3. Working Group Meeting

Item 5b

The role of On-budget and Off-budget finance structures in PPP projects

Vienna - April 24th, 2006

Introduction

Structure of Activities

Chair of Construction Economics

&

Knowledge Center @ Weimar

Alfen Consult GmbH

Introduction

National Clients / Projects

- Federal Government
  - Development of **Guidelines** for PPP in ***Public Real Estate*** (2003)
  - Development of **Standard Documents** for Tendering and Award of the F- and A- Models in ***Roads&Highways*** (2000-02)
  - **Consulting** for Tender&Award of 6 F- and A-Models in ***Roads&Highways*** (2004-06)
  - **Scientific Support** to the determination of the first Toll Ordinances in Germany

- State Ministries
  - Development of **Guidelines** for the application of the PSC in NRW (2003)
  - **Evaluation** mission on the first PPP ***schools*** in NRW (2004)
  - **Support** of Thuringian Finance Ministry in developing a PPP Task Force (2005)

- Municipalities
  - **Consulting on** PSC for a PPP ***schools*** project in Meschede (2003/04)
  - **Consulting** on PSC for a PPP ***school centre*** in Frankfurt (2006)
  - **Consulting** on Tender & Award of a PPP ***Sports Facility*** in Bestensee (2006)

- Public Real Estate Manager
  - **Study on** PREM of the federal government
  - **Study on** international best practice in the ***defence sector***, g.e.b.b. (2005)
  - **Consulting** on Risk Management for the first federal PPP Pilot Project in defence, g.e.b.b. (2006)

- Private Real Estate Developer
  - market analysis on privately financed ***Education Buildings*** in Germany (2003)
  - **Market analysis** on PPP ***schools*** in Germany (2003)

- Facility Manager
  - **Market analysis** on FM for ***hospitals*** (2003)
  - **Research** on Organisational Models for FM in ***hospitals*** (2004)

- Federation of Contractors
  - **Study on *PPP and SMEs*** (2004-2006)
  - **Study on** the Privatisation of the German Autobahn, ***Highways*** (2004-2005)

- Construction Companies
  - **Study on** PPP Models for the German Autobahn, ***Highways*** (2003/04)

Introduction

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The role of <u>Off-budget</u> financing

or

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- The political Point of View

Part 2

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Part 3

- The microeconomic Implementation

Conclusions & Example

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1. The political Point of View
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The political Point of View

Why to adjust the public Budget

- **Public spending is growing over time**
  - Disequilibrium of <u>Budget</u> growth and <u>Economic</u> growth

- **Conflicts in public spending behaviour**
  - Maximising political income vs. Equilibrium in balance of Payments
  - Short election Period vs. A Voter´s life
  - Wider Budget spending vs. Increase future Budgets

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The political Point of View

Fiscal instruments

- **Budget restrictions and rules in fiscal procedures:**
  - Linking of decisions for budget spending and income
  - Linking income to specific sectors
  - Qualified majorities
  - Sunset legislation
  - Sequestration

- **Results of strong Budget rules:**
  - Lower interest margins on state debt
  - Price Level Stability
  - Prevention of „Crowding out effects“

The political Point of View

Strength Measurement of Budget rules

- **Questions to consider:**
  - Is there a consequent review of the strategic budget planning?
  - Are there sanctions introduced?
  - Are there special assets considered beside the usual budget?
  - What is the clear understanding of investment and does the investment increase the assets of the state?
  - Are there depreciations and capital gains to consider?
  - Are there kept in mind the wear and tear of public assets?

„The efficiency of budget rules is questionable if there are a number of specific exceptions existing.“

The political Point of View

Budget rules EU – Maastricht criteria

- **The Statistical Office of the European Community (Eurostat) sets:**
  - Regulations, definitions, classifications
  - Accounting standards
- **based on the European System of Integrated Economic Accounts (ESA 95)**

- **ESA 95 is consistent with the world-wide guidlines:**
  - System of National Accounts (SNA, 1993)
  - The United Nations
  - The World Bank
  - The International Monetary Fund (IMF)
  - The OECD

The political Point of View

The criteria of convergence

- **The member states stipulate the following rules for public budget:**
    - The state debt has to remain under 60% of GDP
    - Annual new deficit has to remain under 3% of GDP
    - Member states have to achieve a mid-term balanced budget
    - EU will refer to the commitment, if a state is likely to fail the targets („Blauer Brief“)
    - EU has the right to claim penalties
    - There is a „no bail out clause“ in the contract

The political Point of View

Definition of On- and Off-Budget

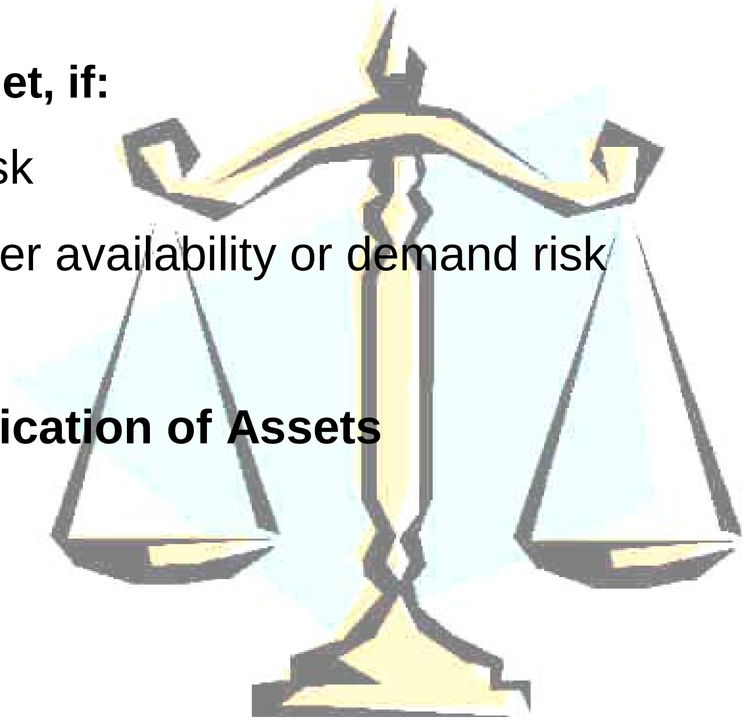
- **On-Budget:**
  - Every direct public investment
  - Accounted in the sector of „General Government“
  - Increase in government deficit and debt

- **Off-Budget:**
  - Every investment without public support (subsidies)
  - Accounted in the sector „Non-Financial Corporations“ or „Financial Corporations“

„ The definition of accounting for PPP´s was unclear. Therefore Eurostat defined in February 2004 how PPP projects should be treated in national accounts.“

The political Point of View

Eurostat criteria for classification of PPP projects



- **Advance classification of the Assets as Off-Budget, if:**
  - The private partner bears the construction risk
  - The private partner bears at least one of either availability or demand risk

- **Risk analysis is the core element in the classification of Assets**
- **Main categories of risk were set:**
  - Construction risk
  - Availability risk
  - Demand risk
- **Each main category contains specific risks and agreements (e.g. warranties or subsidies)**

The political Point of View

CBO* criteria for classification of U.S. PPP projects

- **Advance classification of the Assets as Off-Budget, if:**
  - The fixed Asset serves a general purpose
  - The fixed Asset has a market also in the private sector
  - During the term of the contract, the private partner has ownership title to the Asset, which is not transferred to the government subsequently either
  - The contract does not stipulate a bargain-price purchase option
  - The contractual term does not exceed 75% of the estimated economic life of the Asset
  - The present value of the minimum rent payable during the contractual term may not exceed 90% of the fair market value at the beginning of the contractual term

***CBO – Congressional Budget Office**

Agenda

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The economic Context

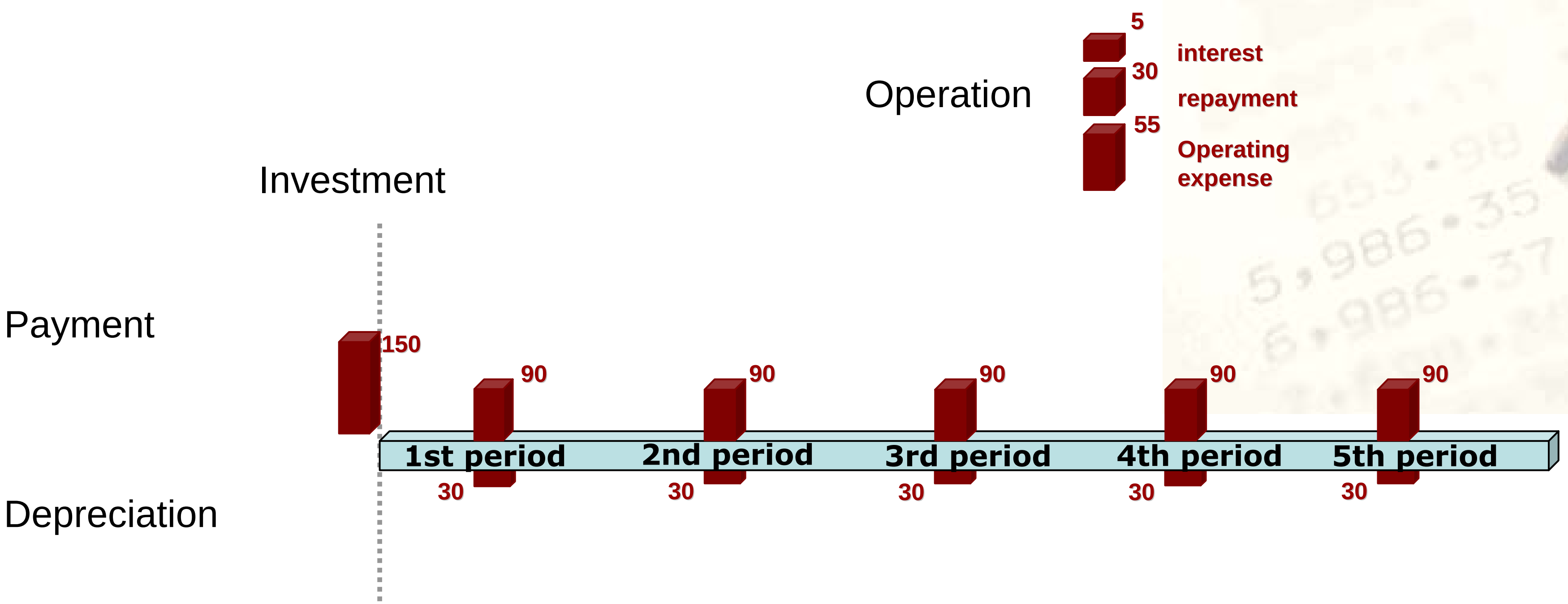
Accounting PPP projects

- **The project is recorded as On-Budget:**
    - Degradation of net borrowing account and debt increase amounting to gross investment
    - Pre-financing by the private partner and the time shift of public expenditures does not change these consequences

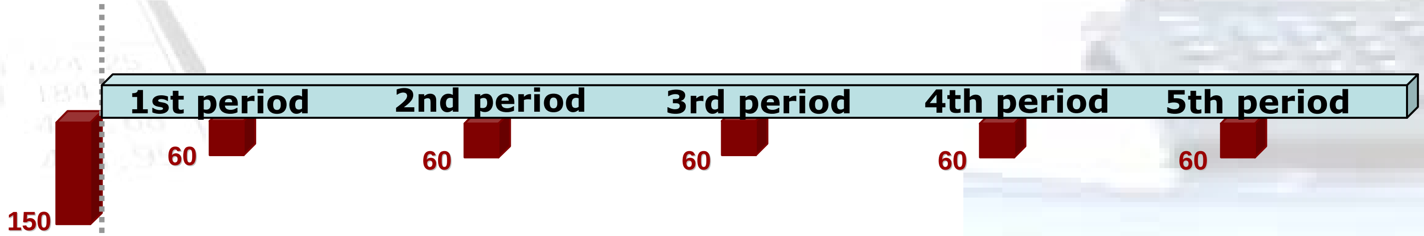
- **The project is recorded as Off-Budget:**
    - Only the periodical public expenditures are ment to be considered in the public deficit
    - The gross investment is not accounted in the public debt

The economic Context

Accounting PPP projects – Public Sector Comparator *(Traditional Project approach)*



Impact on Public Deficit/Surplus



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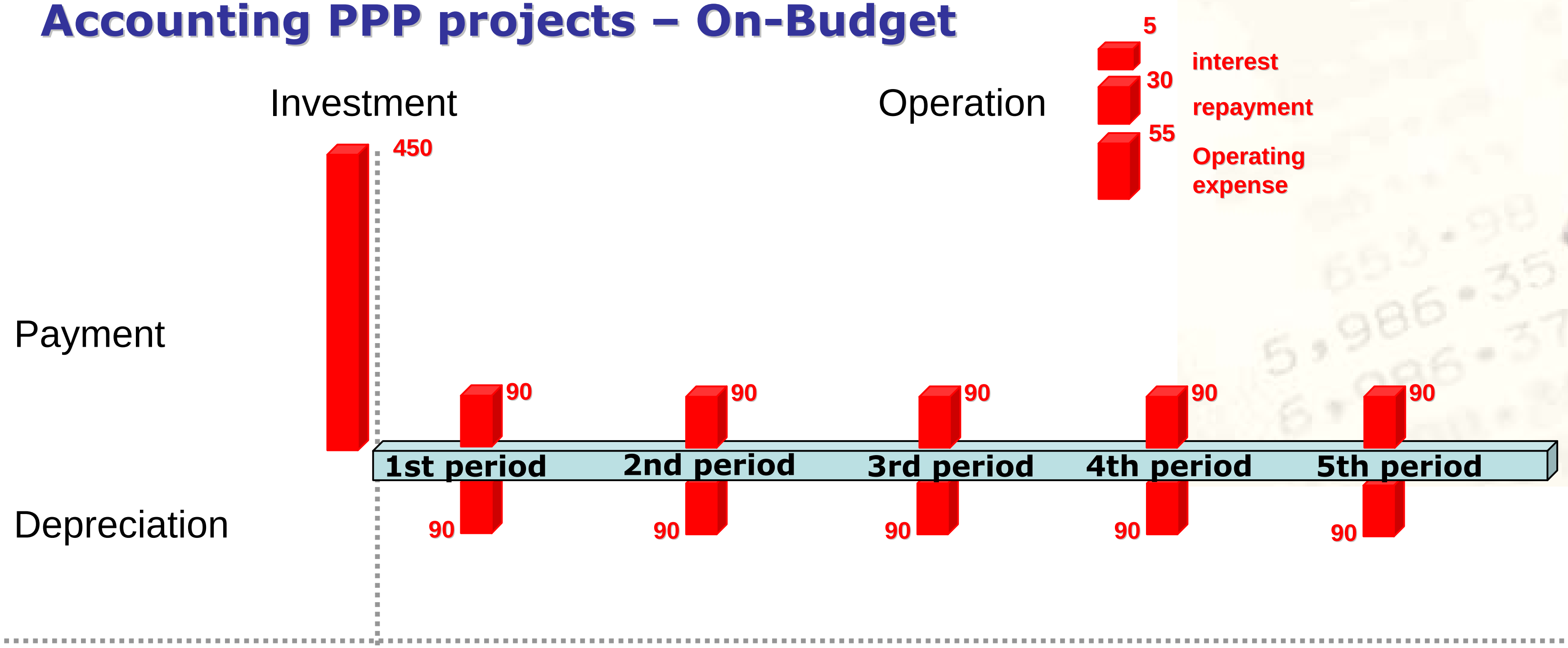
The economic Context

Accounting PPP projects – On-Budget



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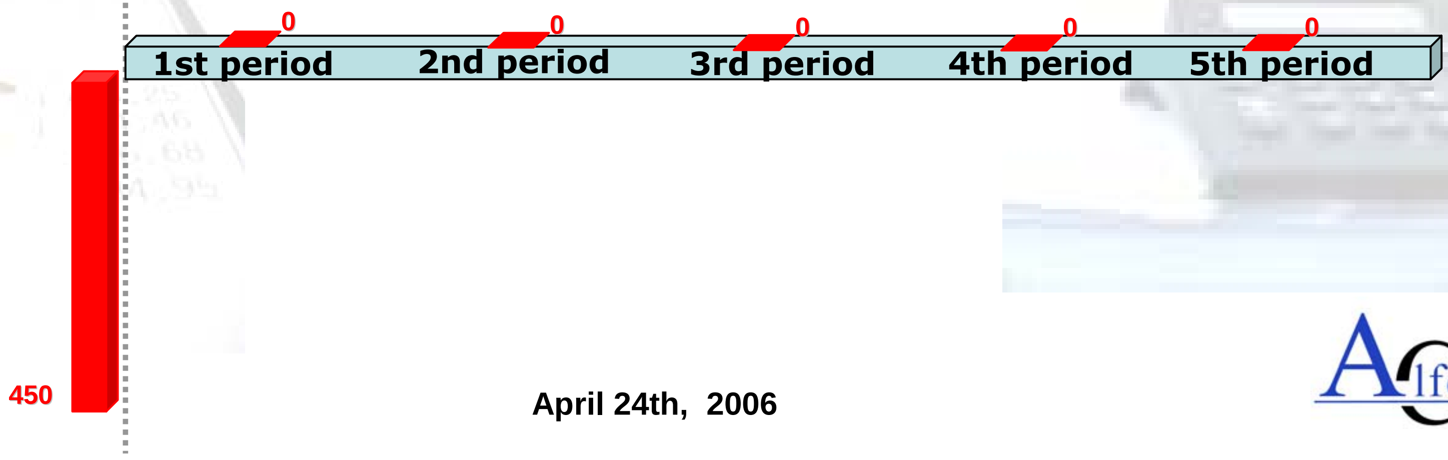


The economic Context

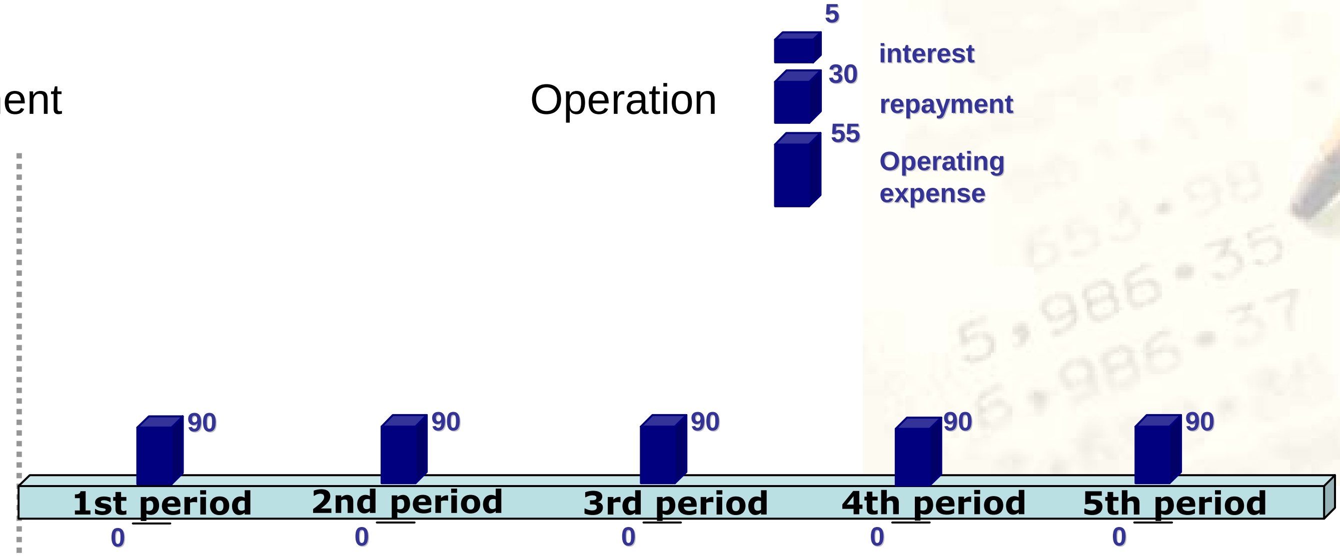
Accounting PPP projects – Off-Budget

Investment

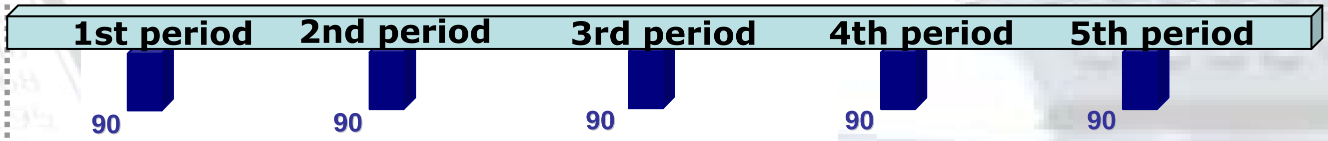
Operation

Payment

Depreciation



Impact on Public Deficit/Surplus



The economic Context

Accounting PPP projects

- **The Maastricht criteria just consider public monetary accounts :**
  - The interexchange of monetary Assets (Money) and non-financial Assets (Property) decline the public debt account
  - The actual value of the property will not be deducted in the gross national debt

- **The public expenditure commitment in PPP projects is not treated as debt in the sense of public budget rules:**
  - Differentiation in debt liabilities and administration liabilities

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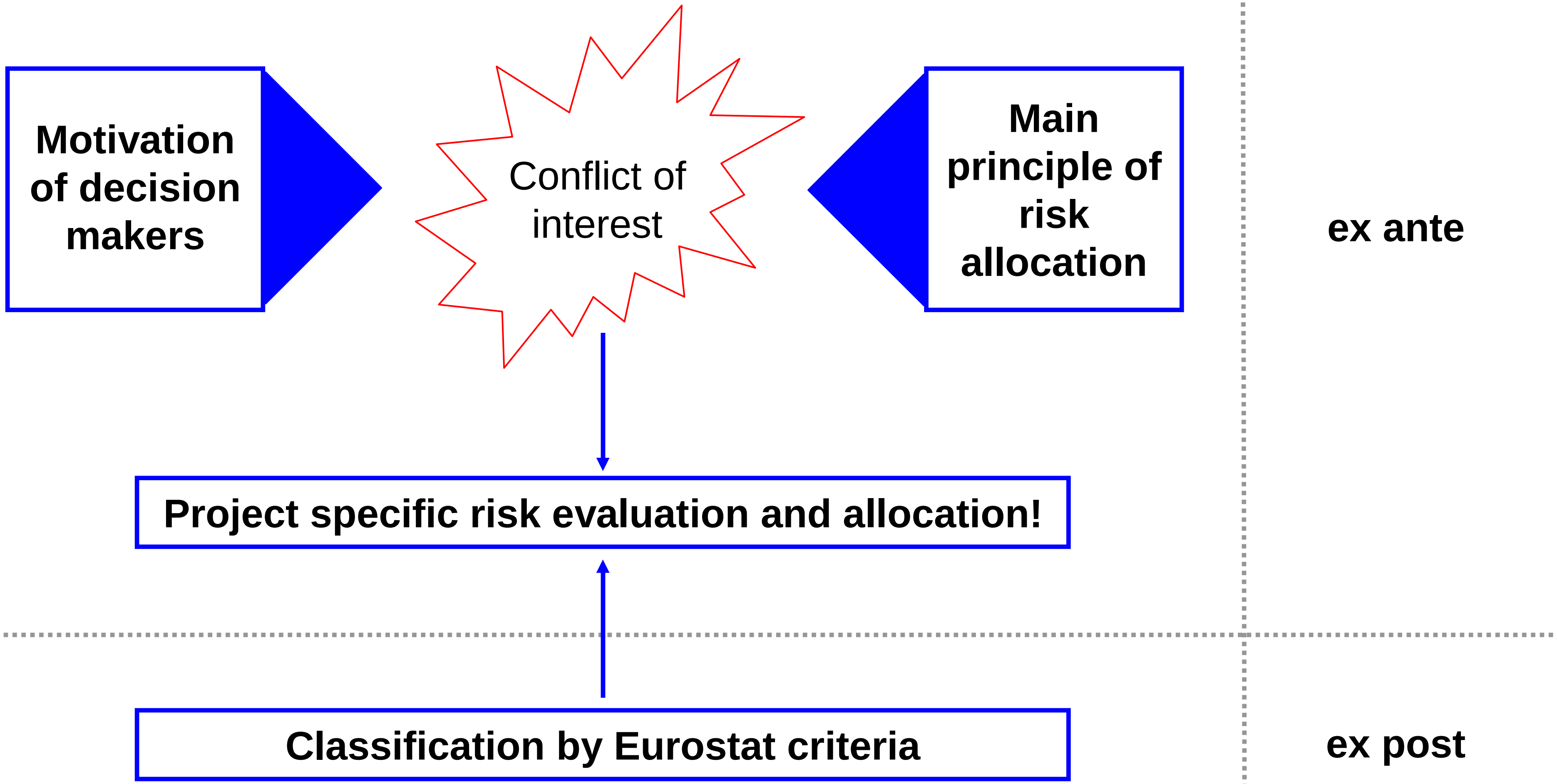
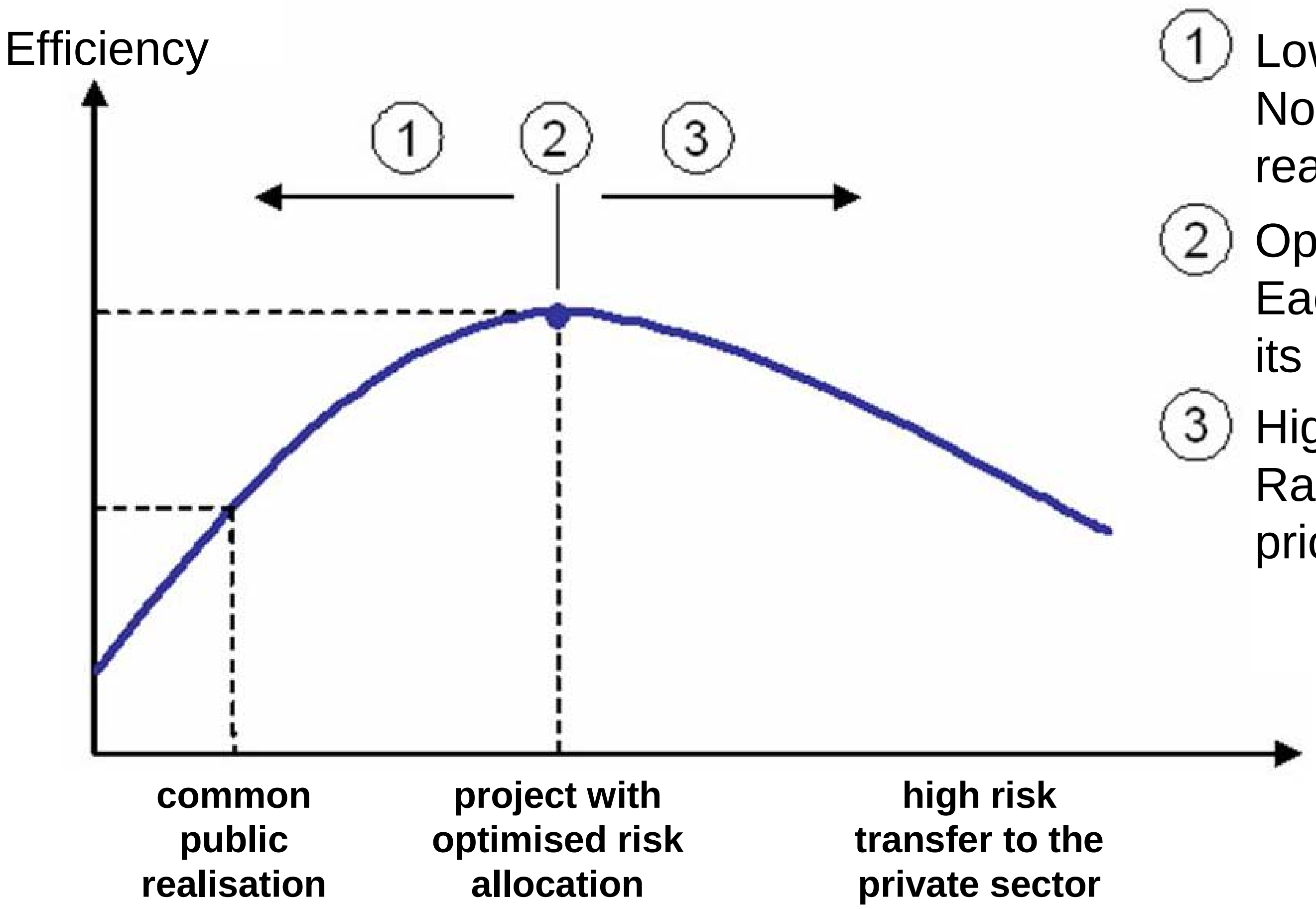
The microeconomic Implementation

Risk allocation



The microeconomic Implementation

Risk allocation



1. Low risk transfer:
No interest of the partners to realise efficiency gains.

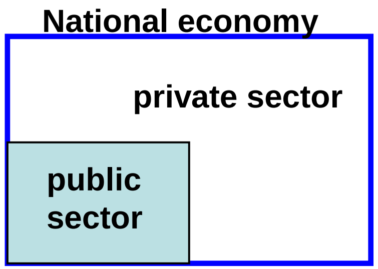
2. Optimised risk transfer:
Each partner is risk carrier in its profession.

3. High risk transfer:
Raise of the total project risk price.

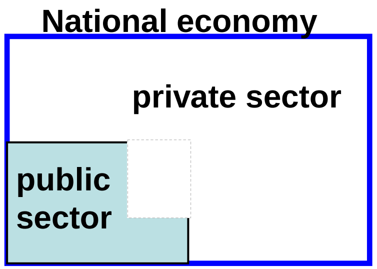
The microeconomic Implementation

Risk & Resource allocation

- **Goal: To increase the economic power within a community**
  - Economical perspective:

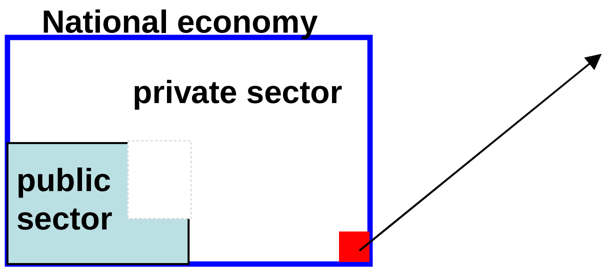


On-Budget



Off-Budget

- **Microeconomic efficient project:**



Space for additional investments

Off-Budget

Agenda

Conclusion & Example

Example – ESA 95

Realisation of an additional project:	Yes
Project is within EUROSTAT Off-Budget:	Yes
Investment expenditure:	10
Public subsidies:	1

		Total	related to GDP
B.9	Net lending (+) / Net borrowing (-)	- 36	2,6%
AF	Financial assets / liabilities	- 736	53,5%
B.1 * g	Gross domestic product	1.376	

	No project	On-Budget	Off-Budget
Net lending (+) / Net borrowing (-)	2,6 %	3,3 %	2,6 %
Financial assets / liabilities	53,8 %	54,2 %	53,5 %
Gross domestic product	1.365	1.376	1.376

Conclusion & Example

Results

- The classification of projects is linked to several criteria
- The nature of PPP is set in the economic mixture of private and public business
- If a statement could be made that a project belongs to the private or the public sector, then it should be treated as a private or public asset in the accounts

Conclusion & Example

Next steps proposed

- **Risk analysis of typical risk allocation in the different funding models**
- **Proposal if the funding model would be in general accounted as On- or Off-Budget**
- **Provide case studies of the different funding models within several infrastructure sectors (roads, railways, energy, waste etc.)**

	funktionale Privatisierung			
	losweise / teilintegriert		PPP [fu], d.h. umfassend integriert	
International	DBF	Design Build Finance	(D)BOOT	(Design) Build Operate Own Transfer
	DBMT	Design Build Maintain Transfer	DBFO (T)	Design Build Finance Operate (Transfer)
	DBR	Design Build Rent	DBROT	Design Build Rent Operate Transfer
Deutschland	BT	Losweise Vergabe	(D)BOT	Betreibermodell / Konzessionsmodell
	DBT	Generalunternehmermodell		- F-Modell
	DBF	Vorfinanzierungsmodell		- A-Modell
		- Bundmodell	DBFO(T)	Schattenmautmodell
		- Mogendorfer Modell		Modell mit Verfügbarkeitszahlungen
		- Thüringer ABC Modell		Inhaber- / Nutzerüberlassungsmodell
	DBMT	Modell Funktionsbauvertrag	(D)BOOT	PPP-Erwerbermodell (Mietkauf)
	DBTO	Betriebsführungsmodell	DBLOT	PPP-Leasingmodell
	DBL	Leasing (ohne Kaufoption)	DBROT	PPP-Vermietungsmodell
	DBLT	Leasing mit Kaufoption		Contractingmodell
	DBR	Miete		
	DBRT	Mietkauf		
		Sale and lease back		
		Cross Border Leasing		

Anwendung typischerweise im Bereich:

Grün	Öffentlicher Hochbau
Blau	Infrastruktur (Verkehr bzw. Ver-/-entsorgung)
Schwarz	Öffentlicher Hochbau und Infrastruktur

Alle PPP-Modelle beinhalten auch ohne „F" die Finanzierung

Contact

Prof. Dr.-Ing. Dipl.-Wirtsch. Ing.

Hans Wilhelm Alfen

Managing Associate

Lisztstraße 4

99423 Weimar

Tel.: +49 (0) 3643 / 77 129 0

Dipl.-Ing.

Michael Korn

Head of Infrastructure Division

Lisztstraße 4

99423 Weimar

Tel.: +49 (0) 3643 / 77 129 12

3. Working Group Meeting

Item 5.b

The role of On-budget and Off-budget finance structures in PPP projects

Vienna - April 24, 2006