European PPP Expertise Centre

New Eurostat rules on contracts that fund the major part of availability payments using tolls collected by or on behalf of the government

The case of the SCUT motorway contracts in Portugal

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1 Background

In April 2011 and after consultation with EUROSTAT, Portugal decided to reclassify three motorway contracts, which were originally off the government's balance sheet, to make them on-balance sheet. All three projects had originally been structured under shadow toll schemes some years ago[1] and were then subject to renegotiation with the same partners in April 2010.

Under the original structure, the private partner was bearing the demand risk through a shadow-toll arrangement and there was no collection of tolls from users of the motorway. After the renegotiation, the government introduced real tolls that are being collected by the private partner under a separate agreement and paid to the government. The shadow toll payment mechanism has been replaced with an availability payment payable irrespective of traffic flows. The private partner thus bears no demand risk. The Portuguese authorities felt that they could continue to classify these projects as off-balance sheet since availability risk remained with the private partner, who had taken on the full risk of construction when the roads were originally built.

2 New rule

The initial contracts, in which the demand risk was borne by the private partner via a shadow toll arrangement, were classified off-balance sheet for the government because both the construction and the demand risk were transferred to the private partner in accordance with the ESA95 rules.

However, the revised arrangements, which combine availability payments and tolls represented a new contract form for EUROSTAT and had no precedent. These were not concession contracts as the tolls were paid by the final users to the State and were only collected by the private partner. They were also not considered to be PPPs on the grounds that availability schemes always assume that the private partner will provide an asset to the public sector for the latter's own use.

When deciding on the reclassification of the assets towards the government's balance sheet, EUROSTAT argued that (i) these are new structures that did not include any construction risk as the assets had been built already and (ii) they did not correspond to the payment mechanisms contemplated under the statistical definition of PPPs (whereby government remunerates the private partner and does not receive revenues from the PPP asset).

As a result, the existing EUROSTAT classification rules were considered not to apply. EUROSTAT did not take account of the fact that the construction risk had been borne by the same private partner under the earlier structure as theoretically, for all these contracts the authorities could have chosen new partner(s) not involved in the

[1] *The Portuguese system of shadow toll motorway contracts was introduced in 1998 and is known under the SCUT acronym.*

construction of motorways. As a result, the new contractual arrangements for these motorways were treated as simple service contracts between government and a private party, and not as PPPs.

EUROSTAT saw no necessity to analyse the question of who takes the availability risk under the new contractual mechanism. A more important point for its analysis was that government is charging the users of the motorway a fee. Applying the “ownership” approach under statistical rules, not only the risks, but also the rights to benefits (rewards) from the asset are deemed to be taken into account. Consequently, in order to classify the motorways concerned (and similar cases in the future), EUROSTAT analysed for each of the motorways the amount of total tolls collected by government in relation to the costs incurred by the Government to secure the provision of the motorway services (i.e. the availability payments).

The new rule that emerged from EUROSTAT’s analysis of the Portuguese motorway cases is therefore the following:

> If government revenues from tolls exceed 50% of the total value of government payments to the private partner (e.g. availability payments), then the project is recorded on the balance sheet of government. In other words, government owns an asset (and records it on its balance sheet) if a majority of government payments to the private partner for a provision of services under a contract are “funded” through revenues from this asset. Concerning valuation, EUROSTAT agrees to use the value of the outstanding debt as a proxy for the asset value.

It is important to highlight that the same rule would be applied by EUROSTAT also in its analysis of new contracts combining real tolls received by government with availability payments paid to the private partner: when the forecast toll revenue of a project represents more than 50% of the availability fee, the asset and debt would need to be classified on the balance sheet of government.

It is expected that the rules elaborated by EUROSTAT for the particular case of the Portuguese motorways will be generalised, i.e. also for other sectors than roads, in the near future by incorporating them into the PPP chapter of the EUROSTAT Manual on Government Deficit and Debt.

3 Implications

The new EUROSTAT approach deviates from the current rules of the risk assessment by introducing additional considerations into the analysis regarding the benefits resulting from a PPP asset. The new rule results from the EUROSTAT’s view that such PPP contracts in which the government, on the one hand, receives tolls and, on the other hand, remunerates the private partner are not PPPs in statistical terms. Such a structure is based rather on a revenue-generating asset exploited by government with a parallel contract for the asset management by the private partner.

This is in line with the general principles of looking at risks and rewards for statistical asset classification under ESA95, but it conflicts with the current rules on the three categories of risk: construction, availability and demand. EUROSTAT argues that there are two types of government services, namely those that are (i) free of charge to the end users and (ii) those that carry a user charge. If government wants to pass the related risks to the private partner and not to record the related asset on its balance sheet, it has to pass on both the availability and the construction risk in the first case and the demand and construction risk in the second.