

**For information  
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**Consultative Committee on the  
Core Arts and Cultural Facilities of the  
West Kowloon Cultural District**

**Financial Matters Advisory Group**

**Public-Private Partnership and Public Sector Comparator**

**Purpose**

This is an introductory note on Public-Private Partnership (PPP), and the construction of Public Sector Comparator (PSC) and its relevance to PPP projects.

**PPP**

2. A PPP is one way for the public sector to involve the private sector in the delivery of public services. As the name suggests, this is based on a partnership approach, where the responsibility for the delivery of services is shared between the public and private sectors, both bringing their complementary skills to the enterprise. PPPs usually possess some of the following characteristics -

- (a) the Government defines the quality and quantity of services, and the timeframe in which they are to be delivered;
- (b) the private sector is responsible for delivering the defined services while the Government is mainly involved in regulation and procurement;
- (c) a long term relationship is established, typically between 10 years and 30 years, depending on the nature of the facilities, assets or services to be delivered;
- (d) responsibilities and risks are allocated to the party best able to manage them; and
- (e) the private sector is encouraged to make use of its innovation and flexibility to deliver good quality, cost-effective services throughout the project life cycle.

3. PPPs allow the introduction of private sector management, which is an effective way of bringing commercial disciplines into the provision of public services. The private sector's usual incentives, coupled with the competitive pressures of the marketplace, can lead to better quality services, delivered earlier and at a lower cost than under traditional means of public sector procurement. The bottom line incentives that motivate the private sector are a more powerful management tool than public sector controls, irrespective of how hard the public sector tries to replicate those same incentives in its own approach. PPPs also bring in innovation, creativity and efficiency of the private sector,

which are unlikely to be matched by the public sector which faces constraints such as budgetary and borrowing restrictions as well as civil service employment conditions.

### **Forms of PPP**

4. PPPs can take different forms. In fact, there is no concrete definition of PPP, with different jurisdictions having their own interpretations. For example, a PPP may take the form of -

#### ***(a) Private finance initiatives***

Under this arrangement, the public sector contracts to purchase quality services, with defined outputs, on a long-term basis, with the private sector maintaining or constructing the necessary infrastructure. It also covers financially free-standing projects where the private sector supplier designs, builds, finances and then operates an asset and covers the costs through direct charges on the users of the asset. Public sector involvement is limited to assistance with planning, licensing and other statutory procedures. In the United Kingdom, there are now over 600 signed private finance initiatives projects worth tens of billions of pound sterling. These include many schools, hospitals and various types of transport projects. The “former Marine Police Headquarters” is a local example where the private sector is responsible for preparing and

developing, at its own costs, the redevelopment and refurbishment of a building of historic significance into a heritage tourism facility.

**(b) *Franchises***

A franchise is a concession awarded by the Government to a private sector organisation to provide a public service for an agreed period. The private sector organisation usually pays a fee during this period for the revenue (or a share of the revenue) that the service generates. In Australia, for example, State governments have used franchises to upgrade/provide water treatment facilities and the distribution network. A recent local example is the Ngong Ping 360 (formerly known as the Tung Chung Cable Car) Project. Under a 30-year franchise, MTRCL is granted the right to design, construct, operate and maintain the Cable Car System and pays a royalty to the Government.

**(c) *Joint ventures***

These are partnerships in which public and private sector partners pool their assets, finance and expertise under joint management to deliver long term growth in value for both partners. The AsiaWorld Expo at the Hong Kong International Airport is a local example of joint venture arrangement involving a tripartite agreement between the joint venture company (of which the

Government and the Airport Authority are members), construction company and management company.

### **Cultural Policy Objectives**

5. At present, the Government is inclined to adopt the PPP approach for developing the WKCD, with a view to meeting the following cultural policy objectives –

- (a) to foster the principle of “partnership” between the Government, the private sector and the arts and cultural community in the development of culture and the arts through the WKCD project. This would be in line with the Government’s cultural policy that the Government should perform the role of a facilitator, providing a favourable environment for the development of culture and the arts; and
- (b) to ensure the sustainable operation of the WKCD by –
  - (i) sharing financial risks with the private sector;
  - (ii) enlarging the scope for market creativity and innovation through a financially self-standing, non-Government operation mode as desired by many practitioners in the arts and cultural sector;
  - (iii) providing reliable streams of income to support the long term planning of arts and cultural

programmes by saving their need to compete for recurrent public funding with other policy areas of higher social priorities; and

- (iv) limiting any intervention by the Government and the legislature in cultural matters for a more liberal and open society, and greater diversity in arts and culture including minority arts.

6. The Government however does not plan to invite private developers to develop the arts and cultural facilities in the WKCD. This function could be vested in the statutory body to be established for the WKCD in future. The private sector could provide a funding source, both on a capital and recurrent basis, for the statutory body to develop and operate these facilities under a PPP approach.

### **Detailed Arrangements for PPPs**

7. It is important to remember that the detailed arrangements for PPPs can and should be crafted individually to suit the particular circumstances that are encountered in each instance. It may well be the case that some forms of PPP mentioned in paragraph 4 may not be suitable for certain arts and cultural facilities to be provided in the WKCD. It may be necessary to adopt different forms of PPP for different facilities. The detailed arrangements have to be carefully considered to ensure that our cultural policy objectives (see paragraphs 5 to 6 above) will be met. In any case the development process

should be highly transparent, in line with other PPP projects.

### **Establishing Value for Money under PPPs**

8. As in other public projects, it is important to establish value for money for PPPs. Establishing value for money involves both quantitative and qualitative analyses. Quantitative analysis focuses on the cost-effectiveness of adopting the PPP approach. It is an objective comparison of the costs of the PPP options against the public sector alternative. It often involves constructing a Public Sector Comparator (PSC) (see paragraphs 11 to 12).

9. Qualitative analysis takes into account policy considerations and intangible benefits brought by adopting a PPP approach. Strictly speaking, if a firm decision has been made that the PPP approach is to be followed for policy reason or where no public money is involved because the project is financially free-standing, a PSC needs not be constructed. This was the case of the development of the WKCD under the original Invitation for Proposals (IFP) process.

10. As mentioned in paragraphs 5 to 6 above, the Government at present is inclined to adopt the PPP approach for developing the WKCD to ensure that our cultural policy objectives will be met. However, as different forms of PPP may be adopted for different facilities, there may be merits for the Government, with the assistance of a Financial Advisor (FA), to construct a PSC for the Core Arts and Cultural Facilities

(CACF) to be re-confirmed for the WKCD. This would allow different forms of PPP to be assessed quantitatively in future. It will also address Legislative Council (LegCo)'s concern that a PSC for the WKCD should be constructed<sup>Note 1</sup>.

### **Components of PSC**

11. A PSC is the hypothetical, risk-adjusted, cost of the Government itself delivering the project output. The PSC is expressed in terms of the net present cost to the Government of providing the output under a public procurement, using a discounted cashflow analysis that adjusts the future value of the expected cashflow to a common reference date. The PSC has three core components -

- (a) raw PSC (the base cost of delivering the services specified in the project brief under the public procurement method where the underlying asset is owned by and the services delivered by the public sector);
- (b) competitive neutrality adjustment (this removes any net advantages or disadvantages that accrue to a Government business by virtue of its public ownership, e.g. tax advantages); and
- (c) the value of transferable risk (risks which the

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<sup>Note 1</sup> As advocated by the LegCo Subcommittee on WKCD Development in its Reports on Phase I and Phase II Study published respectively in July 2005 and January 2006.

Government would bear under a public procurement but is likely to transfer to the private sector, e.g. the risks involved in design and construction, and subsequently in patronage and revenue generation).

In addition, a further component, the value of retained risks (risks that are likely to be retained by the Government) should be added to the private bids to determine the true cost to Government under a proposed partnership model. For example, in the case of a design-build-operate contract for an incinerator, the private contractor may be required to comply with certain requirements on emission standards. The Government should bear the risk if such standards are subsequently tightened, and requires additional expenditure in order to achieve compliance, after the signing of contract. These costs may be calculated and added to the value of retained risks depending on actual circumstances.

### **Limitations of PSC**

12. PSC is an estimate based on an outline reference project. Experience overseas indicates that a PSC cannot be calculated exactly. It should be expressed as a range of values and may be updated to reflect any changes in assumptions. Insofar as the current practice in the United Kingdom and Australia where a PSC is drawn up, this is increasingly used as a reference tool only. It should be realised that the PSC is merely one of a number of assessment tools which may be used in preparing for a PPP approach to

the delivery of services but not a pass/fail test.

**FMAG Secretariat  
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