NSCASE(23)03.1

CLARIFICATION ON THE APPLICATION OF A GUIDE TO THE STATISTICAL TREATMENT OF PPPS: RESPONSES TO FREQUENTLY ASKED QUESTIONS EUROSTAT

ONS responses to Robert Heath on Eurostat answers:

NS-CASE: January 2023

Price movements during the Construction Phase

Question 1:

Eurostat does not provide a clear answer to the question asked. The answer appears to be saying that indexed price movements during the construction phase are neutral to the statistical treatment: "the authority can take or share the risk of movements in construction prices …. without any impact on the statistical treatment of PPP." I do not agree.

If construction costs are indexed, I do not understand why this does not affect Eurostat assessment of the risk to the government. Indeed, the similar stance taken on operational cost – neutral impact on statistical treatment, appears to me to be contradicted in the answer to question 11 regarding interest rates – see ahead.

Indeed, the answer seems to contradict its own 10%, 33% and 50 % rules. What happens if the indexation results in construction costs that breach these rules. One could easily envisage a situation whereby a government sets up a scheme with built in indexation that meant that the initial assessment was that the PPP should not be in the government balance sheet but would be majority financed by government when the indexation kicked in.

I would be grateful if ONS staff could outline their interpretation of the Eurostat answer.

To be answered:

- *construction costs are indexed, I do not understand why this does not affect Eurostat assessment of the risk to the government*
- *similar stance taken on operational cost – neutral impact on statistical treatment, appears to me to be contradicted in the answer to question 11 regarding interest rates – see ahead.*

ONS Response to Question 1.

The statistical treatment refers to the influencing measures as detailed in the PPP guidance. Construction costs are therefore neutral to the statistical treatment in the context of assessing who is bearing the majority of risk and receiving the majority of the rewards but will still be measured against the 50% construction cost criteria set out in Chapter 14.4 of the EPEC PPP Guidance.

The guidance states that the PPP project requires a clear set of provisions for indexation based on an index or indices generally recognised in the relevant jurisdiction or sector. The government takes or shares the risks in price changes related to indexation during the construction phase, but not if they relate to other construction risks as specified in Chapter 2.2 " *There are typically some limited specific circumstances in which the Partner can claim relief and/or compensation for delays and* *increased costs, lost revenues and/or changes in the project's risk profile caused by events (see Theme 6) that arise in the period during which the asset is constructed (the Construction Phase).*

In response to your reference to question 11, Interest rate adjustments, which appears contradictory to the above, is conditional on whether the adjustment is made outside of the initial hedging process put in place at the financial close of the PPP project, which the guidance states in Chapter 14.2, is rare.

Question 19. No comment. Need more explanation to fully assess.

ONS Response

In a fuller explanation, prior to the detailed PPP Guidance being published in September 2016, the government receiving 50% of a refinancing gain would not trigger a reclassification of the asset on to the government's balance sheet. The PPP guidance manual applies from September 2016, and if government is entitled to a share of more than one third of any refinancing gain, it automatically leads to the asset being recorded on the government's balance sheet – see Chapter 14.6.2.

The timing of both the financial close date and the guidance in place at the time, are relevant when assessing the statistical treatment of PPP projects – see PPP Guidance Chapter 1, Page 16.