5. A worked example of a blended project

……questions and discussion

Blending: what and why

Blending: what?

Blending:

- A contribution from ESIF grants

and

- PPP procurement involving private financing (debt/equity)

Public-Private Partnership (CPR Art 2.24):

- Cooperation between public bodies and the private sector
- Delivery of investments in infrastructure projects…
- ….or other types of operations, delivering public services
- Risk sharing
- Pooling of private sector expertise or additional sources of capital

Why blend EU funds with PPPs?

From an ESIF grant perspective: PPPs may **improve value for money in the use of EU Funds**, bringing PPP disciplines to bear, including:

- payments based on performance (outputs)
- project delivery to time and budget
- long-term life-cycle approach to project cost assessment and delivery
- professional project management and implementation
- innovation in asset and service delivery
- appropriate risk allocation
- third party investor/lender scrutiny

➢ **PPPs may help Managing Authorities to improve the quality of expenditure and ensure effective use of EU Funds**

Why blend EU funds with PPPs?

From a PPP project perspective: EU funds may **increase the viability of PPPs**, by:

- reducing the level of national funding required for the project
- lowering the level of user charges
- reducing private financing needs

➢ **EU Funds may make PPP projects more affordable for the procuring authority and/or users and may improve the bankability of PPP projects**

EPEC's journey in blending

Stocktake of past blended projects and case studies (e.g. Poznan)

Work with the Commission on new legislative solutions for the 2014-2020 MFF

Guidance Note "Blending EU Structural and Investment Funds and PPPs in the 2014-2020 Programming Period":

- Raising awareness of PPP specific issues covered in the new regulations for ESI Funds
- Focused advice for Managing Authorities and potential Beneficiaries on combining ESI Funds and PPPs
- Practical guide for PPP procuring authorities to understand possible options and their implications

Guidance now available on EPEC website!
http://www.eib.org/epec/library/index.htm

Past blending activities: what needed to be fixed

Past blending activities

- How many projects?
  - Only 49 grant/loan blended projects in 13 EU countries in over 14 years (vav 1,500 PPP projects worth EUR 279 bn)!
- Which countries were most active users of blending?
  - France: the largest number of projects in various sectors
  - Slovenia: small broadband network projects
  - Greece and Portugal: large projects with a high grant value
- Which sectors?
  - Transport dominated in value terms
  - ICT largest sector in terms of project numbers

Key observations and issues

- Size of the project not a factor
- Difficult integration of the PPP and the EU funds grant application process
  - Selection of the private partner had to be done before the grant application
  - Granting authority had to be the beneficiary in most cases: 'redistribution' of the grant to the private partner
  - Granting authority effectively had to commit/provide funds in case of the grant shortfall
- Disbursement mechanism for EU Funds not aligned with standard PPP payment profile (limited risk transfer)

Key observations and issues – cont.

- Difficulties in calculating the funding gap (based on projections)
- Risk of grant amount recalculation
- Institutional capacity
- Negative market perception

MFF 2014-2020:
what has been fixed

Relevant regulations

- Regulation 1303/2013, Common Provisions Regulation on ESI Funds

  - Commission Delegated Regulation 480/2014: calculation of discounted net revenue for revenue-generating projects
  - Commission Delegated Regulation 2015/1076: replacement of a beneficiary and escrow accounts
  - Commission Implementing Regulation 2015/207: information required on Major Projects and methodology for cost-benefit analysis

  - Implementation Guidance 2014-2020 Version 2 (March 2014): methods for calculating the EU grant amounts for revenue-generating projects

The highlights

- Timing of PPP and ESIF grant processes
- Timing/flexibility of EU grant disbursement into the project
- Calculation of the grant amount for revenue generating projects
- How final is the grant amount?
- Blending now explicitly possible

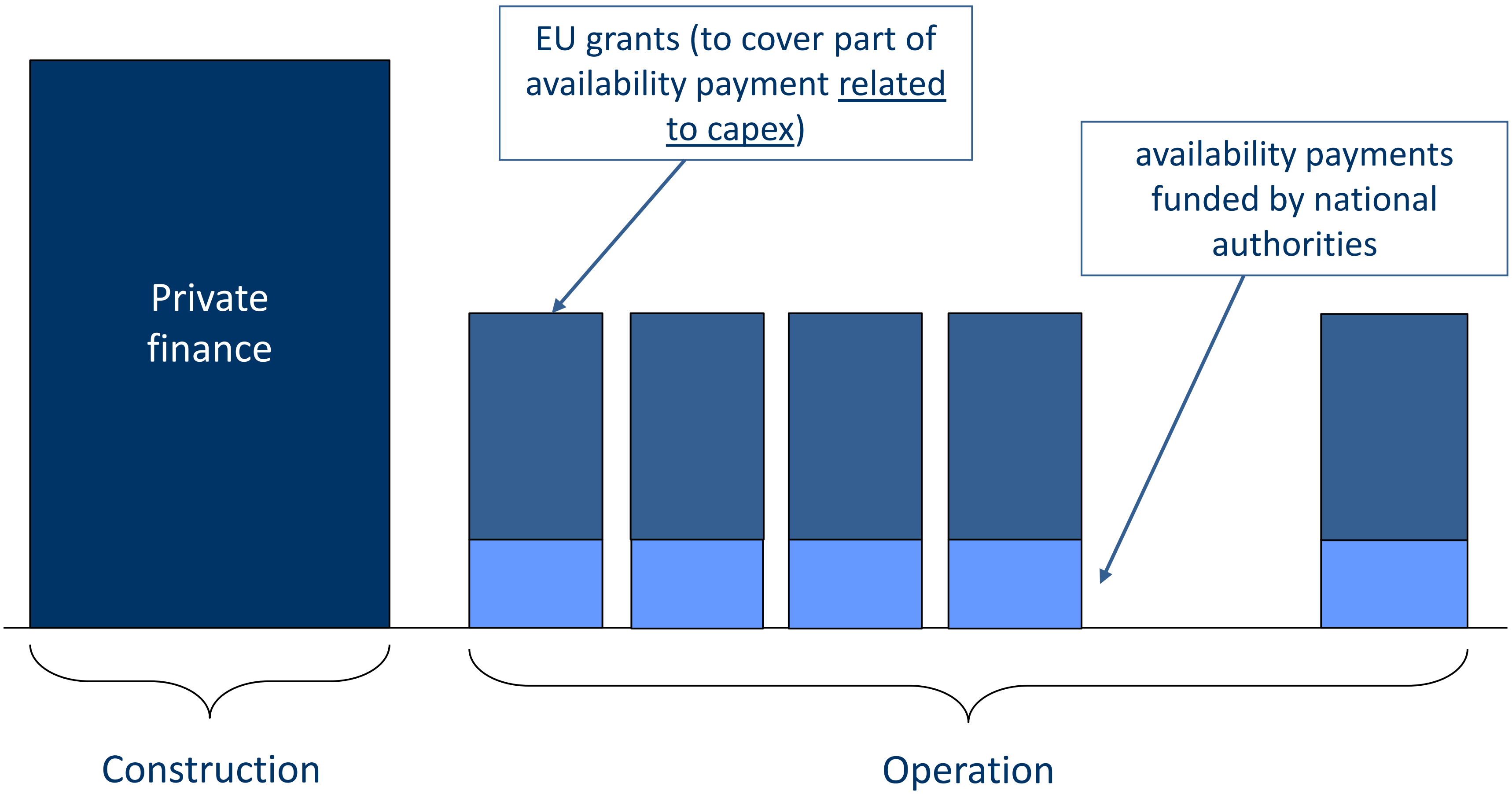
Timing of PPP and ESIF grant processes

- Earlier assurance of grant availability…
- …enabling the PPP and the EU grant processes to run together
- Subsequent identification of the private sector beneficiary
- Possible change of the private sector beneficiary during the contract:
  - core to a PPP effectiveness is the possibility to replace the private partner when not performing
  - foreseen in the financing agreements
  - MA to satisfy itself with the replacement private partner or public body.
- Provides comfort that, in case of exercise of step-in rights, the grant will remain available to the project

Timing/flexibility of EU grant disbursement into the project

- Expenses incurred and paid by the private partner are **considered incurred and paid by the public sector beneficiary** subject to:
  - **PPP agreement** entered into;
  - **Managing Authority** exercises diligence;
  - Payment into a dedicated **escrow account**; and
  - Funds drawn from escrow used for payments are to be made **in accordance with the PPP agreement,** including termination payment.
- **Minimum requirements** to be included in the PPP agreements, including provisions related to **contract termination** and to the **audit trail**

Timing/flexibility of EU grant disbursement into the project – cont.



Calculation of the grant amount for revenue generating operations

- Net revenues are defined in Art. 61 CPR as:
  - cash in-flows directly paid by users; less
  - any operating costs and replacement costs of short-life equipment.
- Impact of net revenues
  - reduces the eligible expenditure of the project
- Principle: grants address funding gap

Calculation of the grant amount for revenue generating operations – cont.

Two options for the Managing Authorities

1. Traditional Funding Gap calculation
   - More or less the same as in the past
2. Application of a flat rate
   - Co-funding rate of eligible expenditure

     = 1- flat rate
   - No risk of recalculation

Sector	Flat rates
Road	30%
Rail	20%
Urban Transport	20%
Water	25%
Solid Waste	20%
RDI	20%

Major projects in the CPR

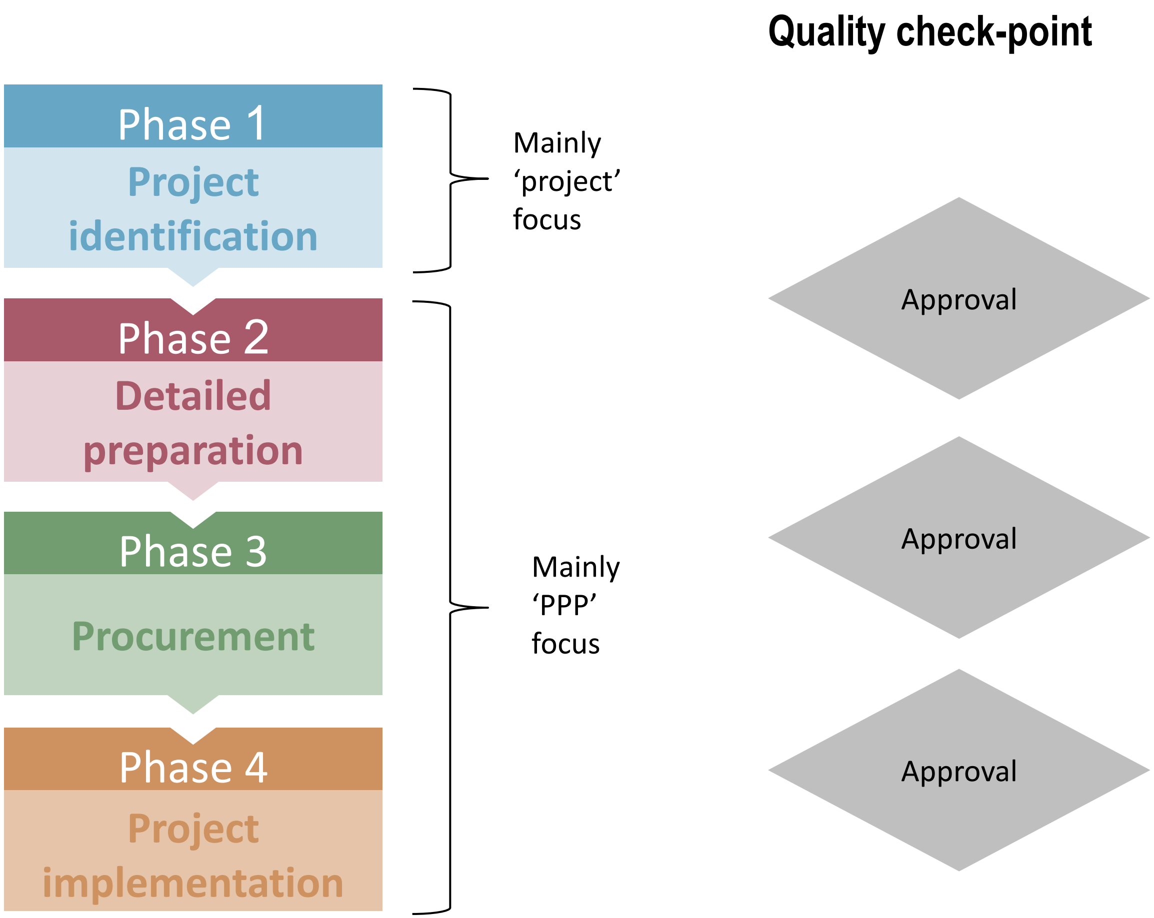
- Definition (Art 100)
  - EUR 50m total eligible costs (EUR 75m for transport projects)
  - Financial instruments not considered as major projects
- Decision process regarding major projects
  - Information required for approval (Art 101)
  - Independent expert review (Art 102)
  - Project deemed approved unless decision to refuse the project within three months of notification (Art 102)
- Specific conditionality of approval for PPP projects
  - Signing of PPP contract within three years of grant approval (Art 102 (3))

Just to recap – have we ticked all boxes?

✓	**Timing of PPP and ESIF grant processes** ✓ Selection of private partner before/after grant application ✓ Subsequent change of private partner beneficiary possible with no loss of the grant
✓	**Timing/flexibility of EU grant disbursement into the project** ✓ Escrow account
✓	**Calculation of the grant amount and how final is the amount** ✓ Flat rate ✓ No recalculation risk
✓	**Negative market perception** ✓ Definition of PPPs ✓ Specific chapter on PPPs in the CPR

The PPP project blending cycle

Outline of typical PPP project cycle



5 key issues to consider throughout the PPP project cycle

Requirements met

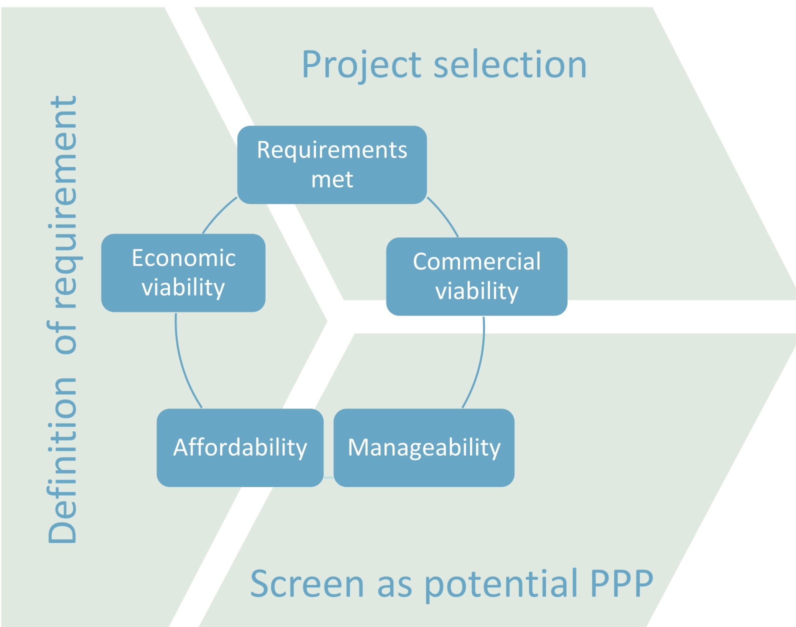
Commercial viability

Manageability

Affordability

Economic viability

Phase 1 – Project identification



- Define need for project
- Identify range of possible options to meet need
- Feasibility of each option
- EIA, cost benefit analysis
- Define and select preferred project option: scope etc.

- Initial assessment of:
  - risks
  - affordability
  - VfM
  - commercial viability
- Assess ability to manage the process

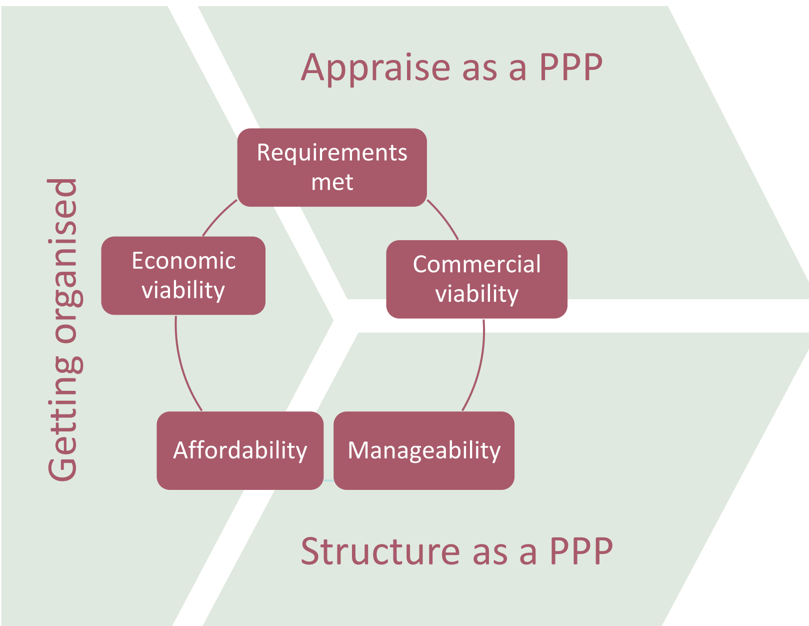
BLENDING ACTIVITIES

- Assess eligibility for grant funding – size, fit with OP priority axes? etc.
- PA dialogue with MA, JASPERS

<u>Key blending decisions</u>:

- Public or private partner as beneficiary? Implications for control, reporting, disbursement risks
- Grant for capex or availability payments
- Grant amount (driven by selected PPP arrangement)

Phase 2 – Detailed preparation for PPP procurement and grant application



- Establish PPP project team and governance structure
- Identify and engage advisers
- Develop the PPP project plan and timetable

- Detailed assessment of preferred option:
  - risks and their allocation
  - commercial feasibility/market
  - affordability
  - VfM
  - Eurostat treatment

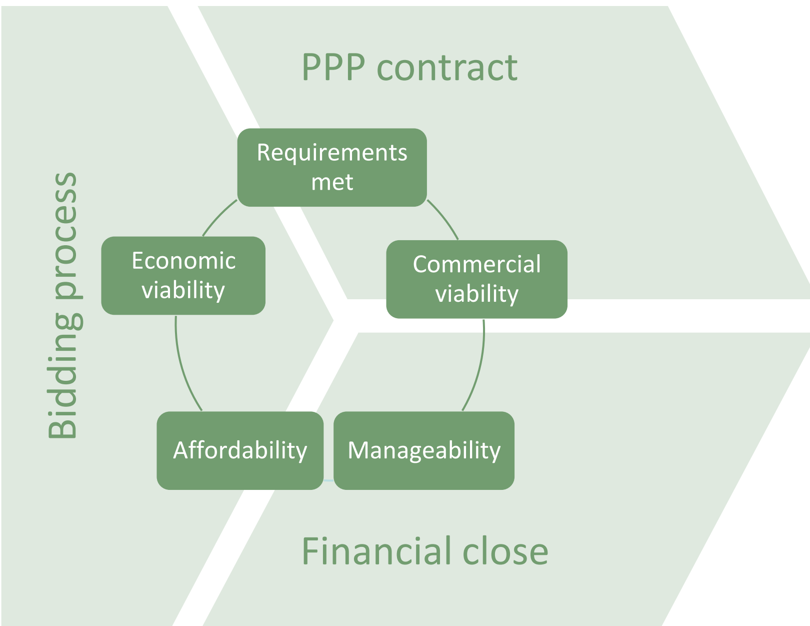
- Design of PPP arrangement – e.g. payment mech, KPIs
- Prepare financial and funding plan incl. grant type and level
- Select PPP procurement method (e.g. CD, NP)
- Prepare the draft PPP agreement
- Define bid evaluation criteria

BLENDING ACTIVITIES

- Check state aids
- Prepare grant application form:
  - grant amount (funding gap, eligible costs, co-fin rates)
  - overall funding and finance plan
  - escrow arrangement
  - finalistaion of CBA
  - PPP agreements to reflect grant reporting obligations
  - timetable

Key blending decision:
Secure grant decision before or after PPP procurement? – implications for timing, bidder interest, back-stopping, capacity

Phase 3 – PPP procurement



- Procurement notice, prequalification and shortlisting
- Invitation to dialogue
- Interaction with bidders
- Evaluation of tenders and preferred bidder selection

- Finalise the PPP contract
- Conclusion of financing agreements
- Financial close

BLENDING ACTIVITIES (assuming decision for parallel PPP / grant application)

- Submission of grant application form by MA
- IQR or Commission evaluation
- Conditional grant approval
- Final grant confirmation

Key blending decision:

- IQR or Commission review

Phase 4 - PPP project implementation/operation

- Allocate management responsibilities
- Monitor and manage project outputs
- Manage changes
- Dispute resolution
- Contract expiry and asset handover

- Estbalish reviewing body
- Define evaluation criteria
- Produce evaluation report

BLENDING ACTIVITIES

- Grant disbursement requests submitted by beneficiary
- Certifying Authority confirmation
- Escrow account operation
- Possible management of change of private sector beneficiary
- Reporting and audit obligations

A worked example of a blended project

Description of the project

- 30 km road between cities A and B in a mountainous area
- Current road long and dangerous and rail links absent
- Significant construction costs and risks (bridges)
- Economic benefits of the project assessed (e.g. safety increase, reduced travel times, etc.)
- Initial VfM, affordability and bankability assessments point toward potential PPP solutions
- Project selected in the Transport and Mobility OP as Major Project
- Funding and financing options being considered, based on:
  - Limited users' willingness and ability to pay a toll;
  - Grant funding needed to make the project affordable.

Description of the project

- Key project dates

Expenditure item	Date	Eligibility period for the purpose of costs that may be covered by the grant
Grant application	2016	Yes
Procurement and grant approval	2016-2017	Yes
Construction period	2018-2020	Yes
Operating period	2021-2045	Yes (2019-2023) No (2024-2045)
Duration of operation (years)	25	-
Reference period (years)	30	-

Description of the project

- Key project data

Expenditure item	Amount (EURk)	Date
Design costs	10,000	2016-2017
Land purchase costs	90,000	2017-2018
Construction costs	450,000	2018-2020
Heavy maintenance costs	135,000	2021-2045
Other investment costs	5,000	2016-2017
Total investment costs	**690.000**	**2016-2045**

Decisions for the procuring authority

- Who will be the beneficiary of the grant?
  - Public beneficiary vs private beneficiary
  - The opportunities of using an escrow account
  - Reporting requirements

- For the purpose of the worked example, the procuring authority decides to be the beneficiary of the grant

Decisions for the procuring authority – cont.

What is the impact of different PPP structures on the level of the grant?

- The procuring authority needs to consider a number of PPP options and associated funding options (i.e. availability vs toll charges; level of traffic risk transferred to private partner; etc.)
- Choice driven by: VfM, affordability, bankability, existing policies on user charging
- Revenue generating options will imply a reduced level of grant

For the purpose of the worked example, the preferred option is:

- Charges on users collected by the private partner

Plus

- Availability-based payments from the public sector (public funding)

Decisions for the procuring authority – cont.

What is the expected grant amount?

Step 1 – Determination of eligible costs

Expenditure item	Amount (EURk)
Total investment costs (incl. heavy maintenance)	690,000
A. Of which, expenditure within the programming period (2014-2023)	600,000
B. Of which, land costs	90,000
C. Cap on land costs (10% of eligible costs)	60,000
Total eligible costs (A-B+C)	**570,000**
Ratio eligible costs/total costs	**83%**

Decisions for the procuring authority – cont.

What is the expected grant amount?

Step 2 – Determination of operating costs and revenue

- Assumption 1: Project operating costs
  - Unitary costs: 150.000/km p.a.
  - Total costs throughout operational period: EUR 113m
- Assumption 2: Project revenue
  - Tolls: 0.1/km
  - Traffic: 19.000cars/day in the 1st year of operation
  - Growth rate: 2% p.a.
- Assumption 3: 4% benchmark discount rate
- Assumption 4: No residual value

Decisions for the procuring authority – cont.

What is the expected grant amount?

Step 3 – Calculation of the grant amount: Discounted net revenue method

- Calculation of discounted net revenue

Disc. net revenue	=	Disc. revenue	–	Disc. operating costs	+	Disc. res. value
247	=	317	–	70	+	0

- Calculation of the funding gap rate

Funding gap rate	=	1	-	Disc. net revenue/disc. Investment costs
63.71%	=	1	-	247/680

Decisions for the procuring authority – cont.

What is the expected grant amount?

Step 3 – Calculation of the grant amount: Discounted net revenue method – cont.

- Determination of the Decisional amount

Decisional amount	=	Eligible costs	x	Funding gap rate
363	=	570	x	63.71%

- Determination of the EU Grant amount

EU Grant amount	=	Decisional amount	x	Max co-financing rate
272	=	363	-	75%

Decisions for the procuring authority – cont.

What is the expected grant amount?

Alternative method of calculation of the grant amount: the flat rate method

- Determination of the Decisional amount

Decisional amount	=	Eligible costs	x	(1- sectoral flat rate)
399	=	570	x	(1-30%)

- Determination of the EU Grant amount

EU Grant amount	=	Decisional amount	x	Max co-financing rate
299	=	399	-	75%

Decisions for the procuring authority – cont.

When to secure the grant approval?

- Procuring authority not able to finance any shortfalls in grant level
- Bidders need clarity on the expected funding sources of the project
- Procuring authority decides to prepare the grant application prior to the start of the procurement process
- Chosen assessment procedure for the Major Project application: IQR

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