General economics of motorway concessions: ART publishes two focuses on the profitability of concessions and risk transfers in contracts, calling for changes to the model

In the wake of its second report on the general economics of motorway concessions, the French Transport Regulatory Authority (ART) is publishing two focuses today, the first on the profitability of historic concessions and the second on risk transfers in contracts. The first focus presents, for the seven main motorway concession companies, the latest estimate of the internal rate of return on concessions (“project” IRR) calculated by the ART, which refers to the return on capital invested by all the financial providers (shareholders and creditors alike) over the entire term of the contracts. The aggregate "project" IRR for the seven historic private concessions, as assessed by the ART for 2022, is 8%, one percentage point higher than market expectations (7%), but consistent with the normal contingencies of a motorway concession. The second focus presents the issues associated with risk sharing in contracts and ways of optimising it to limit windfall effects. In both focuses, the ART proposes corrections to the concession model to prevent the toll from covering more than the concessionaire's costs.

When measuring the profitability of concessions, the ART focuses on the return on capital included in the calculation of tolls

Studying the profitability of a concession contract consists in measuring the proportion of the toll that remunerates the capital (i.e., all the funds contributed by shareholders and lenders) invested in the motorway infrastructure over the entire term of the concession. The exercise involves calculating a project internal rate of return (project IRR), which measures the average annual return on investment over the entire term of the contract. It is used to assess the extent to which the toll revenues collected over the entire term of the concession cover the costs, including a fair return on the capital invested.

The analysis of the profitability of concession contracts does not provide an appreciation of the conditions of privatisation, and this is not its purpose. Privatisation has had no impact on tolls: annual changes in toll rates depend essentially on the tariff law set out in the contracts.

The profitability of concessions is higher than market expectations, but consistent with the normal contingencies of a concession

The IRR measured by ART is 8.0% for the seven main historical concession operators.
This return is higher than average market expectations. Over the period extending from the origin of the historic motorway concessions to the present day, and for an investment of this type, these expectations are of the order of 7%. This means that at the end of the contracts in question, the revenues that will have been received over the entire duration of the contracts will very probably exceed the costs incurred over the same period, even taking into account a fair return on the capital invested.

Nevertheless, this forecast is not sufficient to establish the existence of manifestly excessive profitability, as this variance falls within the limits of the variations that may result from the normal contingencies of the concession. The operation of a motorway concession is subject to numerous uncertainties regarding its costs and revenues. These contingencies can have an upward or downward impact on profitability, and it is the very principle of a concession contract that the operator should bear them. ART’s analyses show that, given the risks transferred and the duration of motorway concessions, a difference of one percentage point in the concession’s IRR cannot be considered manifestly excessive.

It is difficult to determine the reasons for higher-than-expected profitability, which may be due to circumstances favourable to the operator or to the conditions under which contracts and their amendments were negotiated and applied.

A BETTER SUPERVISION OF PROFITABILITY IS NEEDED

The above analyses are not exhaustive of the debate on the profitability of concessions, since the high level of profitability observed may result, as the ART has documented, from imperfections in the concession model that can be remedied by concrete solutions.

From the point of view of regulation, the concession model can still be perfected: negotiations by mutual agreement on amendments for the construction of new infrastructure are often to the advantage of the concession operator; the wording of certain clauses in the contracts has enabled the operator to benefit from windfall effects; certain investments have been double compensated.

The overall economic regulation of the motorway sector therefore needs to evolve to provide a better supervision for the profitability of concessions. Tighter management of contracts and tighter control over the negotiation of amendments between the concession operator and the licensor would be a first step in this direction. In the medium term, and in the event of a renewal of the concessions, their supervision could be strengthened, by preferring shorter contracts and rethinking the regulatory framework applicable to amendments.

OPTIMISED RISK SHARING TO LIMIT WINDFALL EFFECTS

Risk-sharing" clauses must be used wisely and calibrated carefully. While risk transfer can be beneficial for users, by limiting fluctuations in toll rates and encouraging the concession operator to be efficient with the risks it controls, it can be costly when a contractual amendment is made by mutual agreement. Therefore, in the specific context of negotiating amendments, a
lesser transfer of risk, through the use of "risk sharing" clauses, would be appropriate to minimise the concession operators’ rents.

For further details (in French)
- The focus on the profitability of concessions
- The focus on the risk transfer in motorway construction, maintenance and operation contracts
- The second report on the general economics of motorway concessions
- The press release

About the French Transport Regulatory Authority (ART)
Since 2010, the French railway sector has had an independent authority to accompany its gradual opening to competition: the Autorité de régulation des activités ferroviaires (Araf). Law 2015-990 of 6 August 2015 on growth, activity and equal economic opportunity extended the regulator’s powers to road activities - coach transport and motorways. On 15 October 2015, Araf became the Autorité de régulation des activités ferroviaires et routières (Arafer), with the mission to contribute to the proper functioning of public service and competitive activities for the benefit of rail and road transport customers.

With competence for the regulation of airport charges since 1 October 2019, Arafer became the Transport Regulatory Authority (ART) on that date. Lastly, Law No. 2019-1428 of 24 December 2019 -mobility act- extended the Authority’s powers and missions to the opening up of mobility and ticketing data, as well as to the regulation of infrastructure manager activities and security activities carried out by RATP in Île-de-France.

Its opinions and decisions are adopted by a college of five independent members chosen for their economic, legal or technical skills in the field of digital services or transport, or for their expertise in competition matters. It is chaired since 4th August 2022 by Philippe Richert, Vice-President and Acting President.