Japan: Kazusa cleans up

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Japan's promise of a vibrant PFI market is closer to fulfilment with the financial close of the ¥15 billion ($140 million) Kasuza waste disposal project. The deal is the first to reach this stage with the explicit granting of PFI status, although some local municipalities have made similar claims about deals that stick close to the spirit of the private finance initiative. Inevitably then, Kasuza is the best candidate for a template for doing business with Japan's fragmented local government.

The deal signed on July 19 between the Development Bank of Japan (DBJ) and Bank of Tokyo-Mitsubishi, and project company Kazusa Clean System KK. The project is by and large a Nippon Steel play ? it owns 49% of the equity and is carrying out the EPC work on the plant. Minority stakes are taken by Emuko (8.9%), Ichikawa Environmental Engineering (6.1%) and the four municipalities which will benefit from the work.

Kisarazu, Kimitsu, Futtsu and Sodegaura, all of which are located in Chibu province, have been disposing of municipal waste on four separate sites. The facilities currently in use are ageing and approaching the end of their natural life. The need to exploit the necessary economies of scale, and access the necessary calibre of contracting and financing partner, has led to the proposal for a joint disposal site.

The deal is projected to cut disposal costs by 30% and follows the broad outlines of PFI schemes, in that financing is repaid through revenue streams paid by the municipalities. These are derived from commissions paid to the project company according to volumes of waste handled.

The Kazusa project builds upon the foundations laid by the Tokyo Water Authority cogen plant, located across the bay from Kazusa. The Tokyo Metropolitan Government has awarded the concession for the ¥1.1 billion plant to Ishikawajima-Harima Heavy Industries (IHI), Electric Power Development Co. and Shimizu Corp. The build-own-operate (BOO) concession is located at the Kanamachi water treatment plant. IHI & Shimizu will carry out the EPC contract. Kanamachi has already signed a 20-year offtake deal with the private companies ? with DBJ and Dai-Ichi Kangyo Bank as lead arrangers.

However, crucially, despite the use of an open tender system (vital to convince the cynical of a more open procurement policy in the country) the deal came too early to be awarded PFI status. Given the slightly hazy nature of the relevant legislation already introduced it might be difficult to draw a line between the deals. Both projects, on the other hand, do receive subsidies commensurate with their status as environmentally desirable works. Kazusa is categorised as a wide-area waste disposal enterprise, meaning that both the national and prefectural governments will chip in.

Those close to the deal are eager to point out that Nippon Steel's technology has the potential to reduce dioxin emissions from the region's waste dramatically. Moreover, the two junior industrial partners represent the second main stated aim of the initiative ? to bring a private sector management ethos to a traditional stamping ground of the public servant.

And previous government attempts to stir the country from its spending slumber have served simply to hit the state coffers hard. If politicians are serious about their desire to spur the consumer into reactivating their sector, then tax cuts will have to be met by bringing the corporates in. And despite the lack of a more formal statement of measures than March 2000's PFI Promotion Law, the atmosphere, as far as most players are concerned, is relatively conducive.

For instance, the ability of governments to go beyond 10 years' concession length should encourage a serious private sector involvement, as would low-cost funding from the DBJ. Moreover, the system of requiring specific exemptions for private contractors in public works is almost over. Breaking the grip of local entities on works will not be a key priority, however.

There is as yet no indication that the Japanese government would move towards a UK-style system of standardised contracts, since no diversified project base exists. One school of thought also contends that certain projects will need greater doses of sweeteners before a suitable concession-holder can be found. Most of the projects close to financial close have had explicit subsidy support ? others may find that tax-breaks will be a more effective way of finding investment.

The ¥10 billion project debt is only the first part of the Kazusa debt, and a phase two, costing ¥25 billion, may emerge later. The current 200 tonnes per day will be increased to 500 in due course, although phase one only comes on-stream in 2002. Alterations to the contract structure cannot be ruled out, but the risk of upsetting the initiative will encourage a lenient line in any re-negotiation.

The next deal to come to the market is the Kanagawa social welfare university, which has been awarded to the Obayashi consortium. Kanagawa has a more sophisticated concession structure, since Japanese law, which states that educational assets remain in state hands, has led to the choice of a build-transfer-operate (BTO) deal. Nomura securities is examining placing the debt with interested institutions, possibly including the use of credit enhancements. Kanagawa is a strong credit, but the removal of the facility as collateral will create a sizeable shift in credit perceptions. The 30-year debt requirement could be as high as $110 million.