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GUIDANCE ON REVENUE GENERATING  
PROJECTS

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# Guidance on Revenue Generating Projects

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# **Revenue Generating Projects**

## **Background**

The Common Provisions Regulations pertaining to projects which generate revenues aim to ensure the effective use of public resources and avoid the over financing of projects. The regulations make separate provisions for projects which generate revenues after completion (article 61) and those which generate revenues only during implementation (article 65 (8)).

## **Purpose of the Guide**

This paper provides guidance on the treatment of revenue generating projects seeking ERDF support and explains the methodologies available to calculate net revenues. The guidance also sets out additional project monitoring requirements that need to be included in the ERDF Funding Agreement Project Specific Conditions.

## **What is Meant by Revenues?**

Net revenue is defined in the regulations as;

Cash in-flows directly paid by users for the goods and services provided by the project, such as:

- charges borne directly by users for the use of infrastructure;
- receipts from the sale or rent of land or buildings;
- payments for services;
- Operating cost savings (unless they are offset by an equal reduction in operating subsidies;

less any operating costs and replacement costs of short-life equipment incurred during the corresponding period. In summary this means **any** charges levied by the applicant (or delivery partner(s)) and payments made by users (project beneficiaries) of the services/goods/buildings/equipment etc. Any payments made directly to the applicant must be taken into account or considered at the time an application is made and monitored to ensure grant paid does not exceed the gap between the investment costs and the net revenues generated.

How the revenues are treated depends on the nature of the project and when the revenues are generated. Both capital and revenue projects can generate revenues.

Where a facility already generates revenues, only the additional revenues generated as a result of delivering the project are taken into account.

## **Projects Generating Revenues After Completion – Article 61**

Article 61 of Regulation EU 1303/2013 (the Common Provisions Regulation), sets out the requirements for projects which generate net revenue during and after their completion. Wherever possible the eligible expenditure of the operation should be reduced in advance taking into account the potential of the operation to generate net revenue over a specific period covering both implementation and the period after its completion. This is known as the reference period.

Article 61(3) sets out two alternative methods for calculating the potential net revenue, either using a flat rate (usually applicable to large infrastructure projects) or a calculation of the discounted net revenue taking into account the reference period.

Article 61(6) states that where it is not possible (this must be justified and can only be accepted where for example a market rate cannot be determined) to determine the revenue in advance, the net revenue generated within three years of the completion of a project or the deadline for submission of OP closure documents, whichever is earlier, shall be deducted from the expenditure declared to the Commission. Circumstances under which this option is used will be limited as in most cases revenues can be estimated. It may prove difficult to forecast revenues objectively when the project activity is innovative or involved in an emerging or new market where market rates have not been established. It is therefore envisaged that this method will be used in limited, justified and exceptional circumstances.

Exclusions:

Some projects are exempt from article 61:

- ESF projects;
- technical assistance;
- repayable assistance subject to full repayment;
- Financial Instruments;
- where project activities are 100% de minimis aid or compatible State Aid;
- projects with total eligible expenditure not exceeding €1,000,000 (*using the exchange rate at the time the funding agreement is issued*).

## How is the Net Revenue Calculated ?

### Calculating the discounted net revenue pursuant to Article 61(3(b))

As a part of the relevant matters to consider when applying Article 61(3)(b)), a linked and important consideration is whether the project should receive a grant from ERDF at all. To calculate the funding gap and assess whether the project should receive grant funding from ERDF, account must be taken of:

- ***the reference period (also called the project time horizon) appropriate to the category of investment concerned*** – see below
- ***the profitability normally expected of the category of investment concerned*** –see below.
- ***application of the polluter-pays principle*** - those costs generated by pollution must be paid by the polluter and should therefore not usually form part of the funding gap calculation (ie should not be taken into account as revenue).
- ***equity and affordability*** – this relates to the ability of users to pay for using the facility/service. In this regard, the fee, rent etc charged should be set at a level which takes account of users' income within the area/region concerned.

### The Reference Period

The first step for any funding gap calculation is to decide the correct reference period, since this will be the period over which the revenue must be tracked.

The reference period is a set number of years for which forecasts must be provided in order to conduct a financial analysis. The Commission has previously defined the reference period as the “*number of years of the project economic life that is the time period beyond which the investment needs to be replaced.*” Project forecasts should cover the reference period which should be long enough to encompass its likely mid to long term impact. The project's economic life is not the same thing as the expected useful economic life of individual assets within a project since this could be greater or lesser than the appropriate reference period. It is therefore not appropriate to simply base the reference period on the average service life of fixed capital assets set for accounting purposes.

It is normal practice when determining a reference period to refer to a standard benchmark differentiated by sector and based on internationally accepted practices. The table overleaf sets out the 2014-20 reference periods laid down in Annex 1 of Delegated Regulation (EU) No 480/2014.

## Reference Periods ERDF 2014-20

Sector of Investment	Reference period (years)
Railways	30
Water supply/sanitation	30
Roads	25-30
Waste management	25-30
Ports and airports	25
Urban transport	25-30
Energy	15-25
Research and Innovation	15-25
Broadband	15-20
Business infrastructure	10-15
Other sectors	10-15

In order to ensure consistency, the reference periods set out in the table should be applied to all similar projects.

The choice of reference period may have an extremely important effect on the results of the appraisal process and may also affect the amount of ERDF payable. The longer the reference period is, the higher the net revenues to be taken into account in the calculation of the funding gap will potentially be.

The reference period should start from the date on which the project first generates revenues. Revenues may come on stream at the start of a project or later on.

For a capital project the investment period to be used for monitoring purposes is generally clearly defined and incremental revenues would be expected to come on stream when the investment phase is complete.

However, for a revenue project, the situation is less clear cut as the generation of revenue could occur in parallel with the investment phase of the project. For projects where no capital investment is involved, such as provision of a service from an existing facility, it should be easy to establish the starting point when the users start paying, and in many cases it could be at the start of the project or at some point during the investment phase of the project prior to completion.

### Profitability

'Normally expected profitability' means the ability of the project to generate additional financial resources (i.e. profits) as compared to those resources invested,

independently of how the project is going to be financed (such as loans, private equity, or government contribution).

An assessment of the normally expected profitability of a project should be made in order to verify if the appropriate financing route has been selected. Whilst this is not a part of the funding gap calculation, this assessment should be undertaken as part of the appraisal of a project when the funding gap is being assessed.

For the purpose of Article 61 projects, the financial rate of return for the beneficiary should, in principle, be aligned with the standard financial discount rate of 4% in real terms, as set out in Article 19.3 of Delegated Regulation EU No 480/2014, as it reflects opportunity cost of capital. Any higher rate or return would indicate that the grant from EU would bring above normal profits to the beneficiaries. Also projects with high financial rate of return would not need EU grant as they should be able to attract private finance

### **The Funding Gap Calculation**

Article 61(3)(b) applies to projects where the identification of revenue can be objectively estimated in advance. This requires that the contribution from ERDF is determined by the “funding gap” method. This takes into consideration the estimated net revenue from an investment over a specific time horizon also known as the reference period details of which are set out above. The maximum eligible costs (the funding gap) must not therefore exceed the discounted investment costs less the discounted net revenue. This applies regardless of the way the revenue will be managed, such as, where the net revenue will be re-invested in the project.

In terms of the feasibility of making forecasts, the availability of consistent data and previous experience with similar projects will be the most important factors. If the data is lacking or the project is not based on previously tested models then it would not be appropriate to attempt to undertake a funding gap calculation and Article 61 (6) should be used instead.

The estimated costs and the estimated revenues (which must not be adjusted for inflation) must be forecast on an annual basis for the reference period appropriate to the sector of investment in which the project is involved. . If the forecast of revenues over the reference period can be made with reasonable confidence then the revenues should be dealt with under Article 61 (3) The Commission expects market research to be done to establish the expected revenue streams and costs and allows a 10% margin on the understanding that precise figures will not be possible.

The National Eligibility Rules should be consulted to check which costs are eligible. Note that the Commission has confirmed that developer/ operator profit is not allowed as an eligible cost, nor should it be taken into account in the overall funding-gap calculation.

The discounted net revenue can then be calculated using discounted cash flow techniques. Using a discount rate has the effect of reducing the value of future costs and benefits to present day terms. For example a discount rate of 4% per annum implies that society values £1 today equally with the certainty of £1.040 in a year's time.

The Commission recommends that a 4% financial discount rate in real terms is used as an indicative benchmark for public investment projects co-financed by the Funds. The template for Article 61.3 calculations should be used to calculate the funding gap.

Only the cash in-flows directly paid by users, such as rents, fees and tolls have to be taken into account in determining the gap. Public and private contributions that do not stem from charges to the users of the service, such as subsidies, grants or investments are not taken into account.

Where not all the investment costs are eligible for ERDF support, the net revenue must be allocated pro rata to the eligible and non-eligible parts of the investment cost. In order to determine the proportion of the net revenue that is to be taken into consideration, the discounted investment costs need to be compared with discounted eligible costs (i.e. discounted eligible costs divided by DIC and multiplied by 100). Where part of the project is not revenue generating, its costs and operating costs should not be taken into account. Where a project involves alteration to an infrastructure which is already revenue generating, only the additional costs and revenues should be taken into account, therefore a baseline of the starting position should be taken.

### **Calculating the Net Revenue where it cannot be estimated in advance**

Pursuant to Article 61(6), for projects where it is objectively not possible to estimate in advance the revenue which will be generated with a reasonable degree of confidence, there is an option to leave the calculation on net revenue until after the completion of the project (but before programme closure) at which point any necessary deduction should be made. Article 61(6) requires that *“the revenue generated within three years of the completion of an operation shall be deducted”*

The maximum amount to be deducted in accordance with Article 61(3) is to be based on the relevant co-financing rate applied to the project and should not in total exceed the ERDF contribution received by the project in question.

For **capital** projects the incremental revenues would be expected to come on stream when the investment is complete. This would fit with the drafting of Article 61(6). The monitoring period would start from completion, i.e. the point when incremental revenues are generated and would end 3 years from that date, or by 30 September 2023 whichever is earlier. The grant recipient would be required to re-pay an amount

equal to the net revenue generated over that five year period, adjusted by applying the co-financing rate.

Care should be taken to ensure that a project's net revenue is captured accurately, or the Commission could require re-imburement. An annual audited declaration from a person with a suitable level of authority within the grant's recipient's organisation (for example the finance director) supplying details of the net revenue (gross operating revenues less gross operating costs) generated by the project will be included as an obligation in the funding agreement. Audited accounts are not an acceptable substitute for this purpose as these are intended to cover an operation's entire financial position and not simply the position in relation to net revenue.

The funding agreement should include measures to cover this potential debt.

A complete picture as to the net revenue generated by a project will not be possible until three years after its completion. In order to comply with Article 61(3), projects should not be closed at the end of the project activities (project completion) but payment should be restricted to 90% of the ERDF grant final grant claim at completion and retain the remaining 10% until the final audit certificate is submitted by the grant recipient five years after completion and the net revenue generated can be reviewed.

There is of course always the risk that the original grant recipient may not be in existence five years after completion of the project. To manage such a risk, it is encouraged that guarantees from grant recipient's parent companies or its members where possible are in place, and it is required that any revenues generated are paid into a separate ring-fenced account by the grant recipient.

### **Monitoring revenue generating projects**

For projects which have undertaken a funding-gap calculation, the actual revenue should be compared with the original projections. If monitoring reveals important discrepancies between the revenue initially estimated and the revenue which will be actually realised, the grant calculation may be adjusted (if such a situation is discovered before the end of the project) or any overpaid grant may be recovered (if such a situation is discovered during the monitoring period post completion of the project).

Where irregularities occur, because the revenue generated is greater than anticipated due to the calculation being voluntarily underestimated, a financial correction must be imposed in accordance with Article 143 of Regulation 1303/2013.

If a project has ended but the operational programme has not ended then any surplus revenue can be recycled within the programme. This is the case for projects subject to Article 61(3). As part of the Management and Control process, the MA will ensure that an efficient yet proportionate monitoring system for revenue generating projects is put in place at the start of the programme period. The key requirement is the ability to detect variations in revenues in a timely manner, be able to take

corrective action, and thus prevent any adverse effect on the funding of the operational programme.

### **Projects Generating Revenues During Implementation Only (Article 65(8))**

Article 65 sets out the provisions regarding eligibility. Article 65(8) applies to revenue generating projects not covered by Article 61, which are projects where net revenue is generated *only* during implementation of the project.

All revenues must be taken into account.

There are 2 possible approaches to this;

#### **Forecast in Advance**

This method is recommended for projects where the revenues anticipated are a significant proportion of the project costs or if it is anticipated that revenues received may exceed the amount of ERDF anticipated in the final claim. If this is not the case the method below can be used to deduct all revenues at final claim stage. The appropriate route is not a choice for applicants it will be determined by the Managing Authority taking into account risk and anticipated revenues.

Revenues are forecast in advance by the applicant. The applicant must provide a cash flow forecast which covers the lifetime of the project. This should clearly set out operating costs and cash in flows (excluding ERDF and match funding).

The revenues generated during the lifetime of the project effectively reduce the eligible project costs. The remaining costs, not met by the revenues generated are those which can be co-financed by ERDF at the relevant intervention rate. These calculations are undertaken during the technical appraisal of the full application and the offer made is on the basis of the forecast costs.

The applicant would then submit claims which would be paid at the agreed intervention rate. When claims are submitted the applicant will include all eligible approved costs in total and confirm the *actual* revenue generated during that claim period – the claim will be paid on the basis of the amount of eligible defrayed spend less the actual expenditure – at the agreed intervention rate. At the end of the project the final claim must be supplemented by an audited declaration from a person with a suitable level of authority within the grant's recipient's organisation (for example the finance director) which confirms the total actual revenue generated. If any adjustment is to be made this can be done as part of processing the final claim.

#### **Revenues Captured at Closure**

Using this method no reduction in eligible costs is made at appraisal stage – all revenues received by the project will be deducted from the total eligible expenditure when the final claim is submitted and any adjustments to grant made accordingly. Again, the level of revenues must be specified and supported by an audited

declaration from a person with a suitable level of authority within the grant's recipient's organisation, for example the finance director.

## **Exclusions**

Article 65(8) does not apply to:

- technical assistance projects;
- FIs;
- repayable assistance subject to full repayment;
- projects subject to State Aid rules;
- projects with eligible expenditure less than €50,000.

**It is important to note that revenues cannot be used as a source of co-financing – they reduce eligible expenditure.**

### **Example:**

If SMEs have to pay a fee to attend a workshop the fees will be deducted as follows:

- The total eligible cost is £1,000
- The fee charged to the SME is £200
- The eligible cost is £800 (£1,000-£200)
- £800 is the amount which can be considered as eligible expenditure