

# The Study of Asset Securitization on PFI Projects in Taiwan

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**Abstract:**-The private finance initiative (PFI) is a way of creating "public-private partnerships" (PPPs) by funding public infrastructure projects with private capital. Developed initially by the governments of the United Kingdom. PFI and its variants have now been adopted in many countries as well as in Taiwan as part of the wider programme of privatization and financialisation driven by an increased need for accountability and efficiency for public spending.

However for private sector participation the investment of huge capital in financing the construction of the public, in addition to its own funds, the financing loans to banks will be necessary, which make the liquidity and diversity of cash flow for private sector lower so reduces the willingness of the involvement of private sector. Therefore, this study by literature review and interviews with experts in Taiwan aims at providing a practical practice of applying asset securitization to PFI projects to activate the liquidity of the cash of private sector so that to increase the willingness of involvement of private sector.

**Keywords:** PFI, Asset Securitization, PPP.

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## 1. INTRODUCTION

The private finance initiative (PFI) is a way of creating "public-private partnerships" (PPPs) by funding public infrastructure projects with private capital. Developed initially by the governments of Australia and the United Kingdom, and used extensively there and in Spain, PFI and its variants have now been adopted in many countries as well as in Taiwan as part of the wider programme of privatization and financialisation driven by an increased need for accountability and efficiency for public spending.

However for private sector participation the investment of huge capital in financing the construction of the public, in addition to its own funds, the financing loans to banks will be necessary, which make the liquidity and diversity of cash flow for private sector lower so reduces the willingness of the involvement of private sector . Therefore, this study aims at providing a practical practice of applying asset securitization to PFI projects to activate the liquidity of the cash of private sector so that to increase the willingness of involvement of private sector.

## 2. PFI

In 1992, the UK Conservative Government engaged in private finance initiatives (PFI), which is a way of financing and operating public projects. It has been more than a decade since the first PFI project started in the UK. In the PFI procurement, the public sector

defines the requirements to meet public needs and ensures delivery of the outputs through the contract, and the private sector is harnessed to deliver better quality of public services (HM Treasury 2006).

PFI procurement allows the private sector to finance the capital cost for the projects, which is paid back by the public sector over a period of time—the concession period. The government assesses PFI by its commitment to “efficiency, equity and accountability, and on the Prime Minister’s principles of public service reform” (HM Treasury 2006, pp. 295). PFI provides innovative design and delivery of public services and “optimal” risk-sharing between the public and private sectors; therefore, the government claims that PFI can offer better value for money (VfM) than the conventional procurement (HM Treasury 2006, 1997). The incentive of PFI was to achieve closer partnerships between the private and the public sectors at both central government and local authority levels. The guiding principles of PFI are that risks in PFI procurement should achieve a genuine transfer to the private sector and to secure VfM when using the public resources (Allen 2001). Until now, PFI has been the first-choice procurement route for public service in the UK, providing most forms of public service provision, such as health, education, defense, residential, information technology, prisons, and roads. The number of signed PFI projects in the UK is 668 until September 2009, with a total capital value of over £55 billion (HM Treasury 2009). The main sectors among the signed PFI projects are the health and transport sectors, which both account for approximately 20% of the total capital value (HM Treasury 2009). The number of PFI projects in the operation stage has exceeded 500 [National Audit Office (NAO) 2007]. Some of the PFI hospital and school projects have been in operation for over 10 years.

The new characteristics of PFI are (1) public services provided by private sector; (2) integrated package of

design, build, finance, and operation of the project by the consortium; (3) the contract period is much longer construction contracts; and (4) new concepts, such as tendering process. The main advantages of PFI are improved efficiency, decreased inflation, reduced public sector expenditure, and expanded private financing of capital projects (Eaton and Akbiyikli 2005; Chang et al. 2010).

Unlike the other conventional construction contracts, the PFI contracts can be as long as 30 years. The contract design and contracting procedures is the key for public-private partnership (PPP) and PFI because well-designed and managed contracts are the mechanism by which risk is transferred to the private sector, and incentives are thereby introduced for good management of service provision (Palmer 2000).

It is said that PFI projects are mostly delivered on time and within budget compared with traditional procurement (NAO 2003), although some of the early school PFI projects showed high initial cost and poor quality (Audit Commission 2003). Until now, PFI has been introduced to many other countries, for example, mainland Europe, Australia, Canada, Japan, Brazil, China, and Taiwan.

### 3. Methodology

This paper first by the review of current legal right of property which constitutes the “transfer” defined in the article 51 of PPP Law.

(usually 25–30 years) than the conventional whole life costing and VfM, are introduced in the system in Taiwan, this paper explores the possible barriers and problems that the Asset Securitization on PFI projects might meet. Then interviews with 11 PFI and Asset Securitization experts in Taiwan were performed to evaluate the main issues and proposed process of applying asset securitization on PFI Projects.

### Legal Discussion on Asset Securitization on PFI projects

By the review of current legal system in Taiwan, this paper explores the possible barriers and problems that the Asset Securitization on PFI projects might meet.

#### 1. Is the transfer of Asset against the article 51 of PPP Law?

This issue could be discussed in the following two aspects :

##### (1) Does the transfer of asset constitute the “transfer” defined in the article 51 of PPP law?

Yes, according to Article 1 of Trust Law, either form of trust needs the transfer of a

##### (2) Is the right of asset to be transferred within the scope of the right which is forbidden to be transfer by the article 51 of PPP law?

There are two paragraphs of article 51, in the first paragraph it says “A private institution shall not transfer, lease, or create any encumbrance on, the concession obtained under the concession agreement nor shall it make such concession as the object for execution in a civil action, unless it is approved by the authority in charge that such an act is necessary for the improvement plan specified in Article 53 or the proper measures specified in Article 54 hereof.”, in other words, in the first paragraph what is forbidden to be transfer is the concession obtained, according to the letter of PCC, the concession refers to the concession to build and to operate.

## **2. Can the private institute be Originator of Securitization?**

According to the 1st paragraph of Article 4 of PPP Law , the private institute is defined as “a company established under the Company Law or any private juristic person as approved by the authority in charge which enters with the authority in charge into a concession agreement in connection with the participation in the infrastructure project.” And according to no. 1 of the 1st paragraph of Article 4 of Finance Asset Law “shall refer to a financial institution or an institution approved by the competent authority which entrusts

1. The operation assets and equipment are not required to be transferred to the government according to the concession agreement; or
2. Where the operation assets and equipment are required to be transferred to the government after the operation period expires according to the concession agreement, the operation assets and equipment may be transferred before the date set for transfer, with the condition of not affecting the transfer upon expiration; the term of lease or any encumbrance is limited to the timeframe of the permitted operation period.

financial assets (hereinafter referred to as the "Assets") to a Trustee or transfers the Assets to a special purpose company (hereinafter referred to as a "SPC") pursuant to the provisions of this Act, whereby the Trustee or SPC issues Beneficial Securities or Asset-Backed Securities on the basis of such Assets.”

In other words, if the private institute is not a financial institute, with the approval of the competent authority, the minister of finance, it still can be the originator in the finance asset law.

Moreover, according to the letter of minister of finance No.0928010999, "Once the Beneficial Securities or Asset-Backed Securities are approved according to the 1st paragraph of article 9 or article 73, the Originator on the securities are also approved by the ministry according to first clause of the 1st paragraph of article 4.

However in that letter it also says "If the originator is an institution other than a financial institution, the securities affixed to financial asset should be credit rated by the Credit Rating Agency approved by the authority per article 102 of Financial Asset Securitization Act."

On the aspect of Real Estate securitization, according to the Real Estate law the No.4 of 1st paragraph of Article 4, "Securitization" shall mean an act by which a trustee establishes a Real Estate investment trust (REIT) or Real Estate asset trust (REAT) pursuant to the provisions of this Act, and

acquires funds from issuing beneficiary securities to non-specific persons through public offering or delivering beneficiary securities to specific persons through private placement and No.6 of 1st paragraph of Article 4. 6. "Real Estate asset trust (REAT)" shall mean a trust established pursuant to the provisions of this Act, by which trustors transfer their Real Estate or relevant rights to a trustee to issue REAT beneficiary securities to non-specific persons through public offering or deliver REAT beneficiary securities to specific persons through private placement, evidencing the beneficiaries' rights to the Real Estate of such trust, relevant rights, or profits, interests, and other proceeds accrued therefrom. In short as long as the private institute has the right over the Real Estate, then he can be the trustor Real Estate Investment Trust (REIT) or the promoters of Real Estate Asset Trust (REAT).

**Table 3.**

PPP Law	Content
1 <sup>st</sup> paragraph of Article 4	The term "private institution" referred to herein shall mean a company established under the Company Law or any private juristic person as approved by the authority in charge which enters with the authority in charge into a concession agreement in connection with the participation in the infrastructure project.
Financial Asset Act	Content
No.1 of 1st paragraph of Article 4	"Originator" shall refer to a financial institution or an institution approved by the competent authority which entrusts financial assets (hereinafter referred to as the "Assets") to a Trustee or transfers the Assets to a special purpose company (hereinafter referred to as a "SPC") pursuant to the provisions of this Act, whereby the Trustee or SPC issues Beneficial Securities or Asset-Backed Securities on the basis of such Assets.
Real Estate Act	Content
No.4 of 1st paragraph of Article 4	"Securitization" shall mean an act by which a trustee establishes a Real Estate investment trust (REIT) or Real Estate asset trust (REAT) pursuant to the provisions of this Act, and acquires funds from issuing beneficiary securities to non-specific persons through public offering or delivering beneficiary securities to specific persons through private placement.
No.6 of 1st paragraph of Article 4	6. "Real Estate asset trust (REAT)" shall mean a trust established pursuant to the provisions of this Act, by which <b>trustors</b> transfer their Real Estate or relevant rights to a trustee to issue REAT beneficiary securities to non-specific persons through public offering or deliver REAT beneficiary securities to specific persons through private placement, evidencing the

	beneficiaries' rights to the Real Estate of such trust, relevant rights, or profits, interests, and other proceeds accrued therefrom.
No.16 of 1st paragraph of Article 4	16. <b>"Promoters"</b> shall mean owners of Real Estate, holders of related rights of Real Estate or cash financiers who are committed to investing in a REIT fund when the trustee applies for or registers the public offering or private placement of the fund.
Article 30	The property rights transferred pursuant to a REAT contract shall be limited to those prescribed in Subparagraphs 1 and 2, Paragraph 1 of Article 17 herein. The trust property of publicly offered REAT beneficiary securities shall be limited to Real Estate or related rights of Real Estate with stable income. The trustor shall cancel the lien registration on the property rights referred to in the preceding paragraph and submit related documentations to the trustee; in case the trustor is unable to cancel the registration for any reasons, the trustor shall submit a letter of consent notarized by a notary public stating that the mortgagee will not exercise the lien during the duration of the trust contract. The trustor shall provide the trustee with written documents of debt details and shall specify a period of more than one (1) month to notify the creditors for any objection during such period and submit the documents of such objection to the trustee.
Letter of Finance Ministry	Content
No.0928010999	Once the Beneficial Securities or Asset-Backed Securities are approved according to the 1st paragraph of article 9 or article 73, the Originator on the securities are also approved by the ministry according to first clause of the 1st paragraph of article 4. If the originator is an institution other than a financial institution, the securities affixed to financial asset should be credit rated by the Credit Rating Agency approved by the authority per article 102 of Financial Asset Securitization Act.

### 3. Can PFI projects comply with Budget Act?

According to the 1<sup>st</sup> paragraph Article 8 of Budget Act, "The legislative authority may make a Financial Commitment to authorize disbursement of expenses in the next four fiscal years as required by government agencies.", in which the Financial Commitment is defined as "the case wherein the legislative authority authorizes the administrative authority to bear debt through juristic act for the national treasury during the current budgetary fiscal year and commit itself to disburse the expenses in the following fiscal years." by article 7.

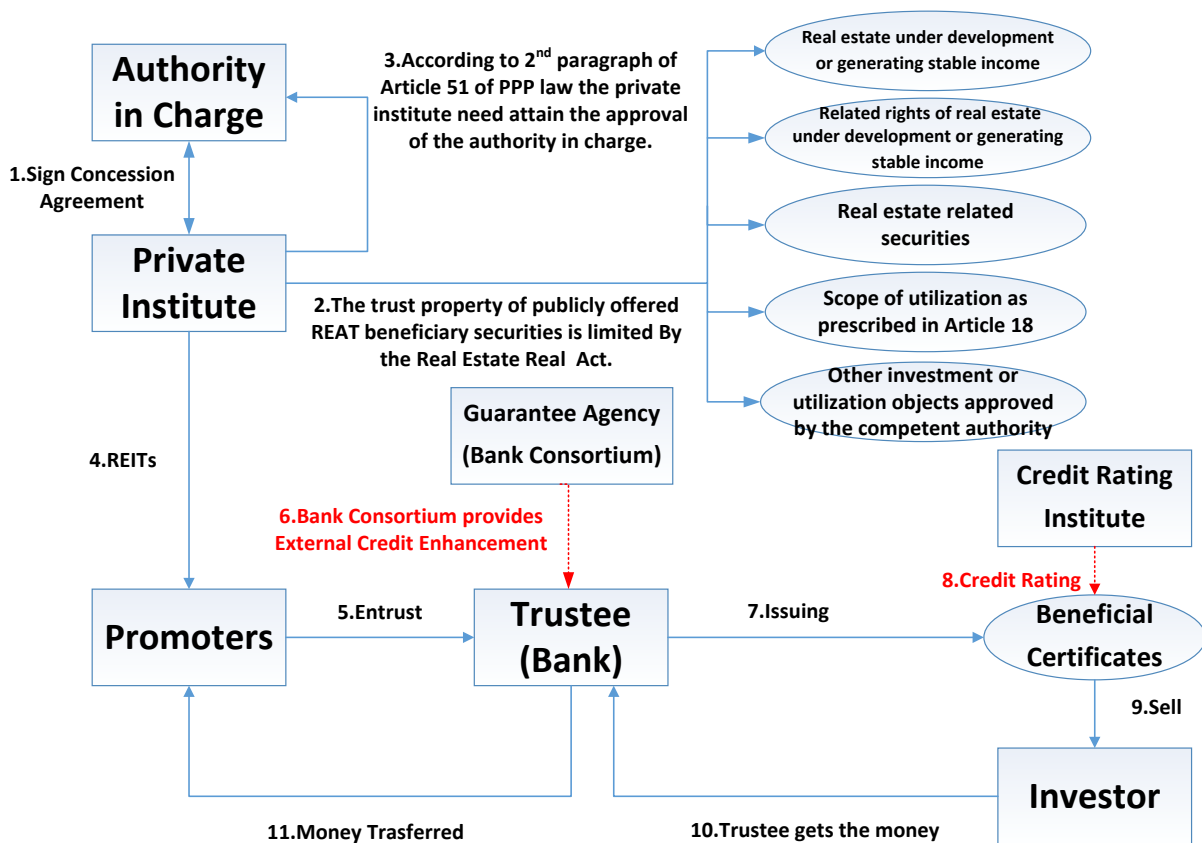
However, the term of most PFI projects is longer than 4 years, therefore a doubt of how PFI project comply with the budget Act is raised. However, Article 39 of budget Act states "The compilation of the budget of Allocations for Continuous Expenses shall state the contents, total expenses, implementation period, and quota for each fiscal year of the complete plan. The budget for each year shall be prepared according to the quota of each fiscal year." Therefore, the budget of long term project can be authorized by legislative authority according article 39 of Budget Act.

### REITs

The process of PFI project on REITs is as follows:

- (1) The private institution signed concession agreement with the authority, in which authority is defined according to the article 5 of PPP Law.
- (2) According to the Article 17 of Real Estate Securitization, it shall be one of the following 5 types.
  1. Real Estate under development or generating stable income;
  2. Related rights of Real Estate under development or generating stable income;
  3. Real Estate related securities;
  4. Scope of utilization as prescribed in Article 18; and
  5. Other investment or utilization objects approved by the competent authority.
- (3) According to article 47 of PPP Rule, if the asset is the operation asset, the private institution must attained the approval of the authority.
- (4) The private institution who owns the rights of the real estate can be the client.

- (5) The private institute acting as a client and start to look for suitable bank providing trust service as the trustee.
- (6) The trustee seek for the bank consortium as the guarantee agency thus to provide external credit enhancement mechanism.
- (7) The trustee taking the real estate as the subject of transaction issues beneficial certificates .
- (8) There is no binding regulation that states the necessary of credit rating, however credit rating increase the willingness of the investors to buy the certificates.
- (9) The trustee sell the beneficial certificates to the investors.
- (10)The trustee gets the money of the beneficial certificates.
- (11)The trustee transfer the money to the private institute.



**Fig 3. the Process to apply REATs in PFI**

4. Conclusions

The Private Finance Initiative (PFI) is a small but important part of the Government's strategy for delivering high quality public services."However the long term and huge amount of investment hinders the

wiliness of the private institutes, with securitization the efficiency of the cash of the private institutes increases, and thus this paper by analyze the legal environment in Taiwan and expert interviews proposes the practical process of applying securitization in PFI projects.

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