Application of the PPP Principle on the Economic and Social Cohesion Policy

Project 1p/05 – 3rd Department of the Community Support Framework

Final presentation

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Project Introduction

Objective:

- Summarise the key findings from the scenarios of PPP* projects financed from EU funds * *;
- Presentation of combined PPP and EU funding models;
- Summary of key recommendations.

Project methodology:

- As-is mapping;
- Key barrier identification;
- Preparation of recommendations for PPP projects financed from EU funds;
- Basic models of PPP projects financed from EU funds;
- Suggestion of the areas eligible for PPP implementations;
- Proposal of the general text of the operational programme;
- Use of technical assistance;
- Preparation of a model project.

* PPP – Public Private Partnership

* * For this presentation, EU funds means Structural Funds and the Cohesion Fund

Major Barriers and Risks

Barriers and risks are perceived at two levels:

1. Program – barriers and risks at this level can underlie a discussion with the European Commission and the Czech Government, and also involve ministries and managing authorities.
2. Project – problems at this level can be discussed with individual managing authorities during the preparation of operational programmes and applicant guidelines.

Barriers and risks at the program-level linked to the European Commission:

- Eligible expenditures must be paid in full amount by the beneficiary; (barrier)
- On-going use of subsidies* from EU** funds during the project investment phase contradicts the key PPP principle: “no service, no payment“; (risk)
- Automatic classification of all PPP projects as the project group generating income (including the projects based on fees for availability); (risk)
- Investment costs in the operational phase cannot be financed from EU funds. (barrier)

* On-going use means a submission of request for payment during the project implementation, after each phase is completed.

** EU funds mean Structural Funds and Cohesion Fund.

Major Barriers and Risks (cont.)

Barriers and risks at the program-level linked to the Czech Government, ministries and managing authorities:

- Impact of state aid rules on individual PPP projects; (barrier)*
- Infrastructure owned by the private sector; (barrier)
- To-date, PPP project-specific costs (incurred mainly during the preparation phase) cannot be financed from EU funds; (risk)
- Insufficient standardisation of PPP project-related documentation (tender documentation, concession contracts). (risk)

Barriers and risks at the project-level:

- Different interpretation and routine application of the Public Procurement Act; (risk)
- Risk of changed concession contract terms during the use of subsidy under EU funds by a given PPP project – due to the missing standardisation of some concession contract provisions required for combined EU and PPP funding; (risk)
- For the public sector, combined PPP and EU funding is demanding in terms of time, administration and costs; (risk/barrier)
- Relatively complicated cash flow of a PPP projects co-financed from EU funds; (risk)
- To prepare a detailed list of eligible PPP projects, absorption capacity thereof should be mapped within relevant operational programmes. (risk)

* Note: The issue is a difference between PPP project rules and the policy on Economic and Social Cohesion. On PPP projects, infrastructure is owned, as a rule, by a private investor while the policy on Economic and Social Cohesion imposes the beneficiary as the owner of infrastructure. This fact must be taken account of and the concession contract drafted accordingly, as a contract of lease.

State Aid and its Relationship to EU Funds

The subsidy provided to undertakings of EU funds may be taken for state aid/public assistance

- This subsidy is public assistance eligible and compliant with the Common Market;
- A detailed investigation should be made to identify whether the beneficiary is an “undertaking“ as specified by the public assistance regulation and whether the subsidy meets all attributes of public assistance (regardless of whether it is a private or public entity).

PPP project subsidy granted to private entities does not have to meet public assistance requirements

- There is no market in certain areas considered for PPP project implementations;
- In certain areas considered for PPP projects, the ownership (of roads, motorways) cannot be transferred to a private investor.

The public assistance issue may appear later due to incorrect project structure or faulty project implementation

- Public awards;
- Transfers of assets from public entities to private investors.

A relatively limited number of potential PPP projects enables conducting assessments regarding public assistance.

State Aid and its Relationship to EU Funds (cont.)

The rules of Community law governing state aid use the term undertaking*, which is imperative to the determination of the amount of subsidy.

In this presentation, the terms “public entity“ and “private entity“ used in connection with the beneficiary are to identify the legal character of the given entity without a specific link to the term undertaking.

Both the public entity and private entity can meet the attributes of state aid, dependent on their services.

The services provided by a public entity are either:

- **Economic activities** – services aimed to ensure infrastructure and standard of living which can be delegated to a different entity; in this event, assessment will have to be conducted to identify whether state aid attributes have been met;

- **Public Administration core activities** – services which cannot be delegated to a private entity (e.g. issuance of statutory instruments).

Consequently, if a ministry/region or an entity established thereby decides to provide economic activities, assessment will have to be made to decide whether this entity is an undertaking and which rules with regard to governing state aids it will be subject to, as specified in Section 53 (4) of the General Conditions Regulation.

* For simplification, the presentation will use the term “private entity instead” of “undertaking”; the entity which does not meet the conditions of an undertaking will be called a “public entity”.

Sector-Specific Projects

- Combined PPP and EU funding seems to be most efficient if used on large infrastructure projects in the transport sector and in the environmental field (investment costs > CZK 1 billion).

- Although operational programmes in transport, environment, business and innovation, and competitiveness seem to be the most desirable for a combined PPP and EU funding under current conditions, this type of funding may also be effective in other OPs, if there are convenient projects.

- Regional operational programmes represent a separate category – implementation of several large projects is, in theory, possible.

- Selection of the most convenient model depends, to a great degree, on the project itself. The following table presents the models convenient for a given sector. Generally speaking, all presented models (except for Model 5) can be *de facto* used in selected OPs.

Sector-specific Projects (cont.)

OP	Eligible Projects	Commentary on State Aid	Convenient Model of PPP and EU Funding
Transport (Ministry of Transportation)	• Highway and freeway infrastructure • Railway infrastructure • Development of airports • Other transportation structures – bridges, tunnels, etc. • Modernisation of waterways	Relatively minor risks (infrastructure owned by the Czech Republic) Separate assessment required for airports and ports (possibility of combined private ownership, land transfers, etc.)	Model 1 Model 2 Model 3
Environment (Ministry of the Environment)	• Water supply and sewerage system • Water treatment plants • Waste management (e.g. incineration plants) • Environmental burden liquidation • Renewable resources	Separate assessment required (possibility of combined private ownership, land and infrastructure transfers, etc.)	Model 2 Model 3
Prague (Prague City Council)	• Metro construction • Prague ring road project • Water supply and sewerage system	Separate assessment required (possibility of combined private ownership, land and infrastructure transfers, etc.)	Model 1 Model 2 Model 3
Business and innovation (Ministry of Industry and Trade)	• Brownfield redevelopment	Relatively high risks – separate assessment required (also in terms of state aid beneficiaries)	Model 1 Model 4

PPP and EU Funding Models

- Public Co-financing (Model 1)
- Operator Co-financing (Model 2)
- Public beneficiary (Model 3)
- Private beneficiary (Model 4)
- Holding Fund (Model 5)

These models present the basic method of combining the EU and PPP funds.

Model prerequisites

The models were developed to:

- Make a combined PPP and EU funding feasible;
- Involve the private sector to a maximum; and
- Ensure maximum efficiency and use of subsidies from EU funds.

Public Co-Financing (Model 1)

Tender procedures are executed separately for the investment and operational phases

Financing structure

Investment Phase

Public Funds | **EU Funds**

Financing of costs to total 100 %

The funding volume depends on the size of financial gap

Beneficiary

Public entity

The public entity which also owns the investment subject-matter in the operational phase

Operational Phase

PPP Model: Operation Contract

EU funds are not used for the operational phase; the government will co-finance the investment subject matter in the form of fees for construction availability, maintenance and operation

Private SPV

SPV operates the project

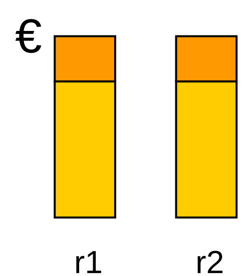
Timeline

Standard design and construction of the investment subject-matter (tender for supplier)

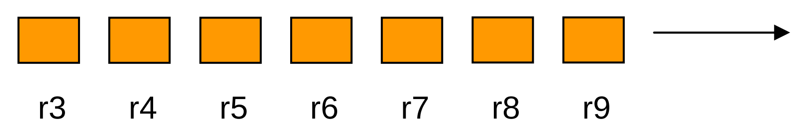
Maintenance and operation of the investment (tender for operator)

Financing scheme

Investment costs are not financed by a private entity but from the EU/State budget



Availability of fees paid by the public entity for the investment maintenance and operation



Public funds

EU funds

Model 1- Advantages and Disadvantages

MODEL 1	
Advantages	• Maximum subsidy for PPP projects from EU funds is up to 85 percent of eligible costs of the financial gap; • More simple use of EU funding (procedures, fewer number of involved entities); and • Tender for operator will correspond with technical possibilities of infrastructure/investment subject-matter.
Disadvantages	• Beneficiary must ensure the financing of remaining project costs; • Additional costs of two tenders (investment and operational phases); • Higher operational costs (private operator does not have a chance to influence the project design); and • Limited possibilities of shifting risks to a private entity.

Operator Co-financing (Model 2)

Tender procedures are executed separately for the investment and operational phases

Financing structure

Investment Phase

Private SPV | **Public funds** | **EU funds**

Financing the investment costs to total

100%

Financing volume depends on the size of financial gap

Beneficiary

Public entity

Public entity which owns the investment subject-matter also in the operational phase

Operational Phase

PPP Model: Operation contract

EU funds are not used during operational phase; the government will co-finance investment subject-matter in the form of fees for availability, maintenance and operation and it will partially finance the investment phase

Private SPV

SPV operates the investment subject-matter

Timeline

Standard design and construction of investment subject-matter (tender for supplier)

Construction maintenance and operation (tender for operator)

Financing scheme

Investment costs covered from EU funds and remaining investment costs (to total 100%) covered by a private entity (private SPV)

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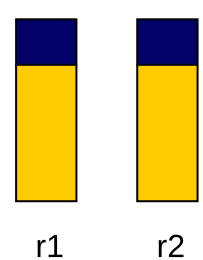
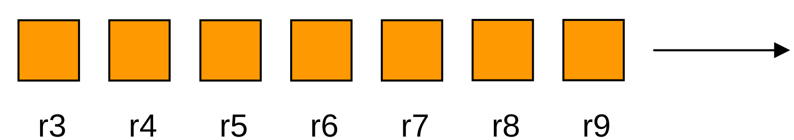


Public entity pays the fees for availability, maintenance and operation of the construction and it will partially finance the investment phase



Public funds | EU funds | Private funds

Model 2 – Advantages and Disadvantages

MODEL 2	
Advantages	• See Model 1; and • Private entity will ensure the funding of remaining project costs (in the form of a supplier loan or interest-free loan).
Disadvantages	• See Model 1.

Public Beneficiary (Model 3)

Tender procedures are executed jointly for investment and operational phases

Financing structure

Investment Phase

Private SPV | **Public funds** | **EU funds**

Financing investment costs to total 100%

The funding volume depends on financial gap size

Operational Phase

PPP Model: DBFO

EU funds are not used; the government will co-finance the investment in the form of availability fees, including the fees to the private entity for its investment in the investment phase

Beneficiary **Public entity**

The public entity owns investment subject-matter also in the operational phase

Private SPV

SPV operates investment subject-matter

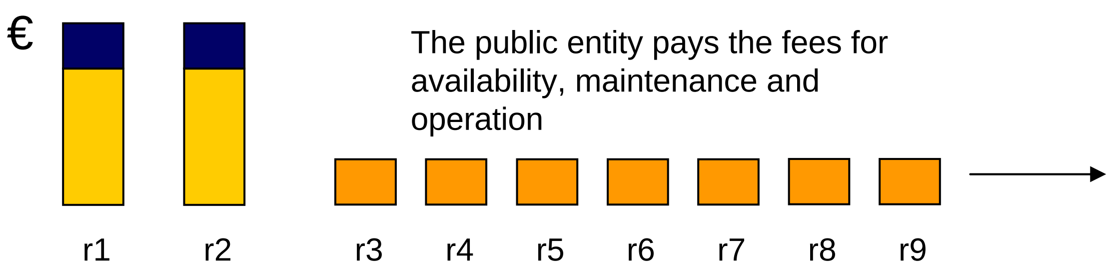
Timeline

PPP Project, type Design, Build, Finance, and Operate

Financing scheme

Financing of investment costs by EU and the remaining investment costs (to total 100%) covered by a private entity/private SPV

The public entity pays the fees for availability, maintenance and operation



Public funds | EU funds | Private funds

Model 3 – Public Beneficiary model

Restrictive conditions of the Economic and Social Cohesion Policy

- The public entity acting as the beneficiary must directly pay 100 percent of eligible costs of the project; the public entity will report such eligible costs to the managing authority in the form of an application for payment together with cleared invoices;
- A problem arises in the event that the beneficiary is a public entity even though a private partner funds the investment phase (see Model 3: Public Beneficiary).

Potential solutions

A. The EC is consulted as to whether expenses paid by an entity other than the beneficiary during the project implementation may be included in eligible project costs; from the beneficiary’s perspective, these costs are contingent liabilities paid in the form of availability fees during the operational phase.

B. Granting of a non-interest-bearing loan to the beneficiary by a private entity which is repaid in the form of service fees:

   1. Granting of a non-interest-bearing loan to the beneficiary by a private partner for the financing of eligible investment costs;
   2. Payment of eligible investment costs by the beneficiary;
   3. Submission of the application for payment by the beneficiary;
   4. Receipt of the subsidy by the beneficiary;
   5. Repayment of a part of the non-interest-bearing loan from the granted subsidy; and
   6. Long-term repayment of the outstanding amount in the form of fees for infrastructure/service availability.

C. Commercial loan

Model 3 – Advantages and Disadvantages

MODEL 3	
Advantages	• The maximum subsidy from EU funds for PPP projects up to the limit of 85 percent of eligible costs of the financial gap; • Financing of investment costs by a private entity; • Using the advantages of the DBFO model*; • Motivation of the private entity for minimum overall project costs and performing all supplier services; • Lower operational costs of the project (the private operator may influence the project design); and • Greater chances of transferring risks to the private entity.
Disadvantages	• Need to deal with the issue of paying investment costs by the beneficiary; • Under the current conditions, the structure of clearing the project costs is rather difficult because the operator (SPV) cannot pay the invoices directly to the supplier but needs to grant a non-interest-bearing loan to the beneficiary who pays supplier invoices; and • The beneficiary cannot submit invoices paid directly by SPV (the operator); the beneficiary must first pay these invoices and then submit them together with an application for payment to the managing authority.

* DBFO model = Design-Build-Finance-Operate

The Private Beneficiary Model (Model 4)

Tender procedures are executed jointly for the investment and operational phases

Financing structure

Investment phase

Operational phase

Private SPV | **Public funds** | **EU funds** | **PPP Model: DBFO**

Finance the investment costs to total 100%

The funding volume is **MAX 40% -** the beneficiary is a private entity.

Subsidies from EU funds are not used; the government is involved in co-financing in the form of availability fees, including fees to the private entity for the investment in the investment phase.

Beneficiary **Private entity (SPV)** → **Private SPV**

SPV owns and operates the subject-matter of investment

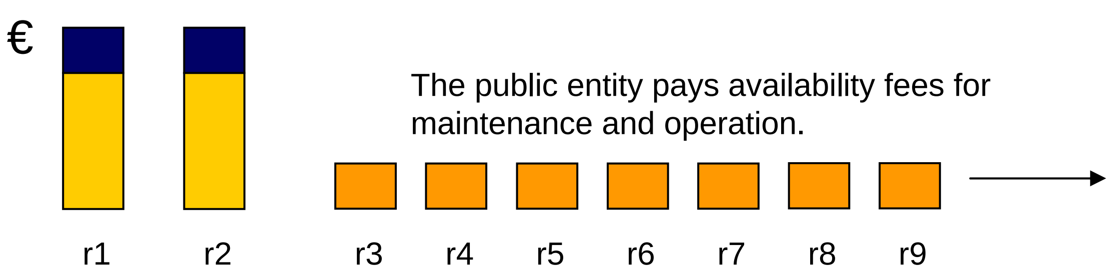
The private entity also owns the subject-matter of investment in the operational phase.

Timeline

Design, Build, Finance, Operate PPP contract

Financing scheme

Investment costs covered from EU funds and the remaining investment costs (to total100%) covered by a private entity (private SPV).



Public funds | EU funds | Private funds

Model 4 – Advantages and Disadvantages

MODEL 4	
Advantages	• Financing of investment costs by a private entity; • Using the advantages of the DBFO model; • Motivating the private entity for minimum overall project costs and performing all supplier services; • Lower operational costs of the project (the private operator may influence the project design); and • Greater chances of transferring risk to a private entity;
Disadvantages	• Minimum volume of received EU funds up to the limit of 40 percent of eligible costs of the financial gap; and • A limited number of priorities where a private entity may be a beneficiary.

The Holding Fund Model (Model 5)

Tender procedures are executed jointly for the investment and operational phases

Financing structure

Investment phase

The funding volume depends on the size of the financial gap

Operational phase

Private SPV

Public finds

EU funds

PPP Model: DBFO

Subsidies from EU funds are not used; the government is involved in co-financing in the form of availability fees including fees to the private entitiy for its investment in the investment phase.

Finance the investment costs to total 100%

Holding fund (EU-CR PPP fond)

Beneficiary

Public entity

The public entity also owns the subject matter of investment in the operational phase.

Private SPV

SPV operates the subject-matter of the investment.

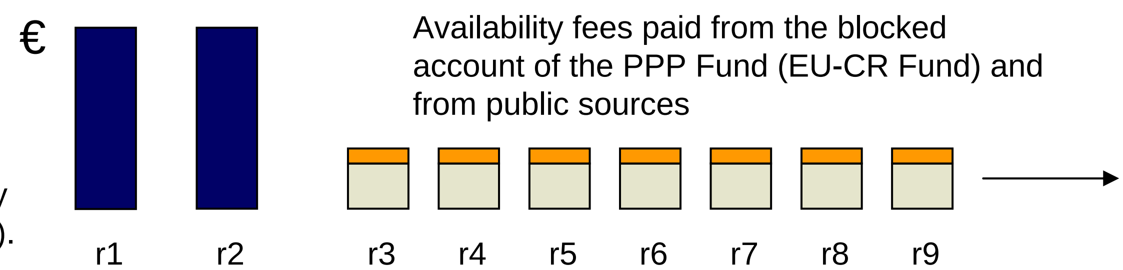
Timeline

Design, Build, Finance, Operate PPP contract

Financing scheme

100% of the project investment costs covered by a private entity. The EU financial contribution is maintained by the Holding Fund (EU-CR PPP Fund).

Availability fees paid from the blocked account of the PPP Fund (EU-CR Fund) and from public sources



Public funds | EU funds | Private funds | Holding fund

Model 5 – Advantages and Disadvantages

MODEL 5	
Advantages	• The maximum subsidy from EU funds up to the limit of 85 percent of eligible costs of the financial gap; • Compliance with PPP principles of projects (“no service, no payment”); • Use of the advantages of the DBFO model; • Motivation of the private entity for minimum overall project costs and performing all supplier services; • Lower operational costs of the project (the private entity may influence the design of the project); and • Greater chances of transferring risks to a private entity.
Disadvantages	• Does not comply with the rules of the Economic and Social Cohesion under which EU funds must be used to cover investment costs; they cannot be used to create another fund from which financial means would be drawn as late as in the operational phase (even if used to cover investment costs); and • The National Fund maintains that the Holding Fund Model is not currently feasible.

Note: The principle of the holding fund is described in relation to Model 3; however, it may be used also within other models (Model 2, Model 4).

Key Recommendations

Key recommendations at the program-level with relation to the EC:

To allow for an effective combination of PPP and EU funds in the programming period, we consider it useful to initiate technical consultations with the EC aimed at clarifying the interpretation of the following points:

- Eligible costs will be covered by the private entity during project implementation; invoices will be enclosed in the application for payment; the public entity will pay its liabilities during the programming period in the form of service fees;
- Payment of the investment costs of the project in the operational phase (the “infrastructure component“);
- Projects based on the payment of shadow toll and infrastructure/service availability fees paid by a public entity to a private partner should not be automatically included among income-generating projects;
- Infrastructure owned by a private applicant during the operational phase provided that the project purpose does not change over the period of sustainability of the project; and
- The question of determining the acceptable level of profitability of projects (based on the indicative income percentage defined for selected fields in Fiche 64; and based on what grounds is it justified to exceed this percentage in individual projects).

Key Recommendations (cont.)

Key recommendations at the program-level with relation to the government, ministries and managing authorities:

- Large infrastructural projects especially in transport and environment (investment costs > CZK 1 billion) seem to be best suited for effective combination of PPP and EU funds;
- Define consistently the understanding of PPP projects at the level of all resorts and set up a standard approach to the preparation and follow-up implementation of PPP projects;
- Realistically assess the opportunities of individual operational programmes and subsequently select PPP projects eligible for co-financing through a specific operational program;
- Perform a detailed selection of PPP projects on the shortest possible time horizon;
- Prepare an indicative list of potential PPP projects combined with EU funds in the Czech Republic (according to individual operational programmes) at the level of managing authorities;
- Standardise documentation related to PPP projects (tender documentation, concession contracts – standard provisions relating to EU funds);
- Deposit funds provided from EU funds to the blocked account of the private entity (operator) to be drawn on condition that the private entity duly meets its contractual conditions;
- Include costs associated with project documentation of PPP projects in the operational programme, or, for selected projects, to technical assistance priority; and
- Strengthen capacities at the level of managing authorities.

Key Recommendations (cont.)

Key recommendations at the project-level with relation to managing authorities:

- Explore opportunities to use EU funds for each contemplated PPP project;
- Begin preparation of combined projects well in advance;
- Prepare projects with the assistance of specialised advisors;
- Prepare a detailed feasibility study of the project before submitting the project application;
- Invite tenders for licensees before registering the application for an EU funded project;
- Realize selection of the most convenient model and the kind of final beneficiary (public authority or private entity) in dependance on the project itself – the main aim is to ensure the maximum subsidy from EU funds for PPP projects based on results of financial analysis calculated in both options, either grant amounts to 85% of financial gap counted from eligible expenditure or grant amounts to 40% of eligible expenditure;
- Assess issues related to the ownership structure always with respect to a specific project;
- Define, in the concession contract, information requirements and the impact of major changes in PPP terms and conditions on financing – the objective is to ensure claims, if any, for returning the subsidy from EU funds; and
- Define control and monitoring conditions during project implementation in the concession contract.

Recommendations: Operational Programme

Key recommendations at the program-level with relation to the government, ministries and managing authorities:

We recommend describing the following aspects in the operational programme:

Typical features of PPP projects co-financed from EU funds:

- Long-term duration of the project;
- The public entity or SPV acting as the beneficiary (or another entity not complying with the definition of “undertaking“ under public assistance rules);
- Project financing from private and public funds; public funds mean EU funds and national public funds;
- Risks arising from the execution of the investment to be distributed among the public entity and the private partner; the private sector will provide the public sector with guidance regarding risks management; and
- Public services are ensured by the private investor in the operational phase.

Advantages of PPP projects:

- Project implementation through PPP may provide the public sector with greater value for money and ensure a higher quality of services rendered by the pubic sector; and
- The private sector assumes risks which would otherwise be borne by the public sector had the project not been implemented through PPP. The private sector is able to assess risks more strictly than the public sector.

Recommendations: Operational Programme (cont.)

Key recommendations at the program-level with relation to the government, ministries and managing authorities:

We recommend describing the following aspects in the operational programme:

Definition of the beneficiary of the subsidy:

- Ministries, regions and municipalities;
- Institutions receiving contributions from the State budget;
- Institutions, within territorial self-governing units, which receive contributions from the State budget;
- Organisational units of the government and territorial self-governing units;
- Public research institutions, universities; and
- State-owned legal persons.

Eligible costs may include:

- Preparation of studies which are an inseparable part of project documentation; and
- Provision of legal services in connection with the invitation of tenders for service suppliers.

Project timeline:

- Selected priorities for PPP projects to be set up for the entire duration of the programming period.

Formalities of project documentation:

- Feasibility study;
- Outline business case (including a cost-benefit analysis);
- Project budget;
- Issue of the planning permit;
- Assessment of the environmental impact of the project;
- Draft of the concession contract including provisions relevant from the perspective of EU funds; and
- Ownership structure of the beneficiary.

Conclusion

The foregoing analysis indicates that PPP projects may be combined with EU funds. However, the structure for such initiatives is rather complicated and thus the implementation of PPP projects needs to focus on:

- Selected areas (such as transport infrastructure, environment, brownfields);
- Large-scale projects whose volume is at least CZK 1 billion;
- Project plans whose implementation may start within three years.

Some issues require clarification at the level of the European Commission, especially issues associated with the financing system (for example, the payment of eligible expenses of the project by an entity other than the beneficiary; from the perspective of the beneficiary, these expenses will represent contingent liabilities not paid until the operational phase of the project).

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