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ESA10: EU accounting trouble for Scotland’s NPD scheme

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Scotland is expected to restructure existing and future infrastructure projects under its hub scheme and non-profit distributing (NPD) initiative due to new EU regulation.

New public accounting laws mean that all costs associated with these projects are now being added to the public debt figure, instead of being kept off the government's balance sheet. If the projects are unamended, Scotland's sovereign debt raising capabilities could be impacted.

The Office for National Statistics (ONS) last week classified Scotland's flagship NPD project – the Aberdeen Western Peripheral Route (AWPR) – as on the government's balance sheet. Two hospital NPDs are due for classification this year.

While Scotland awaits clarity on the reasoning behind the AWPR decision, it already has plans afoot to adapt its hub programme to meet the new rules.

Scotland's flagship NPD

The ONS routinely selects projects and companies for national balance sheet classification across the country. Its assessment of AWPR follows new EU regulations from statistics body Eurostat. The European System of Accounts 2010 (ESA10) law was introduced on 1 September 2014 in the UK with the publication of the UK National Accounts.

The ONS said AWPR’s classification is “due to accrual of surpluses to the Scottish Government” and “based on the collective corporate policies of the special purpose vehicles (SPVs), including effective vetoes over key aspects". The ONS judges that the AWPR’s three SPVs are subject to public sector control and the government has economic ownership of the asset.

The ONS published the classification on Friday (31 July 2015), but has backdated it to 12 December 2014, when the project reached financial close.

The £600 million project financing for AWPR comprises a private placement to Allianz Global Investors, term loans from the European Investment Bank and MUFG and up to £20 million in shareholder debt from each of Balfour Beatty, Carillion and Galliford Try.

NPD model

The greenfield 58km AWPR is the largest project so far that Scotland has procured using its unique non-profit distributing (NPD) model of financing PPPs.

The availability-based NPD model caps the private sector sponsor’s returns, because subordinated debt replaces equity investment. The public sector holds a nominal share, but it does not invest in the project company, and the private sector has some pinpoint shares too, but no shares are dividend-bearing. In AWPR's case surpluses are rebated against Transport for Scotland's unitary charges to the sponsor, saving taxpayer money.

The Scottish Futures Trust (SFT) pioneered, and advises on, the programme of NPDs, which is an alternative to the UK's traditional PFI method. The Scottish government has allocated a total of £3.5 billion to the programme and £1.8 billion worth of projects are under construction.

Barry White, chief executive of the SFT told *IJGlobal* that the £242 million Dumfries and Galloway Hospital NPD and the £185 million Edinburgh Royal Hospital for Sick Children are on the ONS' programme for classification later this year.

White said: "We need to understand the ONS rationale in detail on the AWPR. Subject to that clarification SFT will assess what options exist to amend the AWPR contract that could allow it to seek a reclassification decision."

He added: "At this stage it is too early to say what changes may be possible or required… however we are working at full speed. The AWPR construction schedule and debt drawdowns continue as planned." SFT will also consider if further changes are required to the hub model.

Lowering the public share for the "hub model"

Scotland's hub model follows the same concept of capped returns through shareholder debt replacing equity. But the hub scheme features a 40% public sector share in the hub company. The SFT provides 10% of shareholder debt and the council or granting authority a 30% share, whilst the private sector puts up 60%.

The hub scheme covers healthcare, education and community developments, some through capital grants and some as NPDs. Overall the hub scheme is a £2.5 billion programme split across five territorial hubs. Each hub has a private sector partner and a hub company – for example hub East Central.

White told *IJGlobal* that for the last couple of months, the SFT has been working on restructuring the hub programme to align with emerging understanding of ESA10. "We would change the hub project SPV structure so SFT would have a 10% shareholding, the granting authority 10%, a new independent charity 20% and the private sector 60%... It is generally believed that a 20% public share is ok," he said.

The charity, likely named the "hub Community Foundation", would benefit from hub private partner donations, though independent trustees would control it and it could make grants to other charities in the education and health sectors.

An SFT spokesperson confirmed to *IJGlobal*: "We have a further eight hub design, build, finance and maintain projects that are planning to reach financial close over the summer and there will be an impact on the delivery timetable for these projects. We obviously are working as quickly as possible to mitigate any delay."

A pan-European concern

The new ESA10 rules have already caused major disruption to PPP accounting in Belgium, with its two tram projects mired in similar Eurostat trouble since the first quarter 2015. Liege Tram PPP is rumoured in Belgian media to have received its second Eurostat rejection in late July.

Wales is sourcing advisers for procuring two pilot NPD projects and should pay heed.

Meanwhile, a source with some knowledge of Westminster's approach to PF2 told *IJGlobal* that though initially the government reserved the right to 20% equity in a PF2 projectco, in reality it has scaled down its intended amount to 10%. "There are not a lot of live deals so they have made this change quietly," the source said.