EUROPEAN COMMISSION
DIRECTORATE-GENERAL
REGIONAL POLICY

INFORMATION NOTE TO THE COCOF
GUIDANCE NOTE ON ARTICLE 55 OF COUNCIL REGULATION
(EC) NO 1083/2006: REVENUE-GENERATING PROJECTS

CONTENTS

1. EXECUTIVE SUMMARY

The content of this information note can be summarised as following:

1. <u>From Article 55(1)</u>:

- Only revenues defined as cash in-flows *directly paid by users* have to be taken into account in the determination of the funding-gap as defined in Article 55(2); therefore, although other cash in-flows can be considered in the analysis of the national capital profitability (which is not required by Article 55), they must be excluded from the determination of the funding-gap.

2. <u>From Article 55(2)</u>:

For infrastructure or projects whose revenue can be objectively determined in advance:

- *the method used to consider net revenue when calculating eligible expenditure for the contribution from the Funds is the method of the funding-gap* defined as the difference between discounted investment cost and discounted net revenue. This method is used for two main reasons: first, to ensure that under certain circumstances, projects have enough resources to be implemented without being over-financed; and second, by extension, to ensure a minimum level of project profitability so that beneficiaries can bear the cost of capital needed in addition to public support;

- *net revenue has to be allocated pro rata to the eligible part of the investment cost*, when not all investment costs are eligible.[1] The proportions of net revenue to be allocated are ascertained by multiplying discounted eligible costs times the funding-gap rate; the resulting amount is the discounted eligible expenditure which, when multiplied by the European Union (EU) co-funding rate, identifies the discounted contribution from the Funds from which the related undiscounted value may be derived.

3. <u>From Article 55(2),</u> when managing authorities calculate the funding-gap they shall consider:

- the *reference period* because as the time horizon lengthens, the higher is, in principle, the net revenue to be considered in the funding-gap calculation. However, it should be borne in mind that: (a) due to discounting, net revenue accruing far in the future is progressively less important; (b) the residual value may be a proxy of residual revenue;

- the *normal expected profitability of the category of project in question,* in order to ensure that the appropriate financing scheme (e.g. grant-loan) has been chosen. In this regard, national authorities can play a key role in supporting managing authorities by providing values (or guidelines for their calculation) for the main categories of investment

- *the application of the polluter-pays principle*, which implies that managing authorities should bear in mind that tariffs charged to the users of the goods/services provided by projects must include payments taking account of the external costs generated by pollution;

- *equity considerations*, by assessing tariff affordability, that is, the ability of users to pay tariffs. In this regard, it is advisable that tariff levels are set at a level consistent with users'

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[1] The provisions on eligibility can be found in Article 56 of Regulation (EC) No 1083/2006; in Article 7 of Regulation
(EC) No 1080/2006 of the European Parliament and of the Council; and in Article 3 of Council Regulation (EC) No 1084/2006.

income, which may be based on either average income or lower income levels, depending on the income distribution of the served area.

4. From Article 55(2) and Article 55(3) as regards whether a project's revenue can be estimated in advance, it is emphasised that:

▪ the possibility of estimating objectively revenue in advance depends on the feasibility of forecasting tariffs and demand. To this end, different sectors of investment have been considered (transport, waste treatment, RTD projects). The Commission's services have found that the most important factors to determine whether revenue can be estimated in advance are: (a) the availability of consistent data; (b) previous experience with similar investment projects.

▪ From Article 55(3) it is emphasised that in case of projects whose revenue cannot be objectively estimated in advance, deductions must be made by the national authorities at the latest at the partial or final closure of the operational programme. These deductions shall be equal to the revenue generated within five years from the completion of the operation.

▪ From Article 55(4), which applies only after closure of the operational programme and is about refunding to the general budget of the EU revenue that has not been previously taken into account, it is stressed:

  – as to the reasons for revenue discrepancies, the following causes are identified: (a) unexpected tariff policy changes and/ or sources of revenue not taken into account initially; (b) lack of data and previous experience for projects whose revenue cannot be objectively estimated in advance;

  – as to the rationale and timeframe of refunding, consistent with the principle established by Article 55(4), according to which the refund must be proportional to the contribution from the Funds, it is stressed that the refund required is equal to the difference between the contribution from the Funds calculated in advance and that calculated on the basis of the monitored revenue; this refunding would be based on the results of monitoring revenue until at the latest three years after the final closure of the operational programme.

From Article 55(3), Article 55(4), Article 55(5), it is stressed that the implementation of these provisions must be based on monitoring of revenue. To this end, some *suggestions* on the potential monitoring mechanisms are made but the choice is in any case to be made by the managing authorities of the operational programmes.

5. From Article 55(6), the provisions of Article 55 are not applicable to revenue-generating projects subject to State aid rules.

2. BACKGROUND

Article 55 of Regulation (EC) No 1083/2006 (hereafter "Article 55") lays down provisions for revenue-generating projects seeking co-funding by the Funds. Its provisions specify how revenue must be taken into account in the determination of eligible expenditure for a contribution from the Funds, deductions and refunds.

The *objective* of this note is to give guidance on Article 55 by taking also into account:

▪ Annex XXI of Regulation (EC) No 1828/2006, that is, the application form to be used for major projects seeking co-funding from the ERDF and the Cohesion Fund;

- The "Guide to cost-benefit analysis of investment projects" prepared for Commission services (hereafter the "CBA guide"); and

- Commission services' working document n° 4 *Guidance on the methodology for carrying out cost-benefit analysis* (hereafter "working document n° 4").

The *structure* of this note will be based on:

- sections consistent with the three subjects considered in Article 55: (a) the rationale for the calculation of the funding-gap and the contribution from the Funds; (b) the rationale for the calculation of the revenue, deductions from the contribution from the Funds and refunds; (c) the applicability of Article 55;

- sub-sections in which specific issues related to these subjects will be considered according to the same sequence of Article 55[2]. In particular, the subsections will be concerned with:

  - the identification of revenues in different kind of investment projects (Article 55(1));

  - the funding-gap method, which must be used to take into account revenue in the case of projects whose revenue can be objectively estimated in advance; the factors to be considered (e.g. profitability normally expected per category of investment) when this method is applied (Article 55(2));

  - the determination of whether a project's revenue can be objectively estimated in advance (Article 55(2); Article 55(3));

  - the rationale and the timeframe of deductions in case of projects whose revenue cannot be objectively estimated in advance (Article 55(3));

  - the rationale and the timeframe for refunds to the budget of the EU (Article 55(4);

  - arrangements for monitoring revenue (Article 55(3); 55(4)) and its application to smaller projects (Article 55(5));

  - identification of the scope of Article 55.

3.   THE RATIONALE FOR THE CALCULATION OF THE "FUNDING-GAP"

3.1.   Article 55(1): Identification of Revenue

> "For the purposes of this Regulation, a revenue-generating project means any operation involving an investment in infrastructure the use of which is subject to charges borne directly by users or any operation involving the sale or rent of land or buildings or any other provision of services against payment."

The objective of this section is to identify the concept of revenue to be taken into account in the determination of the maximum amounts eligible for a contribution from the Funds to revenue-generating projects. In this regard, it is worth making the two following remarks.

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[2] The only exception is the concept of projects whose revenue can objectively be estimated in advance (Article 55(2)). In order to ensure greater clarity, in fact, the latter issue is discussed along with that of projects whose revenue cannot be objectively estimated in advance, which is dealt with in Article 55(3).

First, Regulation (EC) No 1983/2006 places greater emphasis on the importance of revenue in the calculation of the contribution from the Funds compared with the former programming period.

Within the previous programming periods, although revenue was taken into consideration, it was only considered in order to determine the maximum rate of assistance to projects co-financed by the Cohesion Fund or ERDF. Thus, pursuant to Article 29(4) of Regulation (EC) No 1260/1999, revenue had to be *considered* in the determination of ceilings for the Community contribution. One ceiling was set at the level of the maximum co-funding rate by Article 29(3) of Regulation (EC) No 1260/1999 and the other arose from the maximum co-funding rate for projects generating substantial net revenue laid down by Article 29(4)(a) of that Regulation. In the same way, pursuant to Article 7(2) of Regulation (EC) No 1164/1994, the amount of assistance from the Cohesion Fund was established taking into account substantial net revenue to be generated by the projects.

In contrast, Article 55 of Regulation (EC) No 1083/2006 provides that revenue *reduces* the investment cost which can be considered as eligible expenditure. In other words, in the last programming period revenue was taken into account to identify the maximum co-funding rates of assistance applicable whereas in the current period revenue reduces proportionally the maximum eligible expenditure.

Secondly, in order to clarify what is meant by revenue, it is necessary to describe the funding-gap method, along with its objectives and key steps.

3.1.1. Allowing for Revenue in the Calculation of a public intervention

The objective of considering revenue in financial analysis is to define that part of the investment costs which can be financed by the project itself (through tariffs, tolls, etc.) in order to identify the part of the investment costs, if any, which needs to be financed by the public contribution (e.g. direct grants, shadow tolls, etc.). In particular, the public contribution aims to ensure a specific level of investment financial profitability.

3.1.2. Investment Financial Profitability

"Investment financial profitability" is the ability of the project to generate additional financial resources (i.e. profits) compared to those invested, *independently* of how the project is going to be financed. In other words, it is the ability of the project in itself to generate financial returns without considering the cash flows due to loans, private equity, or government contributions (e.g. grants). It is worth noting that one of the key indexes of the investment financial profitability is the financial net present value given by the difference between project discounted net revenues[3] and project investment costs derived from a cash-flow analysis[45].

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[3] Discounted net revenue is equal to the difference between (a) the sum of discounted revenue and discounted residual value and (b) discounted operating costs.

[4] This implies that expenditure such as depreciation must not be taken into account. This exclusion is also justified because the related money aims to replace the investment beyond its time horizon. If depreciation is taken into account then the EU would finance both the present and the future investment.

[5] From the above statement, the funding-gap method is to be based on the profitability of the investment. This means that in general, costs and revenues are those accruing to the investor. However, when the owner and the operator are not the same, a consolidated financial analysis needs, in general, to be carried out. This would be the case in order to assess the actual profitability of the investment independently of the cash-flows between investors and operators. In this case, clearly the revenue to be taken into account in the funding-gap is that of the operator. Consolidated analyses should also be carried out in cases where different parts of infrastructure are managed by different operators.

3.1.3. Funding-Gap

The method used to determine the contribution from the Funds to revenue-generating projects is the so-called "funding-gap" method. The funding-gap is the difference between the current value of project investment costs and net revenue[6]. Thus, the funding-gap expresses the part of the project investment costs which cannot be financed by the project itself and that therefore needs to be financed. This method is used for two main reasons: first, to ensure, on the one hand, that the project has enough resources to be implemented, and on the other hand, that it is not over-financed[7]; secondly, to ensure a minimum level of project profitability to borrow money[8].

3.1.4. Classification of Cash in-Flows

From what has been stated so far, cash in-flows can be divided into:

▪ Revenues, that is, cash in-flows *directly paid by users* for the goods and/or services provided by the project, such as charges borne directly by users for the use of infrastructure, sale or rent of land or buildings, or payments for services;

▪ Other cash in-flows, that is, private and public contributions and/or financial gains than do not stem from tariffs, tolls, fees, rents or any other form of charge directly borne by the users.

This division is set out below in Figure 1:

Examples: Figure 1: Revenue and other Cash in-Flows

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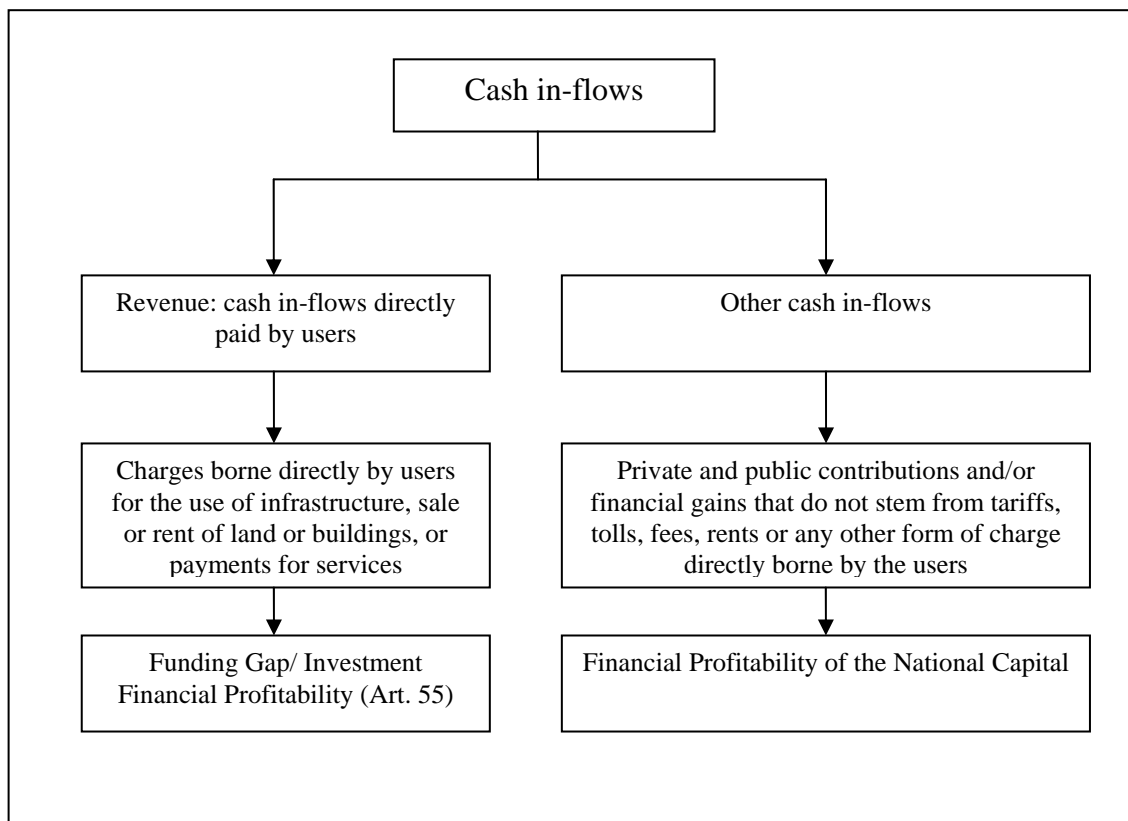
[6] According to the second subparagraph of Article 55(2), "where not all the investment cost is eligible for co-financing, the net revenue shall be allocated pro rata to the eligible and non-eligible parts of the investment cost" (See paragraph 3.2.2 of the present note).
[7] The project financial net present value will in fact become in the former case negative, and in the latter positive.
[8] The part of investment costs "covered" by the discounted net revenues can in fact be financed by borrowing money.

In order to facilitate the comprehension of the above concepts, some examples are set out below which concern the three different categories of revenue-generating projects mentioned in Article 55(1)[9]:

An "infrastructure the use of which is subject to charges borne directly by users"

Highways

- Revenues: tolls charged to drivers to use highways.
- Other cash in-flows: shadow tolls from government to project operators.

Railways

- Revenues: fares paid by travellers[10].
- Other cash in-flows: government contributions towards operating costs.

"any operation involving the sale or rent of land or buildings"

Technological Parks

- Revenues: prices or rents paid by the users to use the buildings and payments by users for other services provided by the project.
- Other cash in-flows: contribution of private equity, gains from loans.

Cultural buildings

- Revenues: rents for exhibitions, etc.
- Other cash in-flows: subsidies from public bodies or private donors.

"any other provision of services against payment"

Waste Water Treatment and Waste Treatment

- Revenues: tariffs paid by users.
- Other cash in-flows: contribution of private equity.

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[9] Examples are given on a purely illustrative basis, in order to facilitate comprehension of the concepts. They do not create a framework of projects. Taking into account the variety of operations concerned, individual cases may not fit exactly with the framework presented here. However, independently of the category to which they belong, all revenue-generating projects remain subject to the same rules.

[10] Taking into account the variety of situations in the Member States as regards the rail market, it is possible that the fees paid by railway operators (track access charges) should be considered as revenue within the meaning of Article 55(1) instead of fares paid by travellers. In principle, if a project has more than one operator, the revenue that needs to be considered for the calculation of the eligible expenditure is that directly paid by the operators through charges.

Conclusions. Only revenues defined as cash in-flows *directly paid by users* have to be taken into account in the determination of the funding-gap as defined in Article 55(2). Other cash in-flows must not to be included in the determination of the funding-gap although they may be considered in the analysis of the national capital profitability.

3.2. Article 55(2): The Funding-gap Method

"Eligible expenditure on revenue-generating projects shall not exceed the current value of the investment cost less the current value of the net revenue from the investment over a specific reference period for:

(a) investments in infrastructure; or
(b) other projects where it is possible to objectively estimate the revenues in advance.

Where not all the investment cost is eligible for co-financing, the net revenue shall be allocated pro rata to the eligible and non-eligible parts of the investment cost.

In the calculation, the managing authority shall take account of the reference period appropriate to the category of investment concerned, the category of project, the profitability normally expected of the category of investment concerned, the application of the polluter-pays principle, and, if appropriate, considerations of equity linked to the relative prosperity of the Member State concerned."

3.2.1. Eligible Expenditure and the Funding-gap

According to the first sentence of Article 55(2), eligible expenditure cannot exceed the difference between current[11] investment costs and current net revenue, that is, the project funding-gap. In formulas, this may be written as:

$$max\, DEE = DIC - DNR = FG \qquad\qquad (1)$$

where   DEE is the discounted eligible expenditure[12];

             FG is the funding-gap;

             DIC is discounted investment cost;

             DNR is discounted net revenue.

According to Article 55(2) it is "the net revenue *from the investment*" which needs to be considered. This means that it is only the *incremental* net revenue generated by the investment that is taken into account in the calculation of the funding. Net revenue is the difference between the revenue and the operating cost[13].

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[11] Note that *current* value is a synonym of *discounted* value. In this regard, it is worth noting that working document n° 4 states that a 5% financial discount rate in real terms may be used as indicative benchmark.

[12] Because it is derived from discounted values, eligible expenditure in this context is a discounted value.

[13] The operating costs to be taken into account in the calculation of the funding-gap must include running costs (e.g. labour, raw materials, electricity), maintenance expenses and costs for the replacement of project short-life equipment. Financing costs (e.g. interest payments) and depreciation should be excluded (the latter is not a cash-

Projects whose revenue is lower than operating costs. Where a project's revenue is less than its operating costs (i.e. negative net revenue), it cannot obviously contribute to financing the project investment costs indirectly by borrowing money or attracting capital from investors. Therefore, since the objective of the funding-gap method is to identify the part of the project investment cost which cannot be financed by the project itself, for projects with negative net revenue it is not necessary to apply the funding-gap method in order to identify the contribution from the Funds. Because operating costs are not covered by revenue, an analysis of the financial sustainability is required to verify that throughout the project's time horizon there is enough cash to cover the related expenditure.

For the purpose of determining whether or not an operation is a revenue-generating project within the meaning of Article 55(1), and whether or not it is necessary to apply the funding-gap method, the residual value of infrastructure does not need to be considered. For example, an investment in a new road, which is not subject to tolls or other user charge revenue, would not become revenue-generating only due to residual value of the road at the end of the reference period. However, where it is determined that a project will generate revenue within the meaning of Article 55(1), and where this revenue can be objectively estimated in advance by applying the funding-gap method, the residual value must be taken into account in that calculation.

It should be noted that operating cost-savings generated by the projects must be considered in the funding-gap calculation. Operating cost-savings can be ignored where it can be demonstrated that they are offset by an equal reduction in operating subsidies.

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Conclusions. In this section it has been explained that the funding-gap is equal to the difference between discounted investment cost and discounted net revenue. Consequently, its application allows: (1) for projects to have sufficient financial resources to be implemented but not to be over-financed; and (2) project promoters to bear the cost of capital needed in addition to grants.

3.2.2. Pro Rata Allocation

"Where not all the investment cost is eligible for co-financing, the net revenue shall be allocated pro rata to the eligible and non-eligible parts of the investment cost."

The eligibility of expenditure is subject to the provisions of Regulation (EC) No 1083/2006[14] and the legislation governing the individual Funds[15]. In this regard, the second subparagraph of Article 55(2) provides that when not all the investment cost[16] is eligible then a proportional part of the net revenue is not to be taken into account in the calculation of the funding-gap. For example, if only 80% of the discounted investment costs is eligible[17], which means that 20% of the

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flow). For simplicity, taxes can be ignored in the funding-gap calculation, although a consistent approach must be used across projects.

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[14] See Article 56. Note in particular that Article 56(4) refers also to eligibility rules laid down at national level.

[15] In particular: for the ERDF, see Article 7 of Regulation (EC) No 1080/2006; for the Cohesion Fund, see Article 3 of Regulation (EC) No 1084/2006; for the ESF, see Article 11 of Regulation (EC) No 1081/2006.

[16] It is to be noticed that the aforementioned provisions also include rules for the eligibility of costs during the project operating stage.

[17] Of course, in order to make the comparison possible discounted investment costs need to be compared with discounted eligible costs.

discounted investment costs are not eligible, then 20% of the discounted net revenue must also not be considered in the funding-gap. This means that we should multiply both the discounted net revenue and investment costs by 80%, that is,

$$DEE = FG * 0.8 = FG * P \qquad (2)$$

where P stands for the percentage given by the ratio of discounted eligible costs over discounted investment costs.

The discounted eligible expenditure multiplied by the EU co-funding rate (CR_{EU}) will then be used to identify the discounted contribution from the Funds, DG_{EU},

$$DG_{EU} = DEE * CR_{EU} \qquad (3)$$

from which it is possible to derive the contribution from the Funds in non-discounted values. A numerical example in the context of the ERDF is provided below.

Numerical Example

Consider that the discounted investment cost of a project is equal to €100 and discounted net revenue equal to €60 so that the maximum discounted eligible expenditure is equal to €40. Consider, in addition, that the purchase of land needed to realise the project is equal to €24. Since pursuant to Article 7(1)(b) of Regulation (EC) No 1080/2006 the cost of land cannot ordinarily exceed 10% of the eligible expenditure[18], then only (0.1*40=) €4 can accounted as eligible cost for land and thus €20 will not be eligible cost. Pursuant to Article 55(2), because non-eligible costs are 20% of the discounted investment cost, then we should allocate 20% of net revenue to non-eligible costs and 80% of the net revenue to the eligible cost. This is done by multiplying the funding-gap by that share of the discounted investment costs which is eligible, P, that is,

$$DEE = FG * P = (100 - 60) * 0.8 = 32 \qquad (4)$$

where DEE stands for discounted eligible expenditure, that is, the amount of investment cost which multiplied by the EU co-funding rate will identify the discounted contribution from the Funds, that is,

$$DG_{EU} = 32 * 0.75 = 24 \qquad (5)$$

from which it is possible to derive the contribution from the Funds in non-discounted values as presented in Annex I.

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Conclusions: the pro rata allocation of revenue to eligible cost is carried out by multiplying the funding-gap times the ratio of the discounted eligible cost over discounted investment cost. The resulting amount, the discounted eligible expenditure, multiplied by the co-funding rate identifies the discounted contribution from the Funds from which the related undiscounted value can be

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[18] Except for exceptional and duly justified cases concerned with operations concerning environmental conservation in case of ERDF.

derived. Given their importance, in the next box the three key steps to calculate the funding-gap are summarised.

The Three Key Steps to Calculate the contribution from the Funds

First Step: Funding-gap

$$max\, DEE = DIC - DNR = FG \qquad (6)$$

where :   DEE is eligible expenditure;
              FG is the funding-gap;
              DIC is discounted investment cost;
              DNR is discounted net revenue.

Second Step: Discounted Eligible Expenditure:

$$DEE = FG * P \qquad (7)$$

where: DEE is discounted eligible expenditure;
               P is percentage consistent with the ratio of discounted eligible cost over discounted
               investment cost.

Third Step: Contribution from the Funds

$$DG_{EU} = DEE * CR_{EU} \qquad (8)$$

where: CR_{EU} is the EU co-funding rate
              DG_{EU} stands for discounted contribution from the Funds

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3.2.3.   Categories of Investment and Reference Period

"In the calculation, the managing authority shall take account of the reference period appropriate to the category of investment concerned, the category of the project (…)"

The reference period or project time horizon is the number of years of the profit economic life, that is, the time period beyond which the investment needs to be replaced.

<u>Examples[19]</u>: Categories of Investment and Period of Reference

Sector of Investment	Time Horizon
Railways	30
Roads	25
Water	30
Energy	25
Telecommunication	15
Industry	10
Other services	15

Managing authorities shall duly take into account the reference period since the longer is time horizon, the higher the net revenue to be taken into account in the calculation of the funding-gap. However, it should be borne in mind that: (a) net revenue accruing far in the future is progressively less important because of discounting; (b) the residual value is a proxy of the remaining revenues.

3.2.4. Profitability Normally Expected for Categories of Investment

"In the calculation, the managing authority shall take account of (…) the profitability normally expected of the category of investment concerned (…)"

In order to explain what it is meant for profitability normally expected for categories of investment, one should consider in greater detail the concept of financial investment profitability previously introduced in sub-section 3.1.2 through the following numerical example.

Numerical Example

As stated in section 3.1.2, investment profitability can be defined as the ability of the project to generate additional financial resources (i.e. profits) compared to those invested. In this regard, one indicator which can be used is the financial net present value of the investment (FNPV/C), that is, the difference between the discounted net revenue and discounted investment cost which can be written (using the same notation used so far) as:

$$FNPV / C = DNR - DIC \qquad\qquad (9)$$

Assume now for simplicity that a project lasts two years. In the first year, only investment cost occurs and it is equal to €1 whereas, in the second year only net revenue arises and it is equal to €3.15. Consider, in addition, that the capital needed could be borrowed through the banking system, and that the related interest rate (i.e. the additional price to be paid for €1) is 5%. Since the net revenue is going to be €3.15 in the second year, then the project promoter could borrow in the first year an amount of money equal to net revenues (€3.15) less the cost of borrowing money, that is, an amount given by the following equation:

[19] In this regard, see the CBA guide.

$$DNR = \frac{3.15}{(1+0.05)} = 3 \qquad\qquad (10)$$

It is possible to see from equation 10 that the project promoter can borrow up to €3 in the first year, and be able to pay back in the second year an amount equal to €3*(1.05)= €3.15. Thus, using the value taken from 10 in equation 9 we find that the financial net present value of the investment considered here is equal to:

$$FNPV/C = \frac{3.15}{(1+0.05)} - 1 = 2 > 0 \qquad\qquad (11)$$

According to equation 11, the project promoter will be able to pay back the capital needed including its costs, and gain also additional financial resources (€2): the project considered here is thus *able* to generate *profits*.

Factors Affecting Financial Profitability of the Investment are those affecting: (a) revenue; (b) investment and operating cost.

As to revenue, it is made of two elements: (a) charges/rent/payments and (b) number of users and/or the quantity of the good/service provided by the project. The former depends on the policy chosen at national/regional/local level, whereas the latter is dependent on the actual and foreseeable demand which can, in turn, be affected by a number of factors[20].

As to investment and operating costs, they also are a product of two elements: (a) the nature of the input (e.g. kind of labour) and therefore its unit price; (b) the related quantities (e.g. number of workers). The nature of the input and its price depend, on the one hand, on the choices made at project level such as technology (incinerator/landfill), location (road across flat or mountain territory) and size (number of highway lanes), and on the other hand, on the structure of the economy and relevant government policies affecting the project through input prices and quantities (electricity prices and energy policy; availability of unskilled workers and labour policy).

Considering all the factors mentioned above, a specific level of profitability may not be established either across sectors of investment or across Member States. However, if the aforementioned factors are broadly homogenous (for example, for projects in the same sector of investment and implemented in the same macro-region, where the structure of the economy and government policies are similar), a normally expected profitability may be identified.

Knowledge of the normally expected profitability may be important to shed light on the approximate financing scheme (e.g. the mix between grant-loan) required for the project considered. To this end, it is worth noting that working document n° 4 emphasizes (p.14), for example, that an airport may require relatively low grants (as the funding-gap may be small) whereas water supply and waste water projects may require relatively higher grants although they can still be financed also through loans (as tariffs are levied for these projects). These examples are clearly in contrast to projects which generate no revenues such as non-tolled roads whose financing scheme can be based only on grants.

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[20] A detailed discussion on factors affecting revenue will be set out in Section 4.2.

Conclusion: from the above, it emerges that when managing authorities calculate the funding-gap, and more generally, the eligible expenditure, it is recommended that the normal expected profitability of the category of the project is considered in order to verify if the appropriate financing scheme (e.g. grant-loan) has been chosen. This clearly implies that managing authorities should either know the figures on normal expected profitability of the category of investment concerned or have guidelines to calculate the said profitability in their context. In this regard, a useful role can be played by national authorities (e.g. Treasury).

3.2.5. Polluter Pays Principle

In the calculation, the managing authority shall take account of (…) the application of the polluter-pays principle (…)

In the calculation of the funding-gap, Article 55 (2) requires that the managing authority must also take into account the application of the polluter-pays principle. This means that the external costs generated by pollution must be paid to some extent by the polluter even though there are not always repercussions on tariffs paid by the users. Examples of external costs are set out below.

Waste Treatment Plants. Waste treatment plants may generate air pollution (e.g. smoke from incinerators), soil and water pollution (liquids from landfills percolating in underground water). This pollution may affect people's health and values of lands and buildings in the surrounding areas. Tariffs paid by users must also include a part of costs proportionate to the consequences of the pollution generated.

In applying the polluter-pays principle, attention of the managing authorities has to be drawn to the fact that:

- not to apply the polluter-pays principle results in, on the one hand, making polluters gain (e.g. drivers paying cheaper tolls for highways) and, on the other hand, generating losses for citizens in the areas affected by the pollution;

- the application of polluter-pays principle, especially when it results in prevention/mitigation measures, may increase consensus from the local population which for some projects (e.g. waste treatment plants) can be essential;

- the application of the polluter-pays principle results in making tariffs higher; to this end, it is advisable that, equity and affordability issues (see next paragraph) are also duly considered when tariffs are set.

3.2.6. Equity and Affordability

In the calculation, the managing authority shall take account of (…) if appropriate, considerations of equity linked to the relative prosperity of the Member State concerned."

When investment financial profitability is taken into account, equity considerations are concerned with assessing tariff affordability i.e. the ability to pay tariffs by users. In this regard, a possible solution to ensure affordability is to set tariffs as a percentage of average income or lower group income[21] depending on the existing income distribution of the served area.

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[21] For some examples of affordability ratios, see Annex II to working document n° 4.

To this end the Commission's services recommend that managing authorities duly consider tariff affordability because if users will not be in a position to pay the related tariffs then the project may experience shortage of money during its life; in other words, ensuring affordability means also verifying project financial sustainability (i.e. to verify that there is enough cash in each year of the project time horizon). As with the issue of the normal expected profitability, national authorities can play an important role to identify criteria for setting tariffs.

In addition, it should be noticed that due to the funding-gap method, ensuring tariff affordability also makes it possible to allocate a higher contribution from the Funds. If tariffs are low because users are poorer, the funding-gap will be wider and allow a higher contribution from the Funds. This result is consistent with the redistribution objective of EU cohesion policy.

4. THE RATIONALE OF DEDUCTIONS AND REFUNDING

4.1. Deductions within the meaning of Article 55(3) and Refunding within the meaning of Article 55(4)

With the exception of those projects subject to the State aid rules (*cf. infra on Article 55(6)*), Article 55 foresees only two situations as regards revenue-generating projects:

- Projects covered by Article 55(2): For these projects revenue can be objectively estimated in advance, by applying the "*funding-gap*" methodology, pursuant to Article 55(2). If the "*funding-gap*" is established correctly and the conditions of implementation of the project do not change significantly, there is, in principle, no need for the managing authority to modify the grant contribution allocated to the project. However, in case monitoring reveals important discrepancies between the revenue initially estimated and the revenue which will be realised in the end, managing authorities are advised to envisage mechanisms that would allow them to readjust the grant calculation. Such mechanisms could involve reducing the maximum eligible expenditure related to a given project (i.e., where the revenue will be higher than previously estimated) and re-allocating the pro rata contribution from the Funds to other projects under the operational programme or increasing the eligible amounts to that project (if the revenue estimated in advance is not realised as expected). Such re-adjustments have to be distinguished from "*deductions*" in the sense of Article 55(3) and from *"refunding"* under Article 55(4).

- Projects covered by Article 55(3): For these projects, for various reasons (see explanations provided in point 4.2) "*it is objectively not possible to estimate the revenue in advance"* and the revenue generated by a given project within <u>five years of its completion</u> has to be deducted from the eligible expenditure declared to the Commission. In other words, these projects are not concerned by the "*funding-gap*" method and the five-year reference period is considered as sufficient to determine the revenue to be taken into account for the calculation of the contribution from the Funds to these projects. The *deductions* may occur until the closure of the operational programme.

It is only where operations[22] generate revenue that was not taken into account under Article 55(2) or 55(3) that the corresponding amounts need to be "*refunded*" to the general budget of the EU (Article 55(4)). Such refunded amounts are definitively lost for the operational programme, because refunding only applies after closure.

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[22] With the exception of the operations referred to in Article 55(5), i.e operations whose total cost is below EUR 200 000€(See paragraph 4.6.2 of this note)

4.2. Articles 55(2) and 55(3): Classification of Projects in terms of the Possibility to Objectively Estimate Revenue in Advance

The objective of this sub-section is to provide guidance for the implementation of Article 55(3) as regards the identification of revenue which cannot be objectively estimated and, by extension, the identification of revenue which can be objectively estimated as referred to in Article 55(2).

To this end, this sub-section will first focus on factors affecting the possibility of estimating revenue in advance and will then deal with a synoptic classification of revenue sources according to their ability to be objectively estimated in advance along with the factors affecting that exercise.

In order to apply the funding-gap method, it is necessary to forecast the cost-revenue stream over the project time horizon. In this regard, it is worth recalling that revenue is the product of two elements: (a) charges/rents/payments (hereafter "tariffs"); (b) number of users and/or quantity of the good/services provided by the project.

Tariffs are determined by policy choices and depend on: current policies (e.g. tariffs for waste treatment charged to users, or tolls on highways); the expected changes in the regulatory framework (for example, the application of the polluter-pays principle may modify the tariffs charged). The number of users depends on all factors affecting demand for the good/service provided by the investment project at stake. In order to clarify factors affecting demand this Information Note will consider examples where revenue can be objectively estimated in advance (e.g. transport and waste treatments) and where revenue cannot be objectively estimated in advance (e.g. RTD projects).

Examples of projects where revenue can be objectively estimated in advance

▪ *Transport*

The following factors need to be taken into account:

a. the socio-economic characteristics of the area;
b. the journey generated by the same area;
c. the journey distribution to different locations;
d. the assignment;
e. comparison of results with actual traffic data.

Demand analysis has to include:

1. *current demand*: this is the base-year traffic data arising from the five factors above, considering the current state of the relevant transport infrastructure;
2. *induced demand*: this is the base-year traffic allowing for all relevant infrastructure changes due to the project in terms of journey generation, journey distribution, modal split and assignment;
3. *forecast demand:* this is the traffic data including macroeconomic and sector forecasts and elasticity estimates of transport demand to generalised cost[23] and income.

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[23] The generalised cost of transport is the sum of monetary (e.g. ticket for train) and non-monetary (value of time) costs.

▪ *Waste Treatment*

The following factors need to be considered to derive demand for waste treatment:

a. main agglomerations producing the waste to be treated described in terms of population, demographic trends, and migratory flows;
b. main productive activities producing the waste to be treated along with their expected growth;
c. habits and possible habit evolutions such as recycling;
d. potential new technologies affecting the quantity and type of waste to be treated.

Demand analysis has to include:

1. *current demand*, that is, the present demand given not only the quantity and type of waste produced but also the existing infrastructure;
2. *induced demand*, that is, demand arising from new users: the new infrastructure may serve a larger area;
3. *forecast demand* due to foreseeable changes resulting from the four factors above and to foreseeable changes in the regulatory framework.

Example of projects where revenue cannot be objectively estimated in advance

▪ *Innovation Centre*

In contrast to the former examples, revenue cannot be objectively estimated in advance for some projects, whose key feature is that of innovation, so that demand cannot be inferred as it is *supply generated demand*, (i.e. it is the innovation itself which creates the demand). In other words, given the lack of data and past experience, estimates can be formulated but they will be highly subjective. Examples of such projects can be found in the priorities set out in Article 4(1) of Regulation (EC) No 1080/2006 (e.g., research institutions and research and technology centres).

Article 55(2) provides that:

"Eligible expenditure on revenue-generating projects shall not exceed the current value of the investment cost less the current value of the net revenue from the investment over a specific reference period for:

(a) investments in infrastructure; or

(b) other projects where it is possible to **objectively estimate the revenues in advance**."

Article 55(3) provides that:

"Where **it is objectively not possible to estimate the revenue in advance**, the revenue generated within five years of the completion of an operation shall be deducted from the expenditure declared to the Commission. The deduction shall be made by the certifying authority at the latest at partial or at final closure of the operational programme. The application for payment of the final balance shall be corrected accordingly."

Therefore, Article 55(2) and Article 55(3) classify projects on the basis of whether revenue can be objectively estimated in advance. As shown above, whether a project's revenue can be objectively estimated in advance is determined by factors on which tariffs and demand are dependent. This indicative classification is synoptically presented in the following Table.

Table: Classification of revenue in terms of their possibility to be estimated in advance and related factors
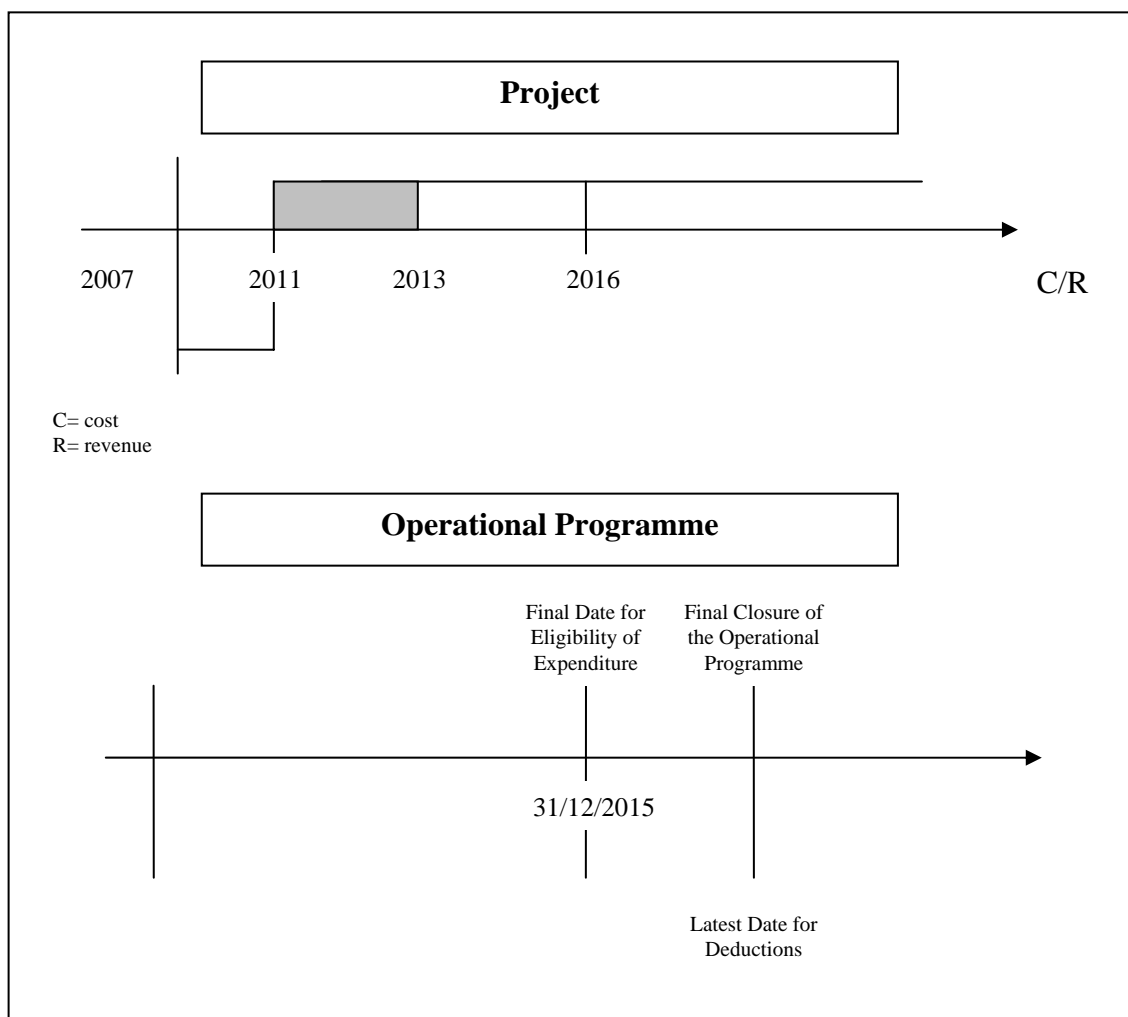
Possibility of Revenue Estimation	Tariffs	Estimated Demand
Revenue Estimation Objectively Possible in Advance (Article 55(2))	Clearly Stated Policy Choice Foreseeable Policy	Models and Data Available Expert opinions based on models and data
Revenue Estimation Objectively not Possible in Advance (Article 55(3)).	Lack of data. New demand generated by supply.	Lack of data. Expert opinion highly subjective

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Conclusions. The identification of projects whose revenue can or cannot be estimated in advance depends on a number of factors affecting the possibility of forecasting the revenue key determinants: tariffs and demand. In this sub-section the key elements needed to forecast tariffs and demand have been identified. As it emerges from the Table above, the most important of these factors are the availability of consistent data and previous experience with similar investment projects.

4.3. Article 55(3): Deductions for Projects whose Revenue cannot be Objectively Estimated in Advance

For projects whose revenue cannot be objectively estimated in advance, Article 55(3) envisages a *deduction* linked to the revenue generated within five years from the completion of an operation. This deduction must be made by the certifying authority at the latest at the partial or final closure of the operational programme. Figure 2 shows a possible case of a project whose revenue (in the period 2011-2013) was not estimated in advance.

Figure 2: Deductions

Project

2007   2011   2013   2016   C/R

C= cost
R= revenue

Operational Programme

Final Date for   Final Closure of
Eligibility of   the Operational
Expenditure   Programme

31/12/2015

Latest Date for
Deductions

In the upper part of Figure 2, it is assumed that the project investment phase lasts from 1 January 2007 to 31 December 2010. Therefore, the revenue to be taken into account is that generated in the period from 1 January 2011 to 31 December 2015.

4.4. Article 55(4): Refunding

Article 55(4) "Where, at the latest three years after closure of the operational programme, it is established that an operation has generated revenue that has not been taken into account under paragraphs 2 and 3, such revenue shall be refunded to the general budget of the European Union in proportion to the contribution from the Funds."

Rationale and Timeframe of Refunding

Article 55(4) is concerned with refunding revenue to the budget of the EU after closure of the operational programme. Such refunds are required at the latest three years after this closure of the operational programme in case an operation concerned has generated revenue *that has not been taken into account under Article 55(2) and Article 55(3).*

For projects subject to Article 55(2), refunds are required where it is established after the closure of the programme, and at the latest within a period of three years following the closure of that programme, that: (a) certain sources of revenue to be generated by the project have not been taken into account in the calculation of the funding-gap and/or new sources of revenues appeared after the calculation of the funding-gap (e.g. a non-tolled road on which tolls are levied afterwards); (b)

there are changes in the tariffs policy of such importance that they question the exactness of the funding-gap calculation. In any case, changes in demand or other external economic factors (such as un-foreseeable price inflation) would not be linked to an inadequate application of the funding-gap method and therefore does not require a refund[24]. The variations under scenarios (a) and (b) will be observed by means of an adequate monitoring of the revenue generated by the projects.

The threshold over which refund could take place could be a 10% variation in the funding-gap. This means that if the funding-gap varies less than 10% no refund must be made. However in principle a variation of the funding-gap of more than 10% is considered by the Commission as the level of variation indicating that the funding-gap has not been properly calculated initially. There must be sufficient monitoring of the revenue position of such projects to observe those situations which can trigger refunds and the level of the resulting variation in revenue.

For projects subject to Article 55(3), refunds are required if, following verification, it becomes apparent that not all generated revenue within the meaning of Article 55(3) has been deducted previously (in other words if the net revenue actually generated during the 5 years reference period is greater than the deducted revenue). In these circumstances there has been an incorrect application of Article 55(3) during the implementation of a programme. Article 55(4) also applies in the case when the five-year period after the completion of the operation ends after the closure of the programme (i.e., when deductions are no longer possible) and at the latest three years after the closure of that programme.

Article 55(4) states that for all projects[25] to which Article 55 applies if revenue has not previously been taken into account, then this revenue shall be refunded to the general budget of the European Union *in proportion* to the contribution from the Funds. The wording "*proportion to the contribution from the Funds*" means that the refund should be equal to the amount corresponding to a percentage of the additional revenue equal to EU co-funding rate. For example, if the additional revenue is €100 and the EU co-funding rate is 75%, then the refund should be equal to €75.

The Refunding Rationale. As mentioned in paragraph 3.1.3 the objective of the funding-gap is to ensure that grants give projects a minimum level of project profitability to borrow money but are calculated by taking into account net revenue so that those projects are not over-financed[26]. Therefore, if net revenue increases significantly after closure, then the funding-gap decreases and a consistent refund to the EU should be made. The latter should be, consequently, equal to the difference between the contribution from the Funds with the estimated revenue and the contribution from the Funds calculated taking into account the net new revenue, that is,

$$RF = G^t_{EU} - G^c_{EU} \qquad\qquad (12)$$

where RF stands for the refund to be made to the European Union budget;

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[24] Nevertheless, if it is established that revenue have been voluntarily underestimated in order to maximize the grant contributions to certain projects, this will constitute irregularities which can be addressed on the basis of Articles 98 and 99 of Regulation (EC) No 1083/2006 i.e. on the basis of a financial correction instead of a refund in the meaning of Article 55(4).

[25] With the exception of the operations referred to in Article 55(5), i.e operations whose total cost is below EUR 200 000€(See paragraph 4.6.2 of this note)

[26] As aforementioned, this condition is ensured under certain circumstances when the investment financial net present value (including public expenditure (EU and national)) is equal to zero.

$G^t{}_{EU}$ stands for the contribution from the Funds calculated ex-ante;

$G^c{}_{EU}$ stands for the contribution from the Funds including the additional revenue verified at the latest after three years of the final closure of the programme.

It should be noticed that although Article 55(3) and Article 55(4) deal with changes in revenue, because the refund is calculated through the funding-gap, the relevant changes in revenue are actually changes in net revenue. In addition, the application of the funding-gap rationale to calculate the refund is also plausible from an economic standpoint where there are increases in both revenue and operating costs. Consider, for example, a waste water treatment plant which is exploited at level higher than that assumed in its appraisal. This overexploitation will result in more water treatments which will increase both revenue and operating costs.

For the sake of clarity and to emphasise the coincidence between (a) refunding an amount proportional to the contribution from the Funds and (b) the difference between the contribution from the Funds calculated in advance and that calculated on the basis of the monitored revenue, two numerical examples of refunding are set out below.

Numerical example: the case of projects where the entire investment cost is eligible

Recall the former example given in section 3.2.2. The funding-gap is equal to

$$FG = 100 - 60 = 40 \qquad (13)$$

since all investment is assumed eligible, then the discounted eligible expenditure is equal to the funding-gap, that is,

$$DEE = 40 \qquad (14)$$

Assume that the co-funding rate used is 75%, the discounted contribution from the Funds is then equal to

$$DG^t{}_{EU} = 40 * 0.75 = 30 \qquad (15)$$

Consider now that after verification it has been found that revenue increased by €20, then the discounted eligible expenditure becomes

$$DEE = 100 - 80 = 20 \qquad (16)$$

and the discounted contribution from the Funds is equal to

$$DG^c{}_{EU} = 20 * 0.75 = 15 \qquad (17)$$

Using equation (12), and the values found in equations (15) and (17), the discounted value of refund is equal to:

$$DRF = 30 - 15 = 15 \qquad (18)$$

Note that the discounted value of refund may also be more straightforwardly identified by multiplying: (a) the increase in revenue; (b) the discounted eligible cost (in percentage with reference to discounted total costs); (c) the co-funding rate, that is, using the former example,

$$DRF = 20*1*0.75 = 15 \qquad (19)$$

Finally, it is to be noticed that consistent with Article 55(4) the refund of the contribution from the Funds is proportional to the contribution from the Funds. In fact, from (19), it is possible to see that the discounted refund to the EU is equal to 75% (the co-funding rate) of the additional revenue.

Numerical example where part of the investment cost is eligible

Using the same example set out in the preceding paragraph, assume now that only €80 (out of €100 of discounted investment cost) is the discounted eligible cost; therefore, the discounted eligible expenditure is equal to

$$DEE = 40*0.8 = 32 \qquad (20)$$

the contribution from the Funds is equal to

$$DG^t_{EU} = 32*0.75 = 24 \qquad (21)$$

Consider now that at the moment of verification, it has been found that revenue increased by €20. Therefore, the funding-gap is equal to:

$$FG = 100 - 80 = 20 \qquad (22)$$

so that the discounted eligible expenditure becomes equal to

$$DEE = 20*0.8 = 16 \qquad (23)$$

and the contribution from the Funds is

$$DG^c_{EU} = 16*0.75 = 12 \qquad (24)$$

Therefore, the refund is equal to:

$$DRF = 24 - 12 = 12 \qquad (25)$$

Note that the discounted value of refund may also more straightforwardly identified by multiplying: (a) the increase in revenue; (b) the discounted eligible cost (in percentage with reference to discounted total costs); (c) the co-funding rate, that is,

$$DRF = 20 * 0.8 * 0.75 = 12 \qquad (26)$$

Finally, it is to be noticed that consistent with Article 55(4) the discounted value of refund of the contribution from the Funds is proportionate to the contribution from the Funds. In fact, **from (26) it is possible to see that the discounted value of refund is equal to the EU co-funding rate (75%) applied to that part of the additional revenue which can be accounted for given the pro-rata allocation emphasised by the second subparagraph Article 55(2).**

Timeframe. The *timeframe* for refunding is illustrated by Figure 3.

Figure 3: Refunding
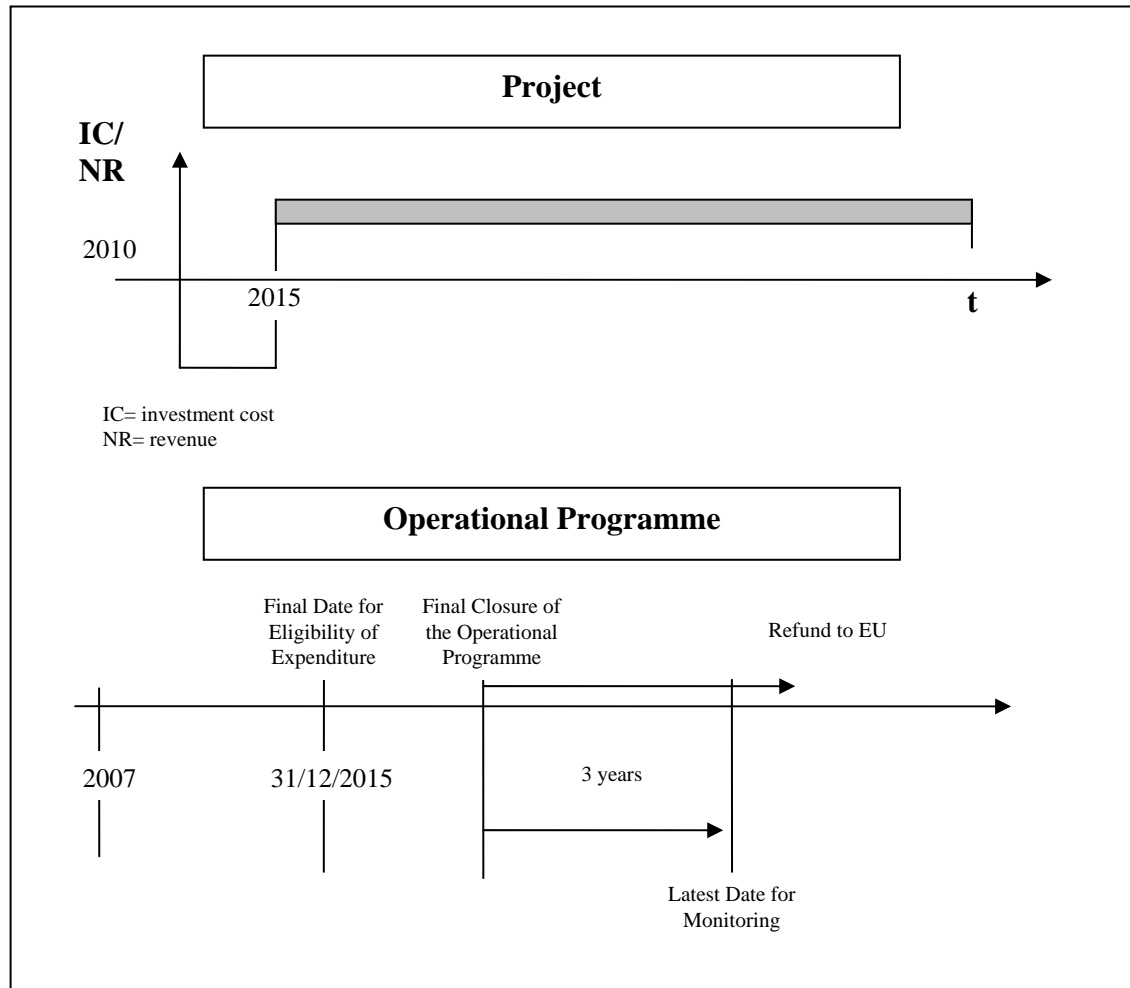
The above figure shows: (a) in its upper part the case of a project whose construction is supposed to start from 1 January 2010 to 31 December 2014; (b) in its lower part, the timeframe for monitoring revenue and refunding[27].

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[27] In reference to the figure is worth mentioning that the final date for the eligibility of expenditure is set at 31 December 2015 by Article 56(1) of Regulation (EC) No 1083/2006.

4.5. Special Case for Deductions and Refunding for projects covered by Article 55(3)

The project investment stage is completed at a date less than five years before the deadline for the submission of the closure documents (See also Figure 4) which is 31 March 2017[28]. The gray rectangle in the figure represents the project investment stage.

Figure 4: Deduction in case of completion at a date of less than five years from the final date for transmission of closure documents
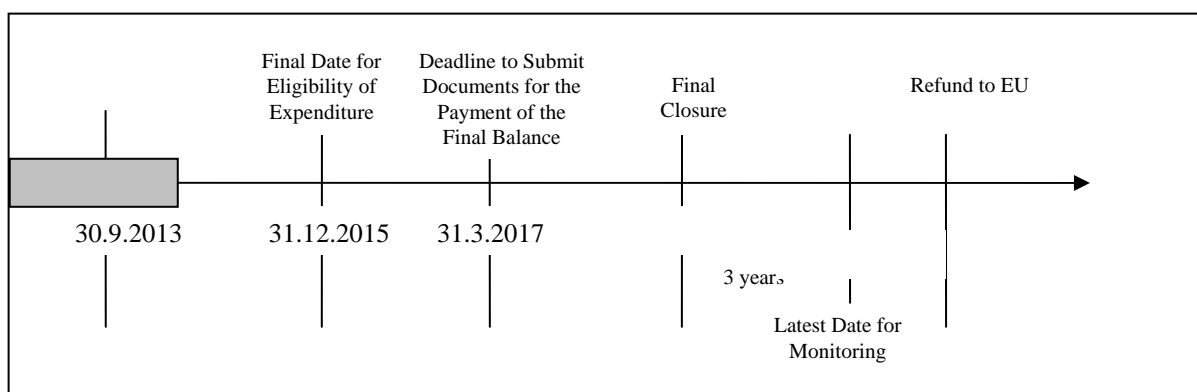
In this case: (a) the *deduction* pursuant to Article 55(3) will be concerned with the revenue generated over a period of less than five years based on the monitoring of revenue which had occurred up to the date of transmission of the closure documents, and in particular the application for payment of the balance; (b) After the closure of the programme, the *refund* will concern the revenue which was not deducted for the period up to the five years after the completion of the project.

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Conclusions: Article 55(4) is concerned with refunding the EU in case of revenue discrepancies for projects to which Article 55 applies. To this end, this section considered the following aspects:

▪ as to reasons for revenue discrepancies, the following causes have been stressed: (a) tariff policy changes and/ or sources of revenue not taken into account initially; (b) lack of data and of past experience for projects whose revenue cannot be objectively estimated in advance;

▪ as to the rationale and the timeframe for the refund, it has been emphasised that: (a) according to Article 55(4) the refund has to be proportionate to the contribution from the Funds, that is, proportional to the EU co-funding rate; (b) such a refund is equal to the difference between the contribution from the Funds calculated in advance and that calculated on the basis of the monitored revenue; (c) this refund will be done on the basis of a monitoring of revenue until the end of the third year after the final closure of the operational programme.

4.6. Article 55(5)

Article 55(5). "Without prejudice to their obligations under Article 70(1), Member States may adopt procedures proportionate to the amounts concerned for monitoring revenues generated by operations whose total cost is below EUR 200 000."

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[28] Article 89 of Regulation (EC) No 1083/2006.

4.6.1. Arrangements for Monitoring Revenue

In order to implement the provisions of Article 55(5), it is recommended that the managing authority set a system for monitoring revenue until the three years after the final closure of the operational programme have passed. To this end, it is worth noting that the need for a monitoring system is also **explicitly mentioned** in Article 55(5) which provides that "Member States may adopt procedures proportionate to the amounts concerned for monitoring revenues generated by operations whose total cost is below EUR 200 000."

The managing authority has a high interest in setting up, as soon as possible in the programming period, an efficient yet proportionate monitoring system for revenue-generating projects. The aim of this requirement is not to impose unnecessarily heavy procedures, but to set up a system which helps to prevent any over-financing of projects, contributes to the most efficient allocation of resources and makes possible, before the end of the eligibility period, the re-allocation of public funding from projects whose revenue was initially not well estimated to other operations within the operational programme. It has to be recalled that any *deduction* intervening after the submission of the application for payment of the final balance, or any *refund* within the meaning of Article 55(4), will give rise to a loss for the programme (i.e. because the corresponding amounts can no longer be used within the operational programme).

Monitoring system for operations subject to Article 55(2) and to Article 55(3) can be different because of the different purposes of such a system in the two cases. The purpose of a monitoring system for operations subject to Article 55(2) is closely linked to the implementation of Article 55(4): to detect cases where not all the revenue has been taken into account properly under Article 55(2) (i.e. there has been an omission from the initial calculation of the funding-gap of certain revenue sources or major changes in tariffs policy) in order to be able to launch a review of the funding-gap calculation. The review might use data from short-term surveys rather than from continuous monitoring of revenue.

Revenue for operations subject to Article 55(3), on the other hand, would need to be monitored continuously because Regulation No 1083/2006 requires the EU contribution matched by revenue generated to be *deducted* or *refunded.*

The arrangements for such monitoring systems are in any case to be decided upon by managing authorities.

This Information Note sets out certain suggestions as to those arrangements. They may consist of a contractual requirement for beneficiaries to report to the managing authority up to programme closure or for a further period of three years after programme closure. Another possibility would be the organisation within the managing authority of resources and procedures for processing such reports and for making repayments by beneficiaries to the managing authority (and also the European Union in case of refunding to EU budget).

4.6.2. Proportionality in the arrangements for monitoring revenue of projects whose total cost is below EUR 200 000

In line with Article 55(5), for operations whose total cost is below EUR 200 000, managing authorities may adopt procedures *proportionate* to the amounts concerned for the monitoring of revenues generated by such operations.

For operations subject to Article 55(2), Article 55(5) does not create an exemption to the application of the "funding gap" calculation. Instead, Article 55(5) implies that managing authorities may adopt proportionate arrangements for monitoring the revenue generated by those projects whose total cost is below EUR 200 000, once the revenue has been properly *estimated* and taken into account *in advance* for the determination of the contribution from the Funds in accordance with Article 55(2). Such arrangements could consist of checks to be made or reports to be provided less frequently than normal. For example, a report might be required only once before the sending of the closure documents. Such an obligation should apply at that stage at the latest, since it will be the last possibility for the managing authorities to adapt the final payment claim if necessary. Such arrangements, however, cannot involve a total waiver of the requirement to check or report the revenue situation.

For operations subject to Article 55(3) Article 55(5) means that less onerous arrangements for monitoring the revenue for operations whose total cost is below EUR 200 000 may be adopted (e.g. monitoring revenue period could be less then five years with extrapolation of revenue on five years period).

Finally, the Commission's services consider that the *proportionality* provided for in Article 55(5) also refers to the duration of monitoring after closure required by virtue of Article 55(4). It would not be in line with the will of the legislator expressed in Article 55(5), to allow for proportionate monitoring arrangements for those projects whose total cost is below EUR 200 000, to impose uniform constraints as to the period for monitoring of revenue generated, irrespective of the cost of the project.. As a consequence, the Commission's services consider that projects whose total cost is below EUR 200 000 may be exempted from the monitoring of revenue generated after the closure of the corresponding operational programme and no refunds, within the meaning of Article 55(4), will be required for them.

Pursuant to Article 55(5), this proportionate monitoring procedure will be without prejudice to Member States' obligation under Article 70(1) to "*prevent, detect and correct irregularities and recover amounts unduly paid*". Nevertheless, the Member States are entitled to adopt the monitoring systems of revenue generated they consider appropriate and proportionate for projects whose total cost is below EUR 200 000, including the possibility to cease monitoring revenue generated for these projects at the closure of their corresponding operational programme. Furthermore, when defining these proportionate arrangements, managing authorities have also the obligation to take into account the principle of equal treatment regarding the operations within the framework of operational programme concerned, which means that they must not introduce proportionate arrangements on an arbitrary basis but must do so based on objective considerations, and principally the total cost of the revenue-generating projects.

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Conclusions: The implementation of Article 55 requires the creation of a system for monitoring revenue by managing authorities or by beneficiaries. To this end, this Information Note makes a number of suggestions on how such a system could be structured and how procedures may be adapted to project size. Member States may adopt proportionate procedures regarding monitoring of revenue for projects below EUR 200 000.

5. APPLICABILITY OF ARTICLE 55

5.1. Article 55(6)

6. This Article shall not apply to projects subject to the rules on State aid within the meaning of Article 87 of the Treaty.

According to Article 55(6) the requirements laid down by Article 55(1) to Article 55(5) do not apply to operations subject to *State aid rules with the meaning of Article 87 of the Treaty*. This paragraph of Article 55 is in detail explained in information note to the COCOF on Article 55(6) of Regulation (EC) No 1083/2006.

Annex I:

Calculation of the Contribution from the Funds: a numerical example

The numerical example given in section 3.2.2. presents the calculation of the contribution from the Funds in discounted values. In order to derive the contribution from the Funds in non-discounted values, each discounted eligible expenditure has to be multiplied by $(1+r)^t$ where r stands for interest rate (recommended value of rate is 5%), and t for the year in which the related eligible expenditure occurs.

Using the same example given in section 3.2.2. and assuming that the project has the following cash-flow profile:

Year	Investment costs	Running costs	Revenues	Residual value	Net cash flow	Eligible cost	DEE	UDEE
2007	32,00	-	-	-	- 32,00	25,71	9,14	9,59
2008	25,00	-	-	-	- 25,00	20,09	7,14	7,87
2009	30,00	-	-	-	- 30,00	24,11	8,57	9,92
2010	25,00	-	-	-	- 25,00	20,09	7,14	8,68
2011	-	2,00	8,50	-	6,50	-	-	-
2012	-	2,00	8,50	-	6,50	-	-	-
2013	-	2,00	8,50	-	6,50	-	-	-
2014	-	2,00	8,50	-	6,50	-	-	-
2015	-	2,00	8,50	-	6,50	-	-	-
2016	-	2,00	8,50	-	6,50	-	-	-
2017	-	2,00	8,50	-	6,50	-	-	-
2018	-	2,00	8,50	-	6,50	-	-	-
2019	-	2,00	8,50	-	6,50	-	-	-
2020	-	2,00	8,50	-	6,50	-	-	-
2021	-	2,00	8,50	-	6,50	-	-	-
2022	-	2,00	8,50	-	6,50	-	-	-
2023	-	2,00	8,50	-	6,50	-	-	-
2024	-	2,00	8,50	-	6,50	-	-	-
2025	-	2,00	8,50	-	6,50	-	-	-
2026	-	2,00	8,50	5,00	11,50	-	-	-
Total	112,00	32,00	136,00	5,00		90,00	31,98	36,05
Discounted	99,63	17,83	75,79	1,88	- 39,79	80,06		

Where DEE stands for discounted eligible expenditure, UDEE stands for non-discounted eligible expenditure.

Contribution from the Funds in non-discounted value:

$$UG_{EU} = UDEE * CR_{EU} = 36.05*0.75 = 27.04$$

where CR_{EU} is the EU co-funding rate;

UG_{EU} stands for non-discounted contribution from the Fund.

For the sake of transparency, it is to be noticed that: (a) in case of project investment phase of one year the approach for calculation of the contribution from the Funds, presented in this note, leads to the same result as the approach presented in the working document n°4; (b) in case of project investment phase longer than one year, the results of the two approaches show an insignificant

difference. In fact, the approach presented in this note leads to a slightly higher amount of maximum eligible expenditure than the approach of the working document n°4[29]. It has to be recalled that for major projects, Managing authorities have to follow the method foreseen in Annex XXI of the Commission Regulation (EC) N°1828/2006 which corresponds to the method presented in the working document n°4.

However, for all other revenue-generating projects, they may choose one of these approaches, both compatible with article 55(2), for the calculation of the contribution from the Funds, which they consider appropriate.

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[29] Using the same assumptions as given in the example in section 3.2.2. and the given cash-flow profile, the approach described in the working document n°4 would lead to the contribution from the Funds equal to 26.96, which gives the difference of 0.301% between the two approaches,