

1. Current situation

- The government had insufficient capital to fund all the public works and services they desired
- PPP approach should only be adopted if the life cycle cost of the project is clearly lower than the estimated life cycle cost if procured under the traditional approach using a Public Sector Comparator
- In favour of allowing the private sector to deliver services for public consumption

2. Features

- The government offers the private sector the opportunities to compete to provide the service on a long-term basis. The private sector is required to finance the provision of the service in return for fees paid (either by the government or the end users as appropriate) for delivering the service. This single-point long-termed contract ensures accountability and long-sightedness in the venture
- The public sector client retains ultimate responsibility / accountability for the delivery of the underlying core services (such as clinical services) to the public
- The public sector client and private sector partner is spread over the term of the contract and is made only to the extent that the required outputs are maintained to the specified service standard
- The government provides an "output specification" describing the service it requires to be delivered by the private sector. This specification is framed in terms of the outcomes desired from the service. It does not prescribe the method by which that service is delivered or the facilities required to deliver it. [Use of output specification]
- The government can retain all fundamental control of the PPP in that:
 - ✓ If still decides on the level of services that are required and the public resources that are available to pay for them;
 - ✓ If sets and monitors performance standards for those services; and
 - ✓ If enforces those standards, taking action if they are not delivered
- The selected private sector provider proceeds to deliver the desired service, monitored by the government. Contractual penalties are applied if the provider fails to deliver to specified service. Mechanisms are provided to vary the contract should the government wish to alter the specified service
- Transfer of risk to private sector
- Performance measurement and incentives built into the franchise arrangements, which were the means of securing the delivery of the value for money promised in the original deal
- Ability to hold effective price-led competition within the PPP franchise award process
- Introduction of private sector management skills that are better able to deliver management and operational efficiencies
- The effect of the PPP is largely to replace the Government's requirement to provide upfront capital with a requirement to pay a recurring charge by way of a service fee throughout the length of the term
- Facing with a rapidly growing population that expects a high level of public service (eg in healthcare, education, security, transport and environmental services), PPP would provide an effective mechanism for expanding public services whilst maintaining a small, efficient government.

3. Advantages

- (a) Delivery of major facilities and /or services without upfront investment from the public sector client
- (b) Facilitating innovative and integrated solutions through the output-based performance award
- (c) Achieving better value for money by optimizing the whole-of-life asset management
- (d) Well-structured risk sharing between the public and private sectors
- (e) PPP take a total solution approach from inception, design, build, operate, service and ongoing enhancement which is of higher long-term value to the public
- (f) The construction of facilities includes design, actual construction & operation, there will be incentive to focus on lifetime costs and value
- (g) The private sector also has a strong incentive and freer hand to offer enhanced, higher value services to its customers and to strive constantly to meet best their changing needs, innovating where possible to improve performance
- (h) The quality of outcome tends to be high, reliable and accountable to the public because the output and responsibilities are clearly defined or specified in the first place and financial and legal liabilities are also in place for non-performance
- (i) The value of money benefits of PPP approach appear to derive fundamentally from the use of an output specification to obtain a privately financed long-term service that is awarded within a competitive environment
- (j) By procuring a long-term service financed by the private sector, the public sector provides itself with a way of transferring risk to the private sector, which has a strong incentive to manage it effectively. The consequences of cost overruns and or late delivery are particularly severe in a arrangement where the provider has its own equity at risk, highly leveraged with debt finance
- (k) It brings significant benefit to the community as a whole

4. Barriers to implementing PPP in HK

- The government currently budgets for and funds capital and recurrent expenditure separately and does not really acknowledge that there is any association between the two. The government needs to recognise that investment decisions impact on recurrent operating costs and that it needs to focus on the whole life cost of assets and the service they deliver. At the moment the government does not appear to know with any precision what the whole life costs of its assets are on a disaggregated basis because of the manner in which it accounts (recurrent expenditure is booked by department rather than by asset). If it is to proceed with PPP it needs to have this information so that it can set a public sector benchmark against which to assess PPP proposals
- The concept of an output specification and the PPP approach in general is a new concept for both the private sector and especially the public sector. If PPP are to move forward, new skills and attitudes will need to be learnt and new procedures for structuring, awarding and monitoring PPP will need to be developed. The PPP award process requires comparison between a number of often-disparate bids and frequently involves complex negotiation. Developing a transparent framework for this award

Handwritten notes: "BOT" and "C45/11" with a vertical line through them.

process and the skills within the civil service to apply it will be particularly important

- The government has a tendency to procure facilities and services on a fragmented basis with the result that transaction values are on average low. In order to achieve the "critical mass" needed to make PPP viable propositions, the government will need to bundle services more (e.g. procure a group of schools rather than individual schools)

5. Stages of PPP

← Duties of Gov.

(a) Construction Stage

- Review the design, construction, maintenance and facilities management procedures to ensure they are generally in compliance with the output-based requirements and proposals submitted by the contractor (without releasing him from his responsibility under the Project Agreement)
- Regularly monitor the contractor's progress to ensure it will deliver the specified facilities and services on time
- Carry out general administrative duties including implementing any changes in client's requirement
- Review testing and commissioning of the facilities upon completion
- Accept the new facilities for occupation and use, thereby triggering payments for facilities / services delivered thereafter
- Monitor the making good of defects by the contractor during the specified defects liability period

(b) Delivery Stage

- Review the delivery of services to ensure that they are in conformity with the specified performance standards
- Monitor the planned and emergency maintenance works including capital replacements
- Audit the contractor's activities in accordance with an acceptable quality management system
- Recommend payments of the unitary charges for the services provided
- Manage any changes in the client's requirements including the provision of new facilities/services
- Carry out general administrative duties required under the Project Agreement including dealing with such complex issues (if encountered) as
 - Change in consortium members,
 - Consent for refinancing proposal
 - Major default by the contractor, and
 - Dispute solution, etc.
- Where necessary, conduct dilapidation and condition surveys of facilities prior to them being handed over to the client at the end of the contract
- Once in operation, the output specification allows the delivery of the service to be monitored transparently and penalties to be applied in the event of the poor delivery. Better quality, more consistent services are provided as a result and there is better accountability when service standards fall

6. West Kowloon Cultural Development

- The government will not pay either an initial capital contribution or recurring service charges. All capital and revenue account liabilities will be for the account of the successful tenderer
- As it is rare for cultural facilities to provide a profitable return on investment, the Government proposes a 'barter' arrangement where the developer/operator will be allowed to include commercial and residential properties in the bid
- The successful tenderer will not be able to cut back on the cultural services element (at least in terms of the space devoted) to it as the canopy must not be reduced in size, and forms a natural barrier into which commercial development cannot encroach

6.1 Invitation For Proposal (IFP)

6.1.1 Features

The IFP sets out the Government's intentions and requirements for the development of the Project. It also provides guidance to Proponents on how Proposals should be developed and submitted together with the Government's assessment criteria.

(a) Mandatory Requirements

- The development of the Core Arts & Culture Facilities etc
 - ✓ Proponents do have some flexibility to plan, design, finance, construct, operate, maintain and manage the remaining developments outlined in the Government's Baseline. This is the Government's wish list but is not a mandatory requirement. Proponents can therefore distinguish their Proposals from others by development innovative commercial ideas which, firstly, satisfy the Government's Project objectives and secondly, maximize the chances of developing a financially viable Project.

(b) Proposals

- A technical Proposal: which includes a preliminary masterplan, a conceptual design, technical feasibility assessments and project management proposal;
- A financial Proposal: to demonstrate their financial capability, commitment to the Project and the long term viability of the Project; and
- An Operation, Maintenance and Management Proposal: which requires Proponents to submit a business plan explaining the Proponent's development mix and business strategy and plans for the operation and maintenance of the Core Arts and Cultural Facilities, and other facilities such as the canopy and the Pier.

(c) Assessment

- The Government's Assessment Process can be broadly divided into two stages: In the first stage, Proposals will be screened to ensure that they have complied with mandatory

requirement. If they don't, then the Government can request additional information or disqualify the Proponent. The second stage involves an assessment of each Proponent's Technical Proposal, Finance Proposal and Operation, Maintenance and Management Proposal marked out of total score of (eg 300)

- After the second stage, the Government may shortlist several Proponents and conduct negotiations before the Successful Proponent is selected
- Refer to diagram

(d) Provisional and Project Agreements

- The successful Proponent will enter into a Provisional Agreement with the Government which will set out each party's key obligation pending negotiation of the Project Agreement, the Basic Terms Offer Letter ("BTOL") and the Land Grant.
- The Project Agreement will document each party's obligations to the completion of the concession period and will include the Government's concession to the successful Proponent to plan, design, finance, construct, operate, maintain and manage the key facilities for that concession period. The Government has indicated that there will be considerable room for negotiation between the parties in relation to many aspects of the Project Agreement.
- The BTOL will set out the Government's terms of the Land Grant. Once the BTOL is accepted, the (50) year Land Grant will be prepared. In the interim, the Government will grant a short term tenancy or tenancies allowing the successful Proponent to commence construction work.

6.1.2 Project Concerns

Projects of the size, complexity and significance of the Project invariably generate some public concern. This is particularly with project evident that have lengthy operational periods. To alleviate public concerns, the Government has taken steps to ensure a wide section of the community is kept informed about developments. Examples include:

- ✓ Consultations with the real estate sector, professional institutes and the arts and cultural sector
- ✓ The development of a Project website
- ✓ Regular press releases, Q&A publications, LegCo Meeting papers and consultation forums

6.1.3 General (Public) Concerns

- Whether additional reclamation works are required
- Outline Planning Zone
- How the Government will ensure that a Project does not generate into a real estate development with second rate arts and cultural facilities and what monitoring measures will be put in place
- Whether the public in fact needs the specified various arts and cultural facilities prescribed in

the Invitation for Proposals (IFP) and whether Hong Kong needs a separate cultural district to house such facilities

- How local performance groups & the cultural community can become involved in the project
- Whether the Government, and therefore taxpayers, will be required to provide any finance to ensure the Project is bankable
- Whether the single-developer approach is appropriate or whether the Project should be divided into several packages to allow various local developers to participate. Artists, architects and some developers have recently openly criticized the Government's approach

7. BOT vs PPP

- Projects in BOT had relatively simple outputs and were often based on designs significantly advanced by the Government before they were offered to the private sector
- To the extent that the projects were already included in government development plan, the main driver to taking the BOT route was normally lack of public funds to complete them in the public sector. There was a pre-supposition that the projects would return to and remain in the public sector once the BOT franchise had expired. BOT was seen more as a means of acquiring a new asset rather than the end of acquiring a new long-term, service.

8. Considerations in the future

- A details review of overseas experience of PPP to establish current best practice
- Establishing the true life-cycle costs of delivering public services in HK to form a benchmark against which future PPP can be properly assessed
- Developing strategy for progressively introducing PPP to HK in a manner that maximizes their overall benefit
- Establishing the principles under which PPP should be awarded and taken forward, including the need for any regulatory change
- Identifying the pilot projects that should be used to test those principles
- Establishing training programmes to assist the public and private sectors in understanding the PPP process and how to implement it
- Educating the public the benefit of PPP

The body should have a limited life, say 2 years, within which time it would be expected to create conditions that would allow the government to implement PPP strategically and effectively