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

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.

- **Private finance**
- **Construction**
- **Operation**

- **EU grants (to cover part of availability payment related to capex)**
- **Availability payments funded by national authorities**
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
     \[ = 1 - \text{flat rate} \]
   - No risk of recalculation

<table>
<thead>
<tr>
<th>Sector</th>
<th>Flat rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Road</td>
<td>30%</td>
</tr>
<tr>
<td>Rail</td>
<td>20%</td>
</tr>
<tr>
<td>Urban Transport</td>
<td>20%</td>
</tr>
<tr>
<td>Water</td>
<td>25%</td>
</tr>
<tr>
<td>Solid Waste</td>
<td>20%</td>
</tr>
<tr>
<td>RDI</td>
<td>20%</td>
</tr>
</tbody>
</table>
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?

<table>
<thead>
<tr>
<th>Timing of PPP and ESIF grant processes</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Selection of private partner before/after grant application</td>
</tr>
<tr>
<td>✓ Subsequent change of private partner beneficiary possible with no loss of the grant</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Timing/flexibility of EU grant disbursement into the project</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Escrow account</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Calculation of the grant amount and how final is the amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Flat rate</td>
</tr>
<tr>
<td>✓ No recalculation risk</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Negative market perception</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Definition of PPPs</td>
</tr>
<tr>
<td>✓ Specific chapter on PPPs in the CPR</td>
</tr>
</tbody>
</table>
The PPP project blending cycle
Outline of typical PPP project cycle

Phase 1
Project identification

Phase 2
Detailed preparation

Phase 3
Procurement

Phase 4
Project implementation

Quality check-point

Approval

Mainly 'project' focus

Approval

Mainly 'PPP' focus

Approval

Blending ESIF grants and PPPs
5 key issues to consider throughout the PPP project cycle

- Requirements met
- Economic viability
- Commercial viability
- Affordability
- Manageability
Phase 1 – Project identification

**Project selection**

- **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.**

**Definition of requirement**

- **Economic viability**
- **Commercial viability**
- **Affordability**
- **Manageability**

**Screen as potential PPP**

- **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**

**Key blending decisions:**

- **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

Getting organised

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

Appraise as a PPP

- Requirements met
- Economic viability
- Commercial viability
- Affordability
- Manageability

Structure as a PPP

- 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
  - finalisation 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

Blending ESIF grants and PPPs
Phase 3 – PPP procurement

Blending ESIF grants and PPPs

Bidding process

PPP contract

- 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

Financial close

- Requirements met
- Economic viability
- Commercial viability
- Affordability
- Manageability

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

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

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

Project Implementation
- Requirements met
- Economic viability
- Commercial viability
- Affordability
- Manageability

Ex-post evaluation
- Define evaluation criteria
- Produce evaluation report

Blending ESIF grants and PPPs
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

<table>
<thead>
<tr>
<th>Expenditure item</th>
<th>Date</th>
<th>Eligibility period for the purpose of costs that may be covered by the grant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grant application</td>
<td>2016</td>
<td>Yes</td>
</tr>
<tr>
<td>Procurement and grant approval</td>
<td>2016-2017</td>
<td>Yes</td>
</tr>
<tr>
<td>Construction period</td>
<td>2018-2020</td>
<td>Yes</td>
</tr>
<tr>
<td>Operating period</td>
<td>2021-2045</td>
<td>Yes (2019-2023)  No (2024-2045)</td>
</tr>
<tr>
<td>Duration of operation (years)</td>
<td>25</td>
<td>-</td>
</tr>
<tr>
<td>Reference period (years)</td>
<td>30</td>
<td>-</td>
</tr>
</tbody>
</table>
Description of the project

- **Key project data**

<table>
<thead>
<tr>
<th>Expenditure item</th>
<th>Amount (EURk)</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Design costs</td>
<td>10,000</td>
<td>2016-2017</td>
</tr>
<tr>
<td>Land purchase costs</td>
<td>90,000</td>
<td>2017-2018</td>
</tr>
<tr>
<td>Construction costs</td>
<td>450,000</td>
<td>2018-2020</td>
</tr>
<tr>
<td>Heavy maintenance costs</td>
<td>135,000</td>
<td>2021-2045</td>
</tr>
<tr>
<td>Other investment costs</td>
<td>5,000</td>
<td>2016-2017</td>
</tr>
<tr>
<td><strong>Total investment costs</strong></td>
<td><strong>690,000</strong></td>
<td><strong>2016-2045</strong></td>
</tr>
</tbody>
</table>
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

<table>
<thead>
<tr>
<th>Expenditure item</th>
<th>Amount (EURk)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total investment costs (incl. heavy maintenance)</td>
<td>690,000</td>
</tr>
<tr>
<td>A. Of which, expenditure within the programming period (2014-2023)</td>
<td>600,000</td>
</tr>
<tr>
<td>B. Of which, land costs</td>
<td>90,000</td>
</tr>
<tr>
<td>C. Cap on land costs (10% of eligible costs)</td>
<td>60,000</td>
</tr>
<tr>
<td><strong>Total eligible costs (A-B+C)</strong></td>
<td><strong>570,000</strong></td>
</tr>
<tr>
<td>Ratio eligible costs/total costs</td>
<td><strong>83%</strong></td>
</tr>
</tbody>
</table>
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: 19,000 cars/day in the 1st year of operation
  - Growth rate: 2% p.a.

- Assumption 3: 4% benchmark discount rate
- Assumption 4: No residual value
What is the expected grant amount?

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

• Calculation of discounted net revenue

\[
\text{Disc. net revenue} = \text{Disc. revenue} - \text{Disc. operating costs} + \text{Disc. res. value}
\]

<table>
<thead>
<tr>
<th></th>
<th>=</th>
<th>Disc. revenue</th>
<th>–</th>
<th>Disc. operating costs</th>
<th>+</th>
<th>Disc. res. value</th>
</tr>
</thead>
<tbody>
<tr>
<td>247</td>
<td>=</td>
<td>317</td>
<td>–</td>
<td>70</td>
<td>+</td>
<td>0</td>
</tr>
</tbody>
</table>

• Calculation of the funding gap rate

\[
\text{Funding gap rate} = \left( \frac{\text{Disc. net revenue}}{\text{disc. Investment costs}} \right) - 1
\]

<table>
<thead>
<tr>
<th>Funding gap rate</th>
<th>=</th>
<th>1</th>
<th>\left( \frac{247}{680} \right) - 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>63.71%</td>
<td>=</td>
<td>1</td>
<td>\left( \frac{247}{680} \right) - 1</td>
</tr>
</tbody>
</table>
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

<table>
<thead>
<tr>
<th>Decisional amount</th>
<th>=</th>
<th>Eligible costs</th>
<th>x</th>
<th>Funding gap rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>363</td>
<td>=</td>
<td>570</td>
<td>x</td>
<td>63.71%</td>
</tr>
</tbody>
</table>

- Determination of the EU Grant amount

<table>
<thead>
<tr>
<th>EU Grant amount</th>
<th>=</th>
<th>Decisional amount</th>
<th>x</th>
<th>Max co-financing rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>272</td>
<td>=</td>
<td>363</td>
<td>-</td>
<td>75%</td>
</tr>
</tbody>
</table>
What is the expected grant amount?

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

- **Determination of the Decisional amount**

  \[
  \text{Decisional amount} = \text{Eligible costs} \times (1 - \text{sectoral flat rate}) \\
  399 = 570 \times (1 - 30\%) 
  \]

- **Determination of the EU Grant amount**

  \[
  \text{EU Grant amount} = \text{Decisional amount} \times \text{Max co-financing rate} \\
  299 = 399 \times 75\% 
  \]
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
For info or further questions on this seminar and the activities of the JASPERS Networking Platform, please contact:

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