

# Statistical treatment of EPC in government accounts

EPC for the public sector

SEIF Roundtable Latvia

Riga, 8 April 2019

Robert Pernetta, Financial Instruments Advisory



# EPC market in Europe

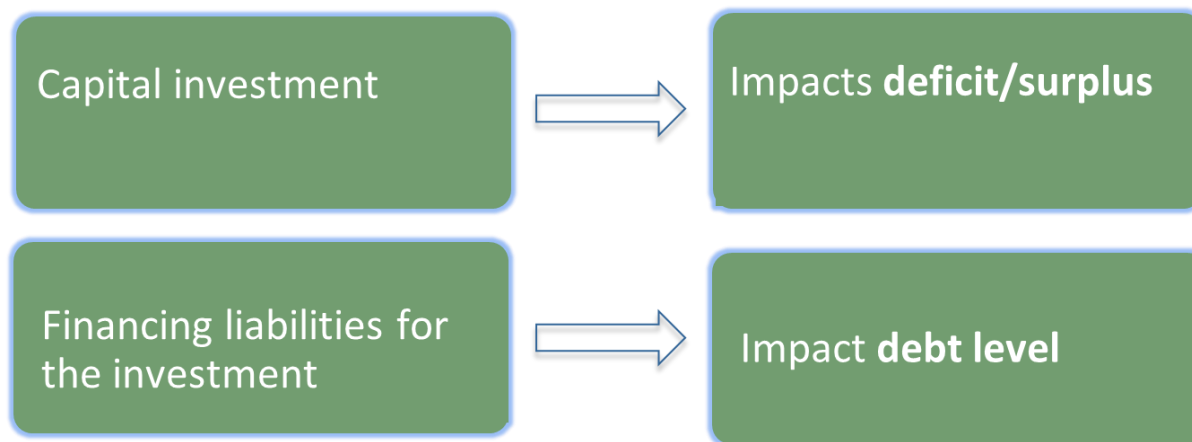
## Obstacles and Potential

Potential of EPC market in the public sector is not exploited due to:

- Lack of information and awareness
- Lack of trust and track record
- Project development capacity of project promoters
- Procurement process
- **Statistical treatment of EPC**
- Access to finance for EPC providers
- Competition with investment grants

# What do Eurostat's rules imply?

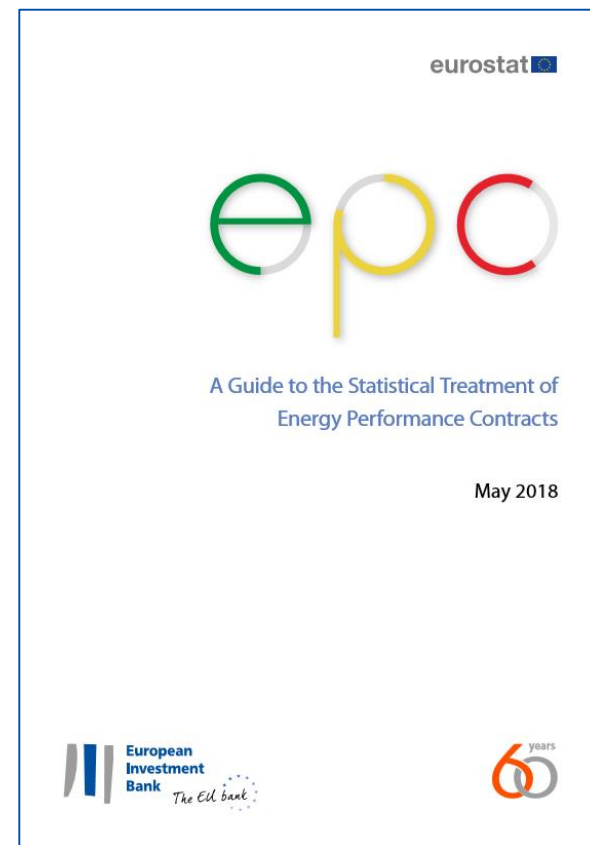
- If an asset is “on balance sheet” for government:



- If an asset is “off balance sheet” for government:  
government only records regular payments for services

# What does the Guide do?

- Translates general statistical rules and principles of “economic ownership” into **contractual terms and concepts**
- Endorsed as **official Eurostat guidance** and the reference point for Eurostat advice and decisions on EPCs
- Eurostat rules relate to **statistical treatment in government accounts** - not with accounting rules/practices and budgeting
- Does not address **value for money** or **bankability** considerations

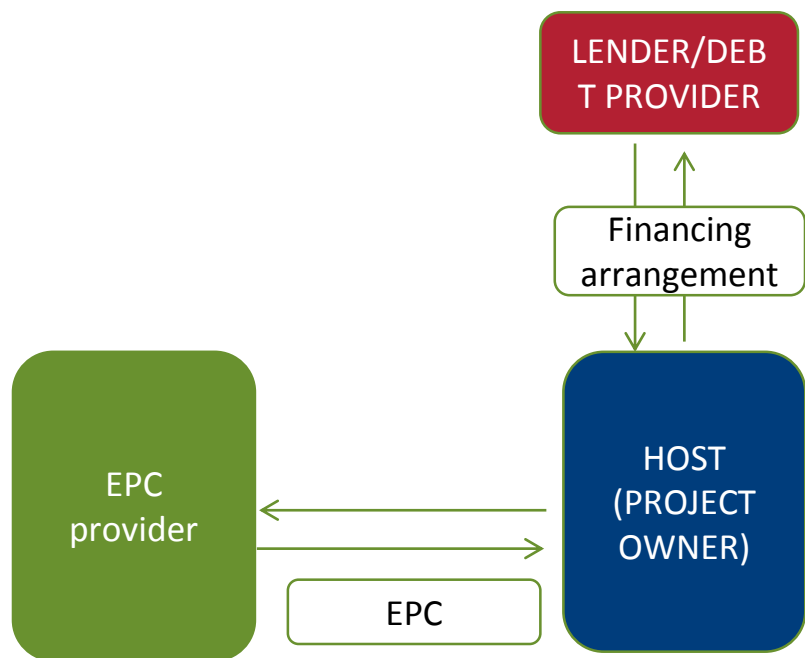


# When does the Guide apply?

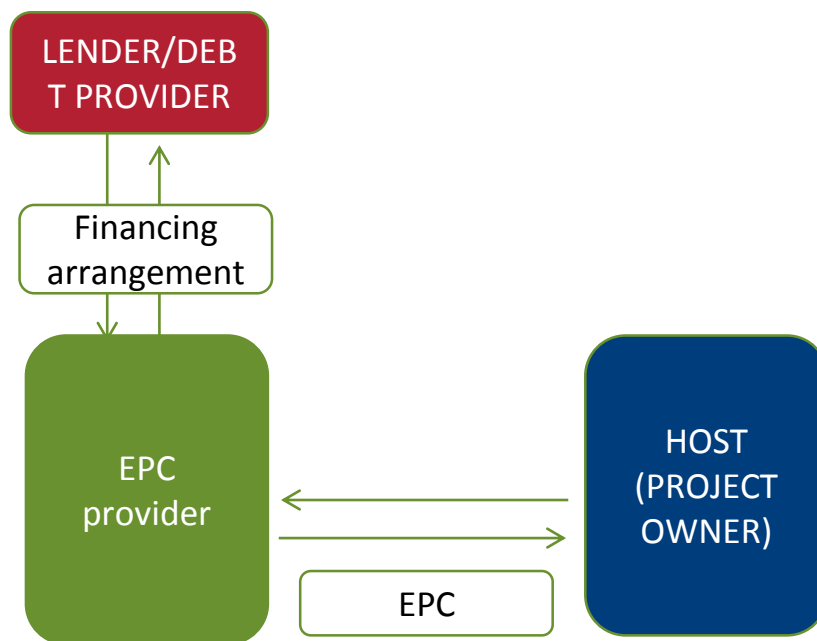
- **Who is contracting?**
  - ✓ A “government” host and “non-government” EPC provider
- **What is the investment?**
  - ✓ Assets reduce energy consumption (can include some renewable energy supply)
- **How long is the contract for?**
  - ✓ Minimum contract duration 8 years
- **Are services included?**
  - ✓ Assets are maintained by the EPC provider
- **How is the investment financed?**
  - ✓ Private finance from the EPC provider

# EPC Financing

## Client financing



## EPC Provider financing



or a combination of both

# The Guide on statistical treatment of EPC

## Themes covered by Guide

**Theme 1** – Legal ownership and access rights

**Theme 2** – Specification, design, construction and installation of the EPC assets

**Theme 3** – Maintenance and operation of the EPC assets

**Theme 4** – The Guaranteed Savings

**Theme 5** – The payment mechanism

**Theme 6** – Compensation, relief and force majeure events

**Theme 7** – Changes to the EPC

**Theme 8** – Changes in law

**Theme 9** – Insurance

**Theme 10** – Warranties and indemnities

**Theme 11** – Early termination of the EPC

**Theme 12** – Compensation on early termination of the EPC

**Theme 13** – Expiry of the EPC

**Theme 14** – Financing arrangements

**Theme 15** – Government influence

**Theme 16** – Miscellaneous provisions

# Selected Themes from the Guide

## Theme 4 Guaranteed savings

- Guaranteed savings must exceed all government payments
- Savings must be derived from a reduction in energy consumption (other energy related savings and revenues can also count)

## Theme 5 Payment mechanism

- Proportionality between payment and savings
- EPC provider fully liable for savings shortfalls
- Excess savings can be shared (up to 1/3 for government)



# Selected Themes from the Guide

## Theme 14 Financing arrangements

- Government financing (grants, loans, guarantees) has an impact on balance sheet treatment:
  - ≥ 50% → ON BALANCE SHEET
  - < 50% → MODERATE, HIGH OR VERY HIGH impact
- EU financing is neutral in assessing balance sheet assessment
- Is there are forfeiting arrangement in place?

# Practitioners Guide for EPC statistical treatment

## Implementation

- ▶ “Maastricht neutral” model contracts approved by Eurostat for: Slovakia, Slovenia\*
  - ▶ “Maastricht neutral” model contracts in preparation or consulted with national statistical offices: Austria, Czech Republic, Ireland, Lithuania, Poland\*, Spain, UK (Scotland),
  - ▶ Other accounting/budgetary barriers:
    - ▶ National budgetary rules do not allow central government bodies to sign “Maastricht neutral EPC”
    - ▶ Public authorities are not allowed to sign long-term service contracts
- \* *Model contracts in Slovenia and Poland are PPP in the definition of national legislation and Eurostat rules. This is possible if the building is considered a **new asset** after renovation. (New investments must represent >50% of total value of asset)*

# Illustrative example

# An example project

## Energy efficiency measures



- Building envelope insulation
- Window replacement
- Fuel switch to wood pellets
- Heating substations
- Thermostatic valves
- Heat pumps
- New cooling system
- Indoor lighting upgrade

## Key figures



Total investment cost  
**EUR 5 million**



Grant  
**EUR 1.5 million**



Guaranteed energy savings  
**40% compared to baseline**



Annual energy cost savings  
**EUR 400,000**



Annual payments  
**EUR 320,000**



Contract duration  
**10 years**

Total payments > savings ⇒ EPC is **on-balance sheet** for the government sector

# Hypothetical example: Hospital

## Test against Eurostat guide

- ▶ Measures: measures are related to energy efficiency ✓
- ▶ Contract length: 10 years ✓
- ▶ Government financing: grant 20% ✓ High importance
- ▶ Guaranteed savings vs payments to ESCO\*:  
Energy savings:  $10 * \text{EUR } 400,000 = \text{EUR } 4\text{m}$   
Payments:  $\text{EUR } 1.5\text{m} + 10 * \text{EUR } 320,000 = \text{EUR } 4.7\text{m}$   
**Operational payments > savings** ✗

⇒ **The asset is on-balance sheet for the government sector**

*\*For simplification reasons the payments and savings are not calculated at net-present value (NPV)*

*Other contract provision may also influence the balance sheet treatment*

# Financing EPC with ESIF financial instruments and grants

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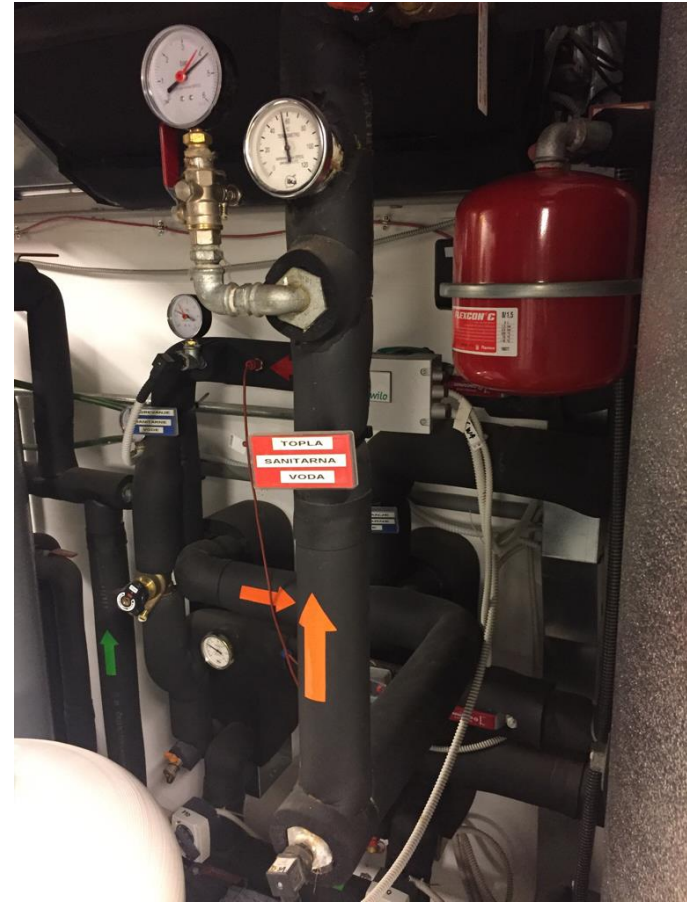
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# Traditional procurement



# EPC procurement





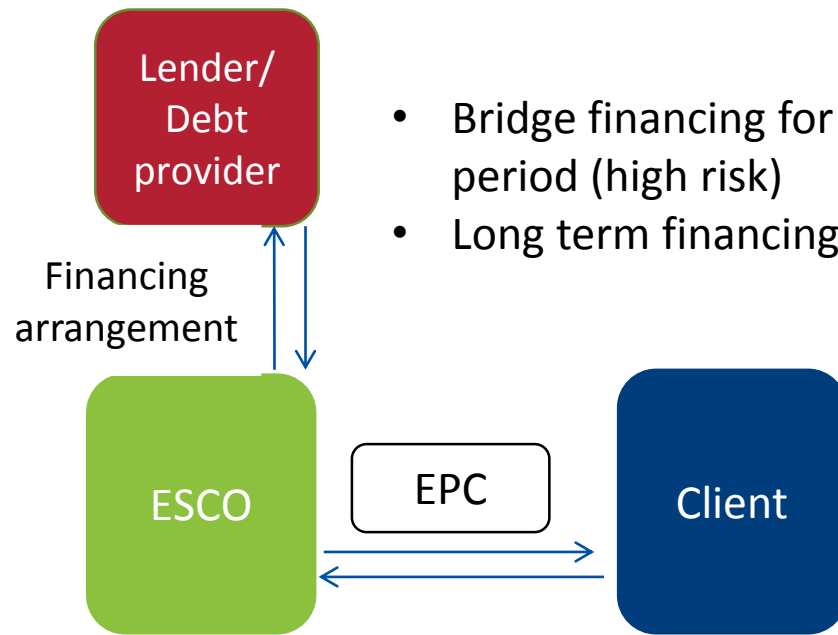
# EPC market in Europe

## Obstacles and Potential

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# ESCO financed EPC: The financial challenges



- Bridge financing for the construction and ramp-up period (high risk)
- Long term financing during contract period (low risk)

- Combining financing and technical solution
- ESCO has limited borrowing capacity due to equity/debt ratio

## Challenge of financing “Maastricht neutral” EPCs

- More risk shifted to private sector
- Contract duration longer than 8 years
- Performance based EPC fees
- Limits to using government financing or guarantees

## Possible solutions

- Standardised templates
- Best practises
- ESIF financial instruments

# ESIF loan product for EPC

- Advantages:
  - Long-term financing
  - Grace periods
- Disadvantage:
  - Does not reflect different risk profile for implementation and performance period
  - Does not reduce performance risk on bank
  - Debt stays on balance sheet of ESCO
- Market perspective:
  - In most countries ESCOs have access to debt

# ESIF guarantee product for EPC

- Advantages:
  - Extended loan tenure
  - Lowering collateral requirement
  - Covering different risks during lifetime of project
- Disadvantage:
  - Debt stays on balance sheet of ESCO
  - Less suitable for financing to EPC client
- Market perspective:
  - In most countries ESCOs have access to debt
  - Interesting for financial intermediaries to lend to ESCOs

# Comprehensive renovation via EPC – combining grants and financial instruments

- Comprehensive renovation has repayment time of +20 years
- To make project EPC-able partial client funding is necessary
- ESIF grant as capital grant to shorten repayment time
  - Client applies for grant and after approval tenders ESCO
  - Client is beneficiary of grant and pays ESCO a capital grant - *like in standards works contracts*
- ESIF financial instrument to provide affordable financing
  - ESCO secures affordable financing through an ESIF financial instrument
  - State aid rules require that benefit is passed on to Client

EPC in the health care sector in Marche  
Region, Italy  
*Combining ESIF financial instruments with  
grants*

# Marche, Italy

## EPC in health sector

- ▶ From 2014-2017 Region of Marche developed an energy efficiency scheme for health sector (MARTE) supported by Intelligent Energy Europe grant
- ▶ Objective: Using EPC for comprehensive renovation including renewable energy sources using EU Funds
- ▶ Outcome of project: Combining ESIF grants, ESIF FI for and ESCO own resources for project
- ▶ Contracts with 15 years duration signed with ESCOs end of 2017
- ▶ Implementation started end of 2018

# Marche, Italy

## EPC in health sector

Healthcare facilities	Investment in € (VAT 22% included)	CO2 savings		Energy savings		RES production
		tCO2/year	in %	toe/year	in %	toe/year
San Benedetto del Tronto Hospital	5.409.220,87	771,2	76	340	77	
Urbino Hospital	3.257.589,48	813,8	67	488	77	
Pergola Hospital	2.530.438,25	314,9	75	138	79	3,6
Sant'Elpidio a Mare Policlinic with Nursing Home	325.990,22	120,3	39	32	39	7,4
Petricoli Policlinic with Nursing Home	400.132,53	128,2	46	43	46	2,6
<b>TOTAL</b>	<b>11.923.371,34</b>	<b>2.148</b>		<b>1.041</b>		<b>13,6</b>



# Financing of Marche health sector EPC

## Financing to project:

- Grant from Operational Programme (max 40%) paid to the beneficiary that will pay ESCO for comprehensive renovation;
- Interest-free loan (max 35% of the investment) for 15 years by to ESCOs directly;
- ESCOs provide remaining amount from own resources;

The experience from the health sector project inspired the set up of a regional Energy and Mobility Fund (EMF)

# Marche: Lessons learned

- Need for proper project preparation, such as a solid energy audit
- Return of investment of energy efficiency measures determines contract length
- ESIF funding is important to reconcile contract length and economic payback time of measures
- Need for affordable financing for projects
- Capacity building on EPC
- Interdisciplinary working group to manage call for tender
- Commitment of additional staff with specialised skills duration of contract (15 years)

# EIB support to implement EPC projects

# EIB advisory examples for EPC

- Review of the Slovak EPC model contract regarding balance sheet treatment
- Financial analysis of street lighting project in Vilnius supported under URBIS
- Smart city and Smart islands study including EPC in Croatia
- Support in the design and implementation of EPC financial instrument with ESIF support in Slovenia
- Developing a Investment Platform for EPC financing with ESIF support in Czech Republic

# EIB support to EPC market

## **Awareness raising** on the benefits of EPC and its financing

- Awareness sessions on Eurostat rules
- Information on combination of EU grants and EPC

## **Technical support** for EPC projects

- Support for preparing model contracts (but no legal advice)
- Market demand analysis
- Technical assistance through **ELENA** facility

## **Sustainable financing** of EPC projects

- Lending to banks to on-lend to ESCOs, e.g. **Private Finance for Energy Efficiency (PF4EE)**  
<http://www.eib.org/en/products/blending/pf4ee/index.htm>
- Dedicated financial instrument or investment platforms using resources from Structural Funds and EFSI

*Our aim is to strengthen Europe's investment environment and improve the quality of investment projects*

A **single access point** to a comprehensive offer of advisory and technical assistance services



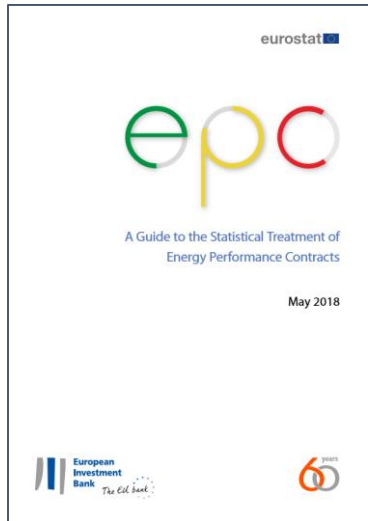
A **cooperation platform** to leverage and exchange expertise from EIAH partners



An instrument to assess and **address** unmet **needs** for advisory support



# Thank you for your attention



<http://www.eib.org/infocentre/publications/all/guide-to-statistical-treatment-of-epc.htm>

EIB Advisory Services:

Laurent Bender  
[l.bender@eib.org](mailto:l.bender@eib.org)

Robert Pernetta  
[r.pernetta@eib.org](mailto:r.pernetta@eib.org)

