



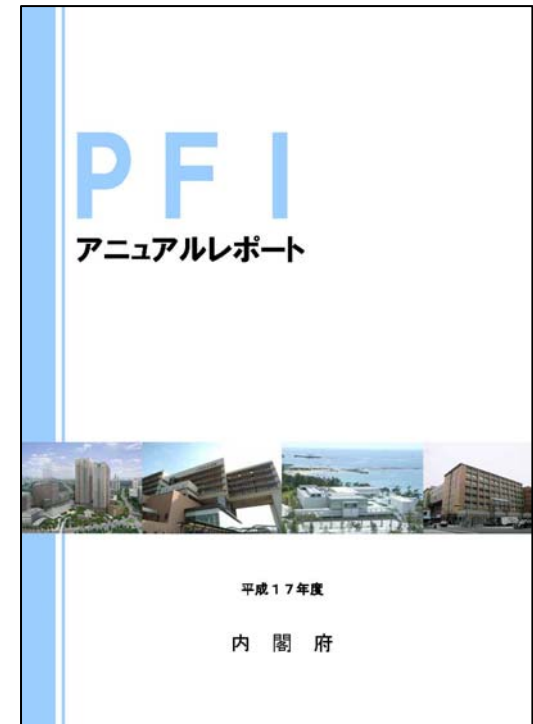
Cabinet Office, Government of Japan

Knowledge Sharing on Infrastructure Public-Private Partnerships in Asia

Day 3 Session 8:
PPP in the Social Sector

Japanese Public Finance Initiative (PFI) in School Sector

by Toshiaki Tashiro
PFI Promotion Office
The Cabinet Office of Japan



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Introduction of PFI in Japan

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Year	National Statute, Guidance etc.	University PFIs	
		MEXT (Ministry of Education, Culture, Sports, Science and Technology)	Number of Project
1999	Enactment of PFI Law		
2000	Publication of Policy Framework	Studies on the introduction of PFI begin	
2001	Release of <ul style="list-style-type: none"> · Process Guidelines · Risk Allocation Guidelines · VFM Guidelines 	Feasibility studies on the introduction of PFI to national university facilities begin	
2003	Release of <ul style="list-style-type: none"> · Contract Guidelines · Monitoring Guidelines 	Implementation of first national university PFI project	13
2004	Release of Interim Report of the PFI Promotion Committee	Establishment of national university corporations	10
2005			1
2006	Release of a guidance for dialogue (an arrangement paper by directors of relevant ministries and agencies)	Review of PFI projects already implemented, study for future PFI polices	1
2007	Report of the PFI Promotion Committee	Making a new policy regarding PFI projects by university corporations	1
2008		Study on monitoring for PFI	1
2009	Release of: <ul style="list-style-type: none"> · Basic Approaches to Issues on PFI Contracts · Basic Approaches to Service Specifications relating to PFI Contracts 	Start of projects that follow the new policy	(3)

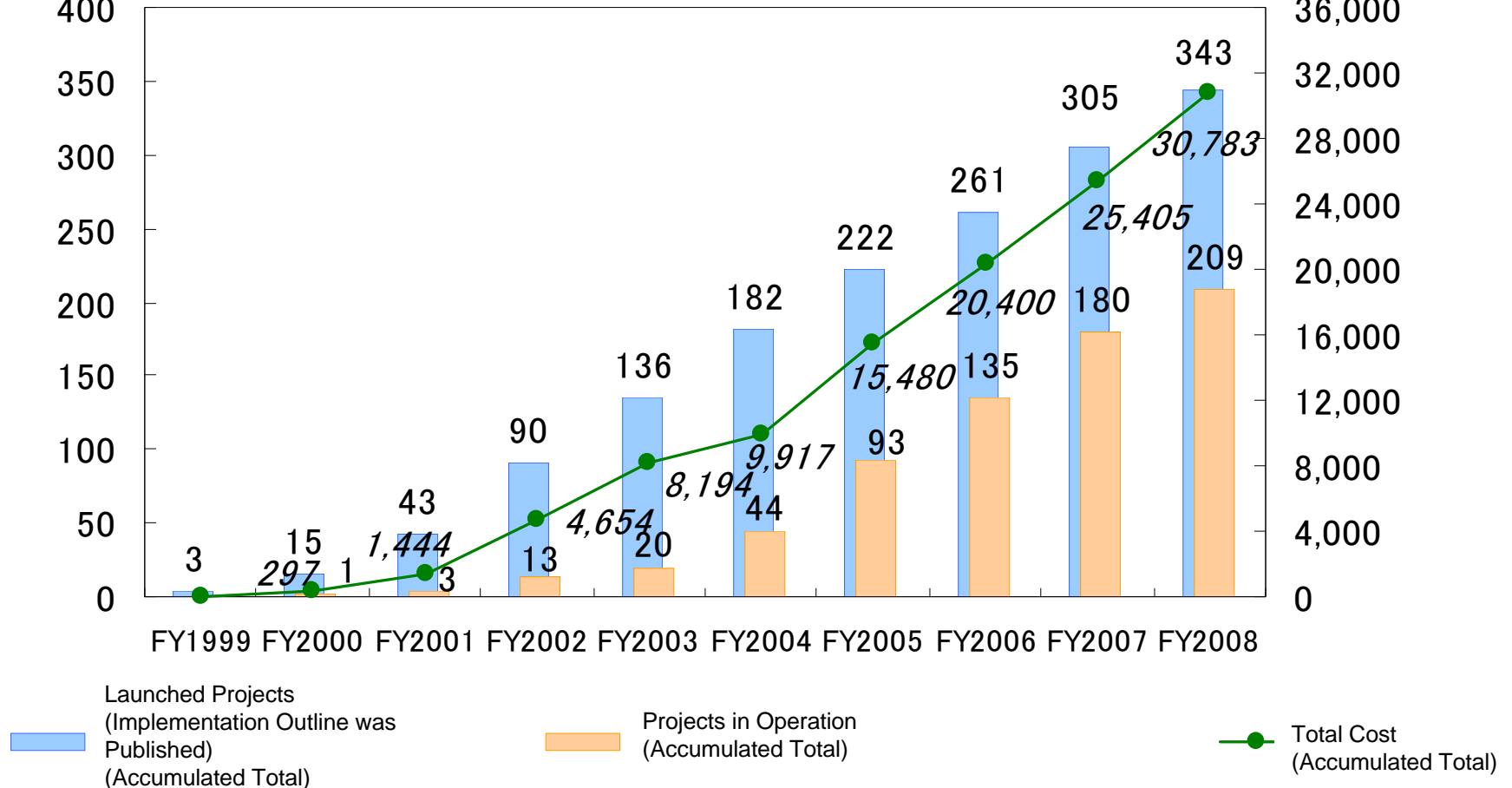


Growth in Number and Cost of Projects

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Number of
Projects

*Hundred Million
Yen*



※Including terminated projects



Number of Projects in Each Field

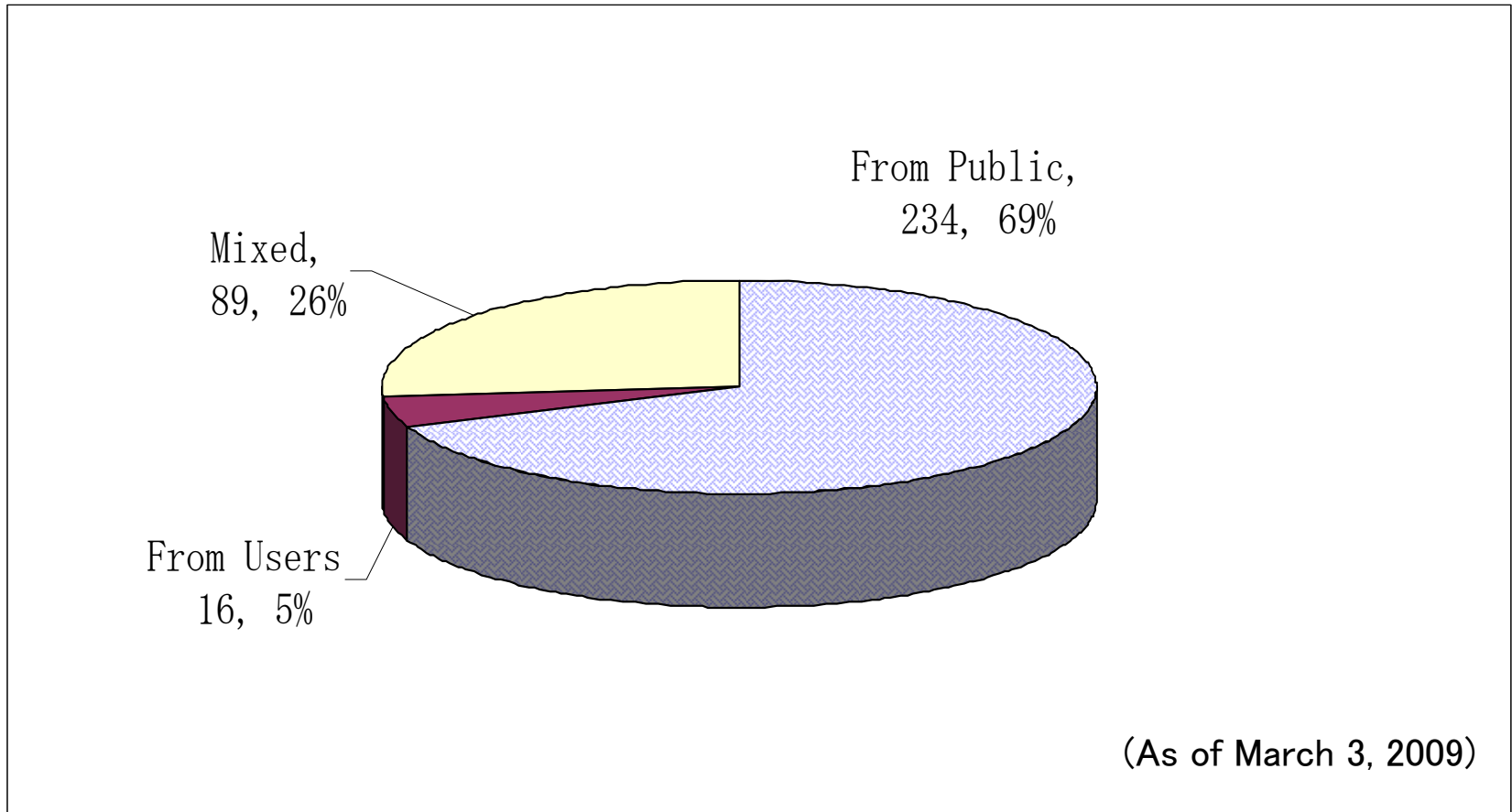
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Fields	Administrator			Total
	State	Local	Other	
Education and Culture (e.g. school, library, etc.)	1 (1)	78 (42)	29 (26)	108 (69)
Life and Welfare (facility for social welfare for aged, etc.)	0	15 (12)	0	15 (12)
Health and Environment (hospital, waste disposal facility, etc.)	0	59 (38)	2	61 (38)
Industry (sightseeing facility, etc.)	0	15 (6)	0	15 (6)
Town Development (parks, etc.)	6 (2)	31 (25)	0	37 (27)
Public Safety (police office, prison, etc.)	6 (5)	13 (5)	0	19 (10)
Government building and accommodation	41 (18)	5 (3)	1 (1)	47 (22)
Others (complex facilities, etc.)	2	35 (21)	0	37 (21)
Total	56 (26)	251 (152)	32 (27)	339 (205)



Types of Gaining Income

- Projects sponsored by governments represent nearly 70 percent of all projects





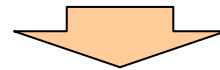
PFI Promotion Committee Report

Private Companies

Private companies are not satisfied with current situation because, from their experiences of actual projects, governments and private companies are not in equal positions

Governments

Some governments are reluctant to use PFI because it is burdensome, and not a method that can be easily used, and furthermore its benefits are not easy to confirm



PFI Promotion Committee Report (11/15/2007)

English outline is available at <http://www8.cao.go.jp/pfi/e/2issue.html>



University PFI Project

2003	14	National Graduate Institute for Policy Studies (School building) Research Institute for Humanity and Nature (Laboratory)
2004	10	Hokkaido University (Laboratory Renovation) Osaka University (Laboratory Renovation)
2005	1	Kobe University (Laboratory Renovation)
2006	1	Kyushu University (Laboratory)
2007	1	University of Tokyo Ocean Research Institute (Laboratory)
2008	1	University of Tsukuba (Hospital)

In Total: 14 Universities, 28 projects

Total amount of project costs: 250 billion yen (US\$ 2.5 billion)

Construction costs: 129.7 billion yen (US\$ 1.3 billion)

Total area of the buildings: 520,000 m² (Renovation 220,000 m²)



Background

Reasons to Introduce PFI Into National Universities:

- Necessity for improvement of deteriorated or overcrowded facilities
- Difficult fiscal situation (fiscal constraints due to increase of social benefits)
- Difficulty to provide new facilities that respond to new research needs





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University of Tokyo Communication Plaza Project



- Contract term: 2005-2023
- Project Cost: JPY 3.1 billion yen (US\$ 31 million)
- Contractor is responsible for design, construction, maintenance, operations (partially) and finance

Communication Plaza Project

Scope of Provided Services

Contractor is responsible for:

- Design and construction
- Hard facility management
- Cleaning
- Security
- Operation of stores
- Operation of bookstores
- Operation of restaurants
- Support of public sector's operation and study



Public Sector remains responsible for education



Communication Plaza Project Photos



Communication Plaza Project Project Type

Government-sponsored / User-sponsored

The project is sponsored by the public sector, that is the main revenue of the contractor is a service charge from the public sector, provided that the contractor runs restaurants and stores (the income from which becomes revenue for the contractor)

Operator: Private or Public

The public sector remains responsible for provision of core services

Public: universities, elementary and high schools, hospitals

Private: leisure facilities, waste disposal plant

BTO/BOT

North Building: BOT

South Building (“Japanese” Building): BTO



Communication Plaza Project Time Table

2004

- May 28: publication of the implementation outline
- August 12: announcement to use the PFI method
- September 8: tendering announcement
- December 21 and 22: submission of proposals

2005

- February 3: determination and announcement of successful bidder
- March 29: execution of the PFI Agreement

2006:

- April 1: Start of operation - North Building (no delay)
- October 1: Start of operation - South “Japanese” building (no delay)

2023:

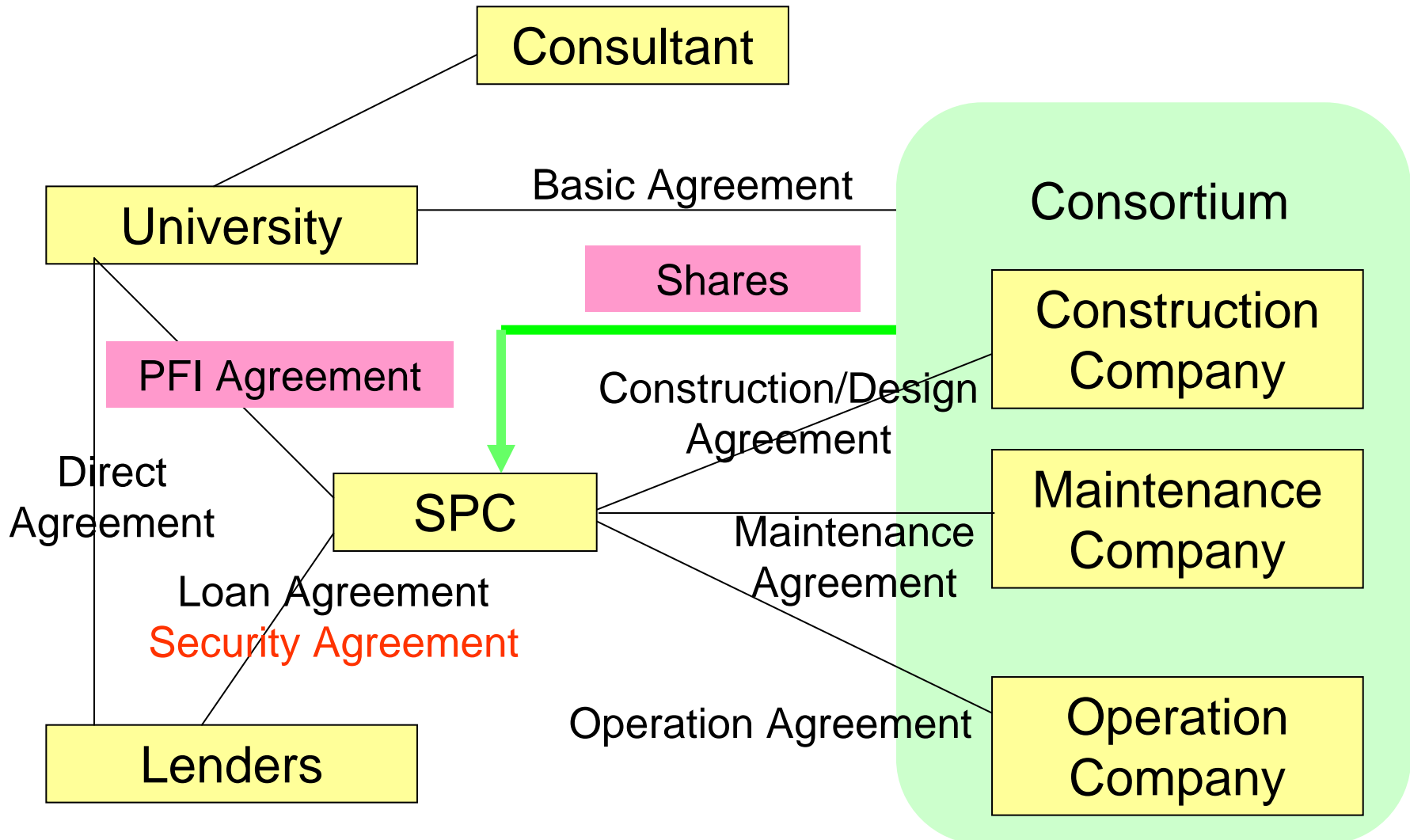
- end of operational stage

Communication Plaza Project Evaluation of Proposal

- The evaluation committee including external specialists evaluated proposals.
- Evaluation criteria includes 41 items (scenery, functionality, economic efficiency, construction plan, management ability, soundness of business plan, funding plan, etc.).
- The successful bidder earned the highest score in non-price evaluation, and proposed the second-lowest price.



Communication Plaza Project Contractual Arrangement





Communication Plaza Project Penalty

Penalty Points

Failure causes clear and serious interference with the use of the facility by students, staff, etc.	20 points
Students, staff, etc. may use the facility, but there is clear inconvenience	2 points

Reduction of Payment

- If the accumulated points in six months reach:

100-	no service charge for the service will be paid.
60-99	0.6 percent (per one point) of the charge of will be reduced.
30-59	0.3 percent (per one point) of the charge of will be reduced.
0-29	the service charge will not be reduced.



Communication Plaza Project Termination due to Contractor's Default

In the case of early termination due to the contractor's default, the contractor must pay the following penalty:

Before completion of construction:	10% of service charge for construction
After completion of construction:	20% of annual service charge for maintenance and operation

If damage exceeds the above amount, the public sector may seek the difference

Communication Plaza Project

Realized Benefits

Reduction of Project Costs

- bidders consider life cycle cost, example:
proposal of materials which enable cleaning cost deduction

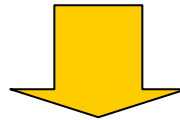
Improvement of Services

- service in restaurants improved and attracted visitors as well as students; as a result, sales increased
- high operating rate has been achieved
- layout attractive for customers was proposed

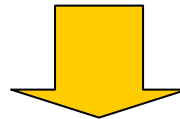
Communication Plaza Project Realized Benefit

How did Public Sector and Private Sector Cooperate?

Private Sector did not have sufficient information
about operation of universities



University prepared detailed specifications, however specifications
were presented only for reference purpose



Private contractor was able to propose a good solution which was
consistent with users' convenience

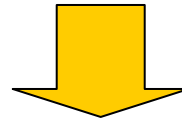
Example: non-binding drawings were presented by the
university, and the contractor proposed a more attractive layout
which was consistent with users' intention

Issues in Implementation

Scope of Services

When procuring authority determines the scope of services, they should consider the following:

- (i) is the private sector able to implement the service?
- (ii) will inclusion of the service be welcomed by potential contractors?
- (iii) will inclusion of the service lead to improvement of services in universities?



Approach

- ① Whether the Private sector has the relevant know-how:
Private Sector must have know-how and experiences regarding the service so that it may contribute towards efficiency and improvement of the service
- ② Risk allocation regarding the service must be clear

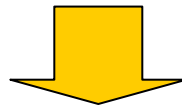
Issues in Implementation

Project Value Assessment (VFM)

VFM is assessed by comparison of the discounted public sector comparator with the discounted PFI life cycle cost

Difficult to understand the result of the VFM assessment because of the ambiguity of:

- (i) estimation of PFI life cycle cost, which is calculated by the assumption that each cost will decrease by a certain percent (called “reduction rate”), say 10%, through adoption of PFI
- (ii) determination of discount rate



- The use of “reduction rate” without reasonable grounds is discouraged
- In principle, 10-year average interest rate for the Japanese Government Bond (10 years) should be used as a discount rate

Issues in Implementation

Measurable Performance Issues

1. Difference in understanding service specification between Public Sector and contractor
 - As for service specifications and attachments, the distinction of binding part and non-binding part was unclear
 - Ambiguous service specifications led to low or unnecessarily high level services

2. Monitoring: scope and criteria was unclear
 - Monitoring methods were not fixed at the tendering stage
 - Monitoring by qualitative assessment has not been conducted
 - Necessity for preparing specifications for age-related degradation

Issues in Implementation

Measurable Performance Issues

3. Procurement and contract management by university
 - Private Sector needed to negotiate with various persons in the university
 - Users demanded something above service specifications at the design stage (i.e. after the execution of the PFI Contract)
 - It took more time at the design stage than the contractor expected
 - Contents of the design were not sufficiently explained to users



Issues in Implementation

Measurable Performance Suggestions

(1) Proper Project Management

The department in charge of procurement should collect opinions from users and adjust them

(2) Service Specifications

- Use of input specifications (slide 24)
- Attachment of Basic Monitoring Plan

In addition to clarifying service specifications, the basic monitoring plan should be attached to tendering documents

(3) Dialogue

Service specifications should be clarified through dialogue at the tendering stage

(4) Construction Monitoring



Issues in Implementation

Measurable Performance Suggestions

- **Use of input specifications**

Input specifications can be used in certain circumstances

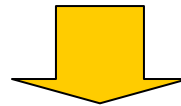
Suggested Format

Output	(1)AAA (output) (2)BBB (output) (3)CCC (output)
Input	(1)AAA (output) 【Binding input specifications】 XXX (input) (1)BBB (output) 【Input specifications for reference purpose】 YYY (input) ZZZ (input)

Issues in Implementation Construction Monitoring

Self-monitoring plays an important role in PFI projects, however:

- (i) several people were injured when an earthquake hit a defective building (not in school sector)
- (ii) in another project (not in school sector), a defect was revealed just before delivery of the building; the parties involved faced difficulties in dealing with it



Public Sector should monitor certain important points by itself

Issues in Implementation

Measurable Performance Suggestions

(5) Monitoring Method

- **Clear Monitoring Standard**
- **Satisfaction Survey**

Satisfaction surveys of users are useful, however the result should not cause the reduction of payment; instead, it should be used, for example

- (i) improvement of the future service
- (ii) bonus, and/or
- (iii) recovery points, which can be used to set off penalty points

(6) Construction and Maintenance Data

For the purpose of proper maintenance after the expiration of the PFI Agreement, construction and maintenance data should be maintained and transferred to the public upon the expiration



The New Policy for University PFI

Cabinet Office, Government of Japan

① Promotion of PFI with No or Limited Government Sponsorship

Examples: dormitory, parking, welfare service facilities, and industry-university cooperation facility

Project Scheme: in principle, financed by the project's operating income (rent fees, usage fees)

② Promotion of PFI Project by a New Scheme

Introduction of project mainly by self-help efforts of university corporations

Project Scheme: in principle, financed by university corporation revenue other than subsidy from the MEXT (e.g., charity funds, utilization of other subsidy system, operating income)



Combination Scheme

For the purpose of early provision of facilities for:

- (i) High-quality facilities for project research
- (i) Basic research and education - PFI projects that include both of the following should be implemented:
 - space for project research funded by the rent fees from research funds (BOT)
 - space for basic research and education funded by the government subsidy (BTO)

Three projects using this scheme have been launched and are expected to be tendered in 2009

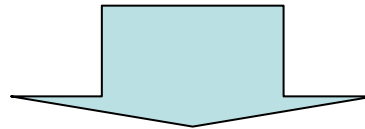


Elementary and High School PFI Project

Cabinet Office, Government of Japan

- **Necessity of earthquake resistant school facilities**
(Rate of earthquake-resistant buildings is 62.3% in public elementary and junior high schools)
- **Improvement of deteriorated facilities**
- **Improvement of facilities to respond to diversification of educational method**

Steady provision of facilities efficiently under limited budgets



Use of PFI for public school facilities
33 Projects (17 projects are at operational stage)



Elementary and High School PFI Project

Manuals for PFI of Public School Building Renovation for Earthquake-Resistance

MEXT prepared two manuals for PFI of public school building renovation for earthquake-resistance, and distributed them to local governments

- **Manual for PFI Feasibility Study:** VFM calculation sheet is attached
- **PFI Practice Manual:** Models of documents necessary for tendering are attached.

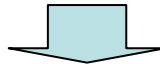


Contractual Issues

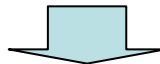
Basic Approaches to Issues on PFI Contracts:

History

Guidelines on PFI Contracts (June 2003)



PFI Committee Report (November 2007)



**Basic Approaches to Issues on PFI
Contracts (April 2009)**



Contractual Issues:

① Changes in services

- Since PFI contracts are long-term agreements, a mechanism is needed to enable adjustment corresponding to changes in the environment in the future
- Perceptual change is needed; the occurrence of the need for change cannot always be seen as a bad thing, rather, ignoring the need for change is bad

Creation of provisions to enable flexible change



- Change procedures do not work if the initial specifications are vague → Clarification of output specifications
- The relevant parties need to share information to enable objective determination of compensation or price variations
- In the case of change initiated by the procuring authority, the costs should be borne by the authority itself
- Small value changes → it may be a good idea for the parties involved to agree a price change formula in advance
- It may also be a good idea to provide reviews just before the operational stage and one year after the commencement of operation, depending on the nature of the project



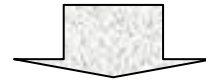
Contractual Issues:

② Changes in construction costs due to price level changes

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It is expected that the private sector will mitigate the impact of variations in construction price levels through innovative solutions; thus the risk of normal variations in construction price levels should be allocated to the private sector

However, in the event of rapid price level changes that were unforeseeable when the private sector submitted the bid, business structures may be weakened, and as a result, damage may be caused to the procuring authority



Price Adjustment due to Changes in Construction Costs

Provide the capacity for price adjustment in line with changes in construction costs.

- ① This is applicable only to rapid, significant, and normally unforeseeable price level changes
- ② Even if the procuring authority assumes the risk, the contractor should also take a share so that it has an incentive to manage risk
- ③ The formula for calculating the amount and the change procedure should be set forth in advance so that the contractor can properly evaluate the risk
 - need to consider the complexity of output specifications
 - using an index may be a good idea



Contractual Issues:

③ Price variations of soft services etc.

To protect against divergence from market prices, service prices are adjusted by index (for example, annually). However, such index-based adjustment is not sufficient to prevent divergence from market prices in the long term



For soft services, PFI contracts should provide the capacity for price adjustment to prevent divergence from market prices

- ① The contract should set the period for adjustment through comparison with the market price for each soft service.
→For example, five years, depending on the nature of the service
- ② Possible methods of adjustment are:
→Benchmarking, market testing (tendering by SPC), shortening the period of service, partial termination of the contract
✂It is necessary to understand the features of the respective methods and properly combine them in line with the nature of the services.

✂The services subject to adjustment here are mainly soft services; these do not include capital investment or related services, because they are difficult to compare with market prices.



Contractual Issues: Voluntary Termination

Necessity of capacity for voluntary termination etc.

Change in Policy of
Procuring Authority

Change in
Resident Needs

✕It is necessary to clarify the rights and obligations that apply when a contract is terminated to prevent the contractor and lender from being placed in an unstable position. There is also a need to enable the procuring authority to explain the matter to the residents through a transparent procedure.

Provide the right for voluntary termination by procuring authorities

Compensation to the contractor for voluntary termination

----It is desirable for items and calculation methods to be clearly set forth.

----Actual and reasonable losses should be properly compensated.

Senior lender	Penalties to compensate actual loss of senior lenders (e.g., interest swap cancellation costs)
Subcontractor	May involve a method by which no compensation will be paid if there is a period of advance notice (exception: when initial investment is involved).

• Future profits should be considered, but the scope should be limited.



Contractual Issues: Sharing and disclosure of information

Procuring Authority

Contractors sometimes refuse to deliver information requested by the procuring authority that is necessary to contract management for confidentiality reasons.

The information necessary for objective calculation of changes in price etc. is not shared between relevant parties.

Contractor

If the disclosure of information relating to know-how is forced, the private sector will lose its incentive for innovation.

Information necessary for the following should be shared:

Objective calculation of price variations in the case of periodical price adjustment, changes in services, termination by the procuring authority, etc.

Proper monitoring of performance by the contractor, and early obtainment of the information necessary for smooth continuance of the project

Sharing

Disclosure

- As a general rule, information received by the procuring authority should be disclosed to the public for the purpose of accountability to residents and widespread sharing of know-how.
- However, if there is no system to protect the know-how of the private sector, its innovation may be discouraged. Accordingly, we need to ensure that the interests of private companies are not improperly infringed.

Contractual Issues: Dispute resolution procedure

Setting of a place for communication

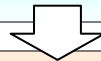
Face to face communication between the relevant parties



Prevention of disputes by establishment of mutual trust

Dispute resolution procedure

Discussion between parties



Neutral third-party involvement

Utilization of dispute resolution procedures involving independent specialists is also effective, depending on the nature of the project.

• For the time being, the use of a mediation procedure (where the determination of an independent specialist is unbinding) is assumed.

← For fear that the procedure will not be used because of the difficulty of appointing an independent specialist

• The contract should also provide for the continuance of services during dispute resolution.

Ensure
Specialty

Necessity of
resolving disputes
without destroying
good relationships



Litigation/arbitration



Contractual Issues: Changes in laws

Who bears increased costs resulting from changes in laws?

→ In principle, the party who can manage the risk most effectively will assume the risk.



Contractors cannot manage the risk.

Procuring authorities should bear the increased costs, except when:

The law change has a general effect.

The impact can be mitigated with reasonable effort from the contractor.

The impact can be passed on to users by, for example, increasing fees.

Points to bear in mind

- Capital costs should be borne by procuring authorities because such costs have individual characteristics and thus cannot be adjusted by indexes etc.
- In any event, the contractor should have an obligation to mitigate the impact.
- The contract should provide a procedure for use in the event of changes in laws, affecting areas such as notice and consultation (including discussion on how to mitigate the impact).

Contractual Issues:

Monitoring and payment mechanism

Integrated preparation of service specifications, monitoring and payment mechanism

A substantial part of the monitoring and payment mechanism – the part necessary for evaluating risk/cost and determining the price - should be disclosed at the tendering stage.

Establishment of an effective monitoring system

Process to fix the contents of monitoring

- It is effective to show a basic monitoring plan at the tendering stage, and to make detailed monitoring plans before the start of operation.
- Depending on the nature of the project, the monitoring items and method should be flexibly adapted to reality for a period of about one year after the start of operation.

Enhancement of contractor management ability, and enhancement of the contract management system of the procuring authority

- In projects where the operational stage of service is a high priority, it is important to enhance the contract management system of the procuring authority as well as the contractor's ability to manage each service.

Utilization of independent organizations

- As a method of examining improvements in service level, it may be a good idea to use evaluation by a third-party institution (a method used in the designated administrator system) as well as a satisfaction survey of users.

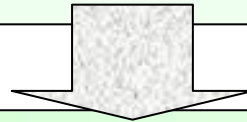


Contractual Issues: Monitoring and payment mechanism

Monitoring at the construction stage

Necessity of monitoring at the construction stage

- Discovery of defects at the building completion examination
- Accidents



Design Phase

- SPC examines design as part of self-monitoring.
- The procuring authority checks whether design documents satisfy output specifications.

Construction Phase

- It is appropriate to establish an effective monitoring system by showing the intentions of the procuring authority in regard to the standards to be used for self-monitoring.
- Though self-monitoring is a primary monitoring method, the procuring authority should monitor the important points itself.
- However, duplicate work or over-intervention should be avoided.



Contractual Issues: Monitoring and payment mechanism

To ensure an effective incentive to maintain service levels

Weighting

Penalties should be weighted according to the purpose of the project so that the contractor can understand the importance of each item.

Relationships between parameters

The contract should specify whether multiple deductions will be made if one event triggers two or more parameters (e.g., the breakdown of an elevator negatively affecting the performance of other services).



Contractual Issues: Monitoring and payment mechanism

Adjustment of service charge according to usage

In the case of government-sponsored projects, and if the costs of the contractor substantially increase due to high usage such as a rise in the number of visitors, the cost increase needs to be properly covered by the service charge.



If the cost of the contractor increase as a result of a rise in the number of visitors, as a general rule, the service charge should also be increased.

- It may be a good idea to limit the number of visitors according to capacity.
- Sufficient simulation of the contractor's cost structure is necessary when the payment mechanism is made.



Global Warming Prevention Measures in PFI Projects

Key point

- The most effective way of embedding in programs incentives to save energy is to include lighting, heating, and water utility costs in the project expenses.
- Thus, even if the initial costs are comparatively high, energy-saving equipment will be enthusiastically adopted if it is possible for such equipment to lower the overall project cost that include lighting, heating, and water utility costs.

