

[Kibe-log]

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The “Availability Payment Method” is needed for infrastructure in Japan

Dear Stakeholders, I am Kazunari Kibe, the President and CEO of INFRONEER Holdings Inc.

Thank you very much for reading the "Kibe-Log" again.

Today, I would like to discuss the necessity of the Availability Payment Method, which has become mainstream in Europe and the U.S in PPP (Public Private Partnership) in our industry. The Japanese government named it “Index-Linked Outsourcing” and included it in its Basic Policy last year, indicating that the government intends to promote it.

The reason I chose this subject is that PPP has become more actively used in infrastructure development in Japan, and the Availability Payment Method is indispensable for promoting infrastructure maintenance and development on a full scale within the limited tax revenues in the public sector.

As I have repeatedly mentioned on this blog, the Concession Method is commonly used in Japanese PPP, in which the right to operate infrastructure is transferred to the private sector for a certain period for a fee. The operator, who acquired the right to operate the infrastructure, is responsible for its operation and maintenance based on the fee income generated by the infrastructure.

In fact, the Concession Method is adopted for six projects that our group companies operate and maintain, such as Aichi Prefectural Toll Road, Sendai Airport, Osaka City Industrial Waterworks, and Miura City Public Sewerage System (which started in April 2023).

Although the Concession Method is incredibly effective regarding the utilization of operating capabilities of the private sector in the public infrastructure operation, it has a weak point. This method cannot be applied to the projects that do not have direct fee income from users.

The Concession Method was introduced back in 2011 when PFI Law (Act on Promotion of Private Finance Initiative), regarding the promotion of the development of public facilities through private finance, was revised.

Looking back at the background of the introduction of the Concession Method, it seems that there was increasing awareness of the issue regarding whether it would be possible to maintain aging infrastructures only by tax revenue when entering a depopulating society. Additionally, whether the current infrastructures could be sustained without the introduction of know-how and funds from the private sector was a significant concern.

Thanks to the introduction of the Concession Method, the private sector's know-how and funds have been invested in operations and maintenance of airports, a portion of toll roads, and water and sewage systems.

However, if we look at the infrastructure around us, such as airports and water and sewage systems, the infrastructure projects that can gain fee income from users directly are quite limited. The reality is that there are many more free infrastructures, such as roads and bridges managed by prefectural and municipal governments.

So, how can we introduce the private sector's know-how and funds to maintain these free infrastructures? A promising solution is the Availability Payment Method I mentioned at the beginning of this blog.

What is the Availability Payment Method?

The Availability Payment Method is one of the Concession Methods, which is a public-private partnership framework where the government pays for the private company's performance during its operation, such as for 30 years.

Some people may argue that if the government pays the fee to the private company, it would be the same as the traditional method, where the government is involved in operations and maintenance of infrastructure.

What differentiates the Availability Payment Method from the traditional method is that, in addition to paying the fee to the private operator, the total cost of operations and maintenance can be reduced while maintaining the high quality of infrastructure by utilizing know-how and expertise of private sector. The government chooses private companies that can propose solutions and entrusts them with infrastructure operation.

As mentioned earlier, the Availability Payment Method is common overseas.

For instance, the M25 motorway, a freeway around Heathrow Airport in London, UK, is operated on the Availability Payment Method by Balfour Beatty, a major British construction company.

Although it is not clearly disclosed, the return on investment or EIRR (Equity Internal Rate of Return) seems to be able to exceed 10%.

As large infrastructure projects of this type are usually associated with new constructions, they are financed through long-term project financing. Considering the financial risks, such as interest rate fluctuations, I believe that this level of EIRR would be necessary.

Although the debate may be divided over whether this return is high or low, this method should lower the cost over the entire operation period compared to projects which the government operates and maintains by themselves. Otherwise, there would be no point in outsourcing the project to the private sector as a concession.

The reason why the “Service Purchase Method” does not work

In fact, there is a framework called the “Service Purchase Method” in PFIs in Japan, which is similar to the Availability Payment Method. It is named so as the government or municipal government pays the fee for purchasing services on public services provided by private companies.

Some people may suggest extending the Service Purchase Method to be included in PPPs. However, there is a problem with the Service Purchase Method. In most cases, as private companies in the project must follow the government's specifications, the opportunities for using their inventions and innovations in the private sector for public infrastructure projects are limited.

The law does not specify up to the specifications of this method, but the operational levels of the government do not allow the private sector to operate freely.

In addition to utilizing private financing, PPP aims to leverage the private sector's management know-how in public infrastructure operations to increase efficiency. However, if the freedom of private sector is constrained, traditional government methods are simply copied and outsourced to the private sector, which is almost meaningless.

Therefore, when the Availability Payment Method is introduced, it should be used together with a framework that enables private operators whose proposals meet quality standards to manage infrastructure freely using their know-how. The government should refrain from questions on operation method and maintenance details as in the case of performance orders.

The current PFI law allows only revenue-generating infrastructure to use the Concession Method. However, it is essential to seriously consider introducing the Availability Payment Method to optimize the operation and maintenance of all types of infrastructure.

Indigress a little, the current concession only focuses on existing infrastructure (brownfield) with fee income, leaving no room for newly developed infrastructure (greenfield) to apply for concession.

However, greenfield concession is now available in the form of "BT + C (concession)," where the private company builds (B) the facility and transfers (T) ownership to the public while remaining involved in the facility's operation. Examples of this method include the New Aichi Prefectural Gymnasium and the New Chichibunomiya Rugby Stadium.

The user burden on the current free infrastructures also needs to be considered

Moving back to maintenance of infrastructure, it is essential to discuss the user burden on free infrastructure, specifically after the Availability Payment Method's introduction.

Discussions with municipal government road operators revealed truck drivers often take local roads instead of charged highways to save money.

However, this increased traffic can cause rapid road surface wear and tear that requires costly repairs, leading to complaints in the community that the national government should cover the repair costs. It is understandable as the road maintenance costs are not cheap.

The Availability Payment Method can be utilized as one solution to repairing roads. However, for free infrastructure use such as local roads, tolls may need to be charged depending on vehicle type and frequency of use especially on local roads where many heavy vehicles like trucks pass.

Germany already does so, charging fees for some large trucks on the Autobahn known for its toll-free policy.

As the EU expands eastward and Germany becomes Europe's transportation hub, there has been a significant increase in truck traffic, primarily from Poland and Hungary, where they've become European Union factories. Many trucks pass through Germany daily.

In this situation, German people became aware and wondered whether it was appropriate to use German tax revenue for the road maintenance and environmental measures in surrounding areas. Then it was decided to impose the toll on the trucks passing through Germany.

London, as mentioned earlier, charges a driving fee into the downtown area, with different fees for electric and gas/diesel vehicles. The purpose of the fees is to ease traffic congestion in the downtown area and promote carbon-neutral policies.

Thanks to advanced technology, it is possible to capture a vehicle's passing by using GPS and other means without setting up entrance gates. It is not difficult to create a user burden system for local roads.

First, we need to promote the penetration of the Availability Payment Method. However, I think we cannot avoid considerations and discussions for a user burden system for free infrastructures such as local roads.

To promote the method's penetration, just like overseas, we should expand the definition of concession in Japan to include the Availability Payment Contract using the Shadow Toll Type (for example in case the roads, the fee is paid by the road administrator, not the road users), in addition to the operation of public facilities (the common name for concession in Japan up to now).