

Research on Legal Regulations of Infrastructure Leasing and Financial Services

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Abstract

The development of infrastructure construction project has been difficult due to limited sources of funding, and the traditional mode of investment and financing for infrastructure construction has gradually revealed many drawbacks due to such practical factors as limited local financial resources. With the expansion of the periphery of the subject matter, financial leasing has subsequently become one of the most popular forms of infrastructure investment and financing. However, compared with the United States and other developed countries where the financial leasing system originated, the legal system of financial leasing in China is not yet sound. Since real estate can be used as the subject matter of financial leasing transactions, China's lack of legislation in the legal regulations of infrastructure leasing and financial services has inevitably led to many risks and challenges in the specific operation of the business. Based on the analysis of the legal dilemma faced by China's infrastructure finance leasing, this paper discusses the way forward to improve infrastructure finance leasing, with a view to providing some reference for the further development of infrastructure finance leasing in China.

Keywords

Infrastructure Leasing and Financial Services; Legal Regulations; New-infrastructure.

1. Introduction

As a sunrise industry in China's financial industry, financial leasing is in the ascendant with the development of the times and the needs of reality, and its eligible subject matter is correspondingly in the process of continuous development. From the initial movable assets to real estate, and then to intangible assets such as software and copyrights, the periphery of financial leasing objects has been expanding. Besides, as early as when the *Measures for the Administration of Finance Leasing Companies (2007 Revision)* and the *Notice of the Ministry of Finance and the State Administration of Taxation Concerning Property Tax and Urban Land Use Tax (Cai Shui [2009] No. 128)* and other relevant laws and regulations were issued, the special type of real estate of infrastructure, as the foundation of urban survival and development, became eligible subject matter of financial lease.

The traditional project funds of infrastructure construction mainly come from three channels: fiscal tax revenue, debt revenue and bank loan. The practical factors such as excessive pressure of central finance and limited financial resources of local finance once made the development of infrastructure construction difficult, and the traditional investment and financing mode of infrastructure construction also gradually revealed many disadvantages. With the expansion of the periphery of the subject matter of financial lease, financial lease has become one of the most popular ways of infrastructure investment and financing. And thanks to its high credibility, stable payback capacity and implicit local endorsement, financial lease has also become a golden business with a low bad debt rate among many financial lease projects. [1] These

consequently make many scholars at home and abroad turn their research perspective to infrastructure financing lease.

2. Practical Difficulties of Infrastructure Leasing and Financial Services

From reform and opening up to 2015, the proportion of infrastructure investment in China's GDP increased from around 4% to around 15%. Infrastructure spending is increasingly dependent on debt financing, which has grown from about 7% of total investment to about 70%. [2] Compared with other debt financing methods, financial lease has irreplaceable significant advantages. Therefore, infrastructure leasing and financial services have also experienced a huge uptrend in the past 40 years. However, it cannot be ignored that infrastructure is different from general equipment, and as the subject of financial lease, it has inherent disadvantages, so infrastructure leasing and financial services also face many risks and challenges.

2.1. The Inherent Characteristics of Infrastructure as the Subject Matter of Financial Lease

2.1.1. Large Demand for Construction Funds

Developing countries have a huge demand for capital for infrastructure construction, and investment in this area is often insufficient, resulting in an imbalance between demand and supply of infrastructure assets. The World Bank estimated that unmet funding needs are equivalent to 1% of global GDP. [3] These projects cannot be financed only by financial sources and official development assistance, which require private financing and are highly dependent on social capital.

2.1.2. Strong Characteristic of Cost Accumulation

Almost all the six subsystems of urban infrastructure have natural monopoly which refers to the coexistence of a large number of fixed costs and a small amount of marginal costs. The laying of power supply, gas and heat pipeline networks in the energy system and the construction of bus lines in the transportation system make the fixed costs in the operation of these departments large, while the marginal cost of new users is small. [4] The initial capital demand of infrastructure construction is huge and highly accumulated. Particularly in the case of spillover benefits, except for a portion of projects where costs can be recovered over a longer period of time, a significant portion of projects form a cumulative sink, resulting in low or no direct returns.

2.1.3. Long Capital Payback Period

The profit level of large-scale infrastructure construction project in China is generally not high, and its capital structure determines that it is difficult to repay the loan principal. And the repayment period of construction funds loan is much shorter than the depreciation life of large construction projects, and the construction period and delivery period of large construction projects generally occupy 1 to 3 years. Even if all the depreciation cost is used to repay the loan, the accumulated depreciation cost is generally less than half of the loan principal until the loan maturity date, so that most new projects borrow new debt to repay old debts, creating a huge loan debt. A considerable proportion of operating income is used for loan repayment, and less funds are used for actual production and construction, leading to increasing difficulties in incremental investment.

2.2. The Real Risk of Infrastructure as the Subject Matter of Financial Lease

2.2.1. Policy Risk

In China, the development of infrastructure projects is mainly planned by the central or local government, so it's greatly affected by the policy environment. Thus, policy risks faced by infrastructure financial lease projects mainly come from the impact of national or regional

macroeconomic policies and development planning on projects. As can be seen from Table 1, in 2009, the central government launched the “Four Trillion Stimulus Plan” to resist the global financial crisis, the second of which explicitly pointed out that rural infrastructure construction should be accelerated. This measure undoubtedly greatly promoted the wave of infrastructure construction in China, and related infrastructure project financing also benefited from it.

However, with the decline of the growth rate of domestic infrastructure construction, the central government and relevant departments strengthen the supervision of financing in the field of infrastructure construction, which reduced the financing capacity of the industry and had a negative impact on the development of the industry.

In 2010, the State Council issued relevant regulations on the financing of local government financing platforms, forbidding the financing of public welfare infrastructure projects through financing platforms, and making strict provisions on the guarantee commitments of local governments. In addition, the four ministries and commissions jointly issued regulations in 2012 to strictly prohibit local government financing vehicle companies from financing directly or indirectly through leasing, trust, finance and fund companies.

Since then, corresponding financial leasing policies have been issued every year. As can be seen from relevant regulations, with the strengthening of supervision of local financing platforms, the development of infrastructure financial leasing business will also face certain policy risks. Additionally, leasing companies of different regulatory types face different regulatory policies, so the future changes in regulatory policies and regulatory pattern will have a great impact on different types of leasing companies.

Table 1. Key infrastructure policies at the central level from 2009 to 2020

Date	Title of Policy
2009	<i>Ten Measures to Further Expand Domestic Demand and Promote Economic Growth</i>
2010	<i>Circular of The State Council on Strengthening the Management of Local Government Financing Platform Companies</i>
2011	<i>Guidance of the Ministry of Commerce on Promoting the Development of Financial Leasing Industry During the 12th Five-Year Plan Period</i>
2012	<i>Circular of the Ministry of Finance, the National Development and Reform Commission, the People's Bank of China and the China Banking Regulatory Commission on Stopping Illegal Financing Activities of Local Governments</i>
2012	<i>Implementation Opinions of the Ministry of Commerce on Encouraging and Guiding Nongovernmental Capital to Enter the Field of Commercial Circulation</i>
2013	<i>Opinions of The General Office of the State Council on Accelerating the Development of Aircraft Leasing Industry</i>
2014	<i>Opinions of The General Office of the State Council on Supporting the Steady Growth of Foreign Trade</i>
2015	<i>Guiding Opinions of The General Office of the State Council on Accelerating the Development of Financial Leasing Industry</i>
2016	<i>Guidelines on Promoting the Integrated Development of Primary, Secondary and Tertiary Industries in Rural Areas</i>
2017	<i>Guidance on Actively Promoting Innovation and Application of Supply Chain</i>
2018	<i>Decision of the Communist Party of China Central Committee on Deepening Reform of Party and State Institutions</i>
2020	<i>Interim Measures for the Supervision and Administration of Financial Holding Companies</i>

2.2.2. Legal Risks

Financial lease related business is in full swing. Although the Document No. 68 of the State Council of Development (2015) [5] clearly stated that special legislation for the financial leasing industry would be studied and promulgated, China has not yet issued the Financial Leasing Law. At the present stage, financial leasing industry is subject to multiple supervision, the relevant legal system is not perfect, and the infrastructure financial leasing project lacks clear legal provisions. As for whether the real estate involved in the infrastructure financial lease project can be used as financial lease, there have been some conflicts in relevant laws and regulations, which could not play a correct role in guiding the industry.

Table 2. Laws related to financial leasing

Title of Document	Relevant Content
<i>Administrative Measures for Foreign Investment in Leasing Industry</i> (2005)	Article 6 The leased property referred to in these Measures includes (1) production equipment, communication equipment, medical equipment, scientific research equipment, inspection and testing equipment, engineering machinery and equipment, office equipment and other types of movable property; (2) aircraft, automobiles, ships and other types of transport; (3) intangible assets such as software and technology attached to movable assets and vehicles referred to in (1) and (2) of this Article, provided that the value of the attached intangible assets shall not exceed 1/2 of the value of the leased property.
<i>Draft Finance Leasing Law</i> (2006)	Article 2 The leased items applicable to financial leasing transactions shall be non-expendable movable property such as machinery and equipment.
<i>Judicial Interpretation of Contract Law IV</i> (2013)	Article 9 A financial lease contract in which immovable property is the object of the lease shall be null and void, provided that the object of the lease becomes attached to the land or is embedded in the land.
<i>Supervisory and Management Measures for Financial Leasing Enterprises</i> (2013)	Article 10 Financial leasing enterprises shall carry out financial leasing business with leased objects that have clear ownership, real existence and are capable of generating income rights.
<i>Measures for the Administration of Financial Leasing Companies</i> (2014)	Article 4 The leased items applicable to financial leasing transactions shall be fixed assets, except as otherwise provided by the CBRC.

As can be seen from Table 2, from the original movable property to the present real estate, such as roads, railways, rail transit, bridges and other infrastructure, and then to intangible assets such as intellectual achievements, the scope of leased property gradually expands with the issuance of relevant legal documents. Financial leasing of real estate such as infrastructure has also come within the scope of legal protection. However, despite this, infrastructure financial leasing projects still face many legal risks. The first is the industry legal risk, and the second is the project legal risk.

The legal risk of infrastructure leasing and financial service industry is mainly for infrastructure real estate financial lease project. According to relevant laws and regulations in China, financial leasing of infrastructure real estate has become relatively mature and operable. However, given that China's financial leasing system is not sound and the legal environment of the industry still needs to be improved, there will be certain conflicts in relevant laws and regulations to some

extent, accordingly there will be certain legal risks in practical operation. The project legal risk of infrastructure leasing and financial services mainly refers to the risk of profit loss to the leasing company caused by various reasons during the operation of a specific project. For example, the current financial lease registration system in China is not perfect, and there are often legal disputes in the later stage of the project when the lessee still takes the mortgaged infrastructure project or equipment as the lease. In the whole process of project operation, the lessee may face risk factors in every link from project contact, due diligence, project approval, contract signing to later-stage management.

2.2.3. Investment Risks

Governments and municipal utilities have major responsibilities for financing, building and operating core municipal infrastructure in areas such as roads, drainage, solid waste management, sanitation and water supply. However, these infrastructure investment needs cannot be met by existing city budgets alone. At the same time, the environmental problems facing the world today have increased the need for rapid mobilization of private finance for sustainable urban infrastructure and created new investment risks that need to be managed. [6]

3. New Way Out of Infrastructure Financing Lease

According to the United Nations Department of Economic and Social Affairs (DESA), the world's urban population will increase by 2.5 billion by 2050. Driven by the need for sustainable urban development and adaptation and mitigation of global climate change, there is a huge demand for financing urban infrastructure worldwide. Hence, exploring a new way out of infrastructure leasing and financial services is a necessary measure to solve the current predicament of infrastructure leasing and financial services.

3.1. New Infrastructure

New infrastructure refers to the construction of new types of infrastructure. China's Central Economic Work Conference first put forward the concept of new infrastructure in 2018. Up to now, there have been several central meetings or documents that have clearly indicated the strengthening of new infrastructure, which is rich in connotation of the new era. It not only conforms to the trend of future economic and social development, but also adapts to the needs of China's current stage of social and economic development and transformation. At the same time, it will become a new engine of social and economic development. Economies around the world attach particular importance to 5G base stations, artificial intelligence, industrial Internet and other new infrastructure areas. China, the US and other important countries have introduced relevant development strategies and policies. New infrastructure projects are on the forefront in 2020, and according to statistics, the total investment of new infrastructure projects is at least 50 trillion CNY at present. At the corporate level, investment in new infrastructure is also increasing. Tencent alone has announced 500 billion CNY in new infrastructure spending. [7]

In addition, according to the report, Biden is expected to announce a \$2.25 trillion infrastructure and jobs support package in Pittsburgh. He said he would make sure the US invested more in promising new technologies such as quantum computing, artificial intelligence and biotechnology. "We are going to make real investments," he said, "China is investing three times as much as the US in these infrastructures." Behind the boom of new infrastructure is the general trend of digital transformation. It is foreseeable that with continuous development and improvement, new infrastructure will become an important starting point and driving force for China to lead the technological and industrial revolution, develop the digital economy, and build a smart society and digital China. Based on this, this part

of the paper will study the development status of new infrastructure in China and the existing policies, and put forward policy suggestions on this basis, so as to provide some reference for promoting the projects of new infrastructure in various provinces and cities.

3.2. Feasibility Analysis of New-infrastructure Leasing and Financial Services

3.2.1. Comparison of Traditional Infrastructure Financing Models

Traditional infrastructure financing modes mainly include PPP, ABS, BOT, BT, TOT and financial lease mode. Infrastructure financial lease and other financing methods have their own characteristics, and the main differences are shown in Table 3.

Table 3. Comparison of infrastructure financing modes

Mode	Complexity /Cost	Project Ownership /Management Rights	Application Scope
PPP	Simpler	Model project sponsors	Large one-off projects
	Lower cost		
ABS	Like PPP	Special Purpose Vehicle (SPV)	Facilities or services that generate revenue through tolls
		Government (The original investor)	
BOT	Complex & difficult	The investor has the operation right and ownership during the concession period, and government takes back the ownership at the end of this period without compensation	Traditionally government-dominated operational infrastructure projects
	Financing costs increase due to intermediate links		
BT	Relatively simple	The funder has no ownership of the project and the ownership and operation rights belong to the government	Any infrastructure or development project
	Small financing costs		
TOT	Same as BT mode	Same as BOT mode	Operating infrastructure projects

Compared with the traditional infrastructure investment and financing mode, financial lease involves three contracts, but the operation is simpler and the financing cost is smaller. It is mainly applicable to the projects of pure operational infrastructure that can exert its benefits independently and achieve independent financial accounting. [8] For the right of construction and operation of the project and the ownership, the lessor has ownership of the leased property during the lease period and the lessee has only the right to use it. At the end of the lease term, the lessee can only acquire ownership of the leased property by way of a retention purchase. In terms of project risk, the government can avoid project risk under the mode of infrastructure leasing and financial services, and the cash flow of the project itself can reduce the risk of lessor to a certain extent.

3.2.2. Financial Lease of New-infrastructure Comes at the Right Time

As a systematic project, new infrastructure needs the wisdom and strength of all parties to advance it. In this process, government departments should have scientific and pragmatic development plans, constantly explore and innovate oversight methods, and create a more conducive institutional environment for innovation-driven development. At the same time, we need to make full use of market forces, explore innovation in investment and financing mechanisms, and fully unleash the market's internal driving force and innovation vitality, so that enterprises can truly ride the wave of new infrastructure and become new forces. Different

from traditional infrastructure construction, which is mainly invested by the government, new infrastructure focuses on market-oriented investment, with the government focusing on providing policy support and creating a good investment environment. New infrastructure involves the upgrading and integration of many industries, as well as the development of new business forms and new models, which will inevitably produce long-term and large-scale investment needs. Finance leasing companies are consequently ushering in a window of new infrastructure.

Data showed that investment in five new infrastructure sectors -- 5G, Artificial Intelligence, Internet of Things, Industrial Internet and Data Center -- exceeded 600 billion CNY in 2019. Total investment in the five sectors is expected to reach 10 trillion CNY in the next five years. [9] *Beijing Municipal Bureau of Economy and Information Technology also released the Action Plan for 5G Industry Development in Beijing (2019-2022)* in January 2019, which pointed out that Beijing would accelerate network construction and invest more than 30 billion CNY in 5G network by 2022. The core functional areas of the capital, sub-centers of the city, important functional areas and important places will be covered by 5G networks. The revenue of Beijing's 5G industry has reached about 200 billion CNY, and the scale of information service industry and new forms of business has exceeded one trillion CNY. [10] According to the *Shanghai Version of New Infrastructure Action Plan* jointly formulated by the Shanghai municipal government and the Shanghai Municipal Development and Reform Commission, Shanghai will support policy banks, development financial institutions and commercial banks to establish a special credit facility with a total size of over CNY 100 billion for new infrastructure at preferential interest rates. [11] It can be seen that there will be a trillion-level investment and construction every year.

Different from the real estate and infrastructure in the "Four-trillion Plan" [12] era, the investment in the 5G era will be in the upgrading of new business forms from chips and products to system networking and application scenario development. Financial lease, as one of the financing tools most closely combined with real enterprises, will make a great show in China's 5G network construction and application promotion, and further integrate industry and finance. [13] Additionally, driven by emerging industries such as digital economy and Internet economy, there is no doubt that big data-related industries will usher in an era of accelerated development, and the accompanying large investment demand will bring many opportunities to financial leasing companies. In many segments, the Internet Data Center (IDC) has become one of the most potential directions. In the future, explosive growth of data demand and land scarcity in first-tier and second-tier cities can effectively support the long-term upward trend of the industry, and its asset-heavy characteristics are highly compatible with financial leasing business. Finance leasing enterprises can give full play to the advantages of combining financing and financing to help IDC flourish.

Infrastructure development not only serves to improve people's wellbeing, but has a multiplier effect on economic and social development. In view of the reality of economic operation, it is inevitable to expand effective investment and foster new consumption by launching a round of infrastructure construction against the backdrop of the epidemic. Financial lease, as one of the financing modes of infrastructure, is bound to usher in a new tuye. However, opportunity and risk always go hand in hand. One of the attributes of the financial industry is the coexistence of opportunities and risks, including financial leasing. Therefore, facing the historical opportunity of new infrastructure, it is necessary for finance leasing enterprises to further strengthen risk prevention and control capabilities.

From the perspective of financial support, the yield of traditional infrastructure is stable but relatively low, and its financing source is single, mainly relying on bank loans, which makes it difficult to carry out securitization and financing innovation. While new infrastructure may have excess returns in the future. Its income sources are diverse and highly dispersed, and its

financing means are more suitable for securitization and financing innovation than traditional infrastructure. Therefore, finance leasing companies should fully understand the technical characteristics of new infrastructure projects and further innovate their business models. How to reflect and use the value of soft assets brought about by technologies related to new infrastructure and how to better grasp risks from the perspective of credit granting and risk control need further exploration. Finance leasing companies should train and introduce professional talents and expand business opportunities in emerging market segments based on their own advantages.

3.3. Policy Suggestions on Financing Lease of New-infrastructure

Above all, policy goes first, mechanism follows up. Government departments should intensify the promotion of new infrastructure-related policies while formulating functional industrial policies, and strengthen the top-level design of new infrastructure by formulating and planning construction guidelines and related rules. At the same time, the overall coordination between new infrastructure and traditional infrastructure should be strengthened, the coordinated development of various areas of new infrastructure should be enhanced, and the overall optimization of the whole new infrastructure system should be ensured, so as to make it better serve economic and social development. Besides, it is necessary to further strengthen coordination between departments and the upper and lower levels, establish and improve the mechanism for promoting cooperation among governments, enterprises, industrial organizations and alliances, and think tanks, as well as strengthen coordination and cooperation in technological breakthroughs and standard-setting.

Additionally, multiple measures should be taken simultaneously to enrich financing. In addition to further amplifying the leverage of financial resources for development and special government funds for strategic emerging industries and industrial transformation and upgrading, it is essential to actively guide private capital to increase investment, strengthen financing support for key projects, and encourage private capital to invest in new infrastructure development. Besides, support the establishment of RMB cross-border trade financing and refinancing service systems to provide RMB financing services for cross-border trade, and support the establishment of RMB cross-border trade financing support platforms to innovate overseas financing models.

Moreover, expand opening-up and achieve win-win cooperation. In the post-pandemic era, no country can stay immune. Only through openness and cooperation can the global economy get back on track and turn the crisis into a safe one. To further promote the building of an open world economy, government departments should step up efforts to support the development and construction of cross-border infrastructure in cooperation between domestic enterprises and overseas institutions. Domestic enterprises should seize the opportunity of international industrial restructuring and advantageous domestic production capacity going abroad, expand new business areas, seize the opportunity of digital transformation and upgrading of traditional infrastructure industry and technological innovation, and improve the quality of enterprise development. Translate the domestic competitive advantages of Chinese enterprises into strong support for the development of overseas business, and introduce the international operation experience into the domestic market, so as to realize the mutual promotion and organic circulation of domestic and international business, especially the introduction of foreign advanced design concepts such as green and energy saving into the Chinese market. And enhance the capacity to integrate international resources, and make use of cross-border industrial cooperation and third-party market cooperation to complement each other's strengths and achieve win-win cooperation.

4. Conclusion

Infrastructure leasing and financial services rely on strong institutional, fiscal and regulatory systems that developing countries often lack. Regardless of the financing method, accountability, transparency and efficient frameworks are prerequisites for attracting social capital into infrastructure development. Improving the capacity of city governments and utilities to attract and absorb social capital also requires sustained political commitment, an overhaul of national policies, and the strengthening of institutions related to infrastructure financing groups at national and local levels. At the same time, there is need to grasp the current reality and combine social needs to explore the new direction of infrastructure leasing and financial services.

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