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Hong Kong Government support for PPPs

The Hong Kong Government recently released its policy position on Private Public Partnerships. Partners, Alan Millhouse and Matthew Barnard and Lawyer Clare Lennox look at the main points of the policy.

The HK Government acknowledges the benefits of PPPs

Increasing pressure on public finances, particularly on capital expenditure budgets, has focussed interest on private sector involvement in the delivery of public infrastructure and services. Inspired by the apparent success of Public Private Partnerships (*PPP*) in the UK and in other countries, the Hong Kong Government released *Serving the Community By Using the Private Sector – An Introductory Guide to Public Private Partnerships* (the **Guide**) in August this year with the view to encouraging private sector involvement in the provision of infrastructure and services. The Guide builds on the broader policy principles contained in the Private Sector Involvement Program, 'Serving the Community by Using the Private Sector' introduced by the Hong Kong Government in June 2001.

The Hong Kong Government acknowledges the major benefits of PPPs as being essentially:

- Value for money – Greater value for money and increased efficiency when compared with similar projects delivered on a traditional procurement model. The whole-of-life approach that integrates the different functions of design, construction and operation enables synergies to be realised and discourages low capital expenditure/high operating expenditure solutions.
- Harnessing private sector innovation and expertise – The private sector can contribute management skills and innovation, leading to reduced project costs, increased efficiencies, improved design, construction, and operation of assets and services.

- New investment opportunities – The PPP model leads to new investment opportunities. This is demonstrably the case of financially free-standing projects or with joint ventures in which the private sector is only looking for a limited input of public funds. In those cases, projects may proceed which would not have occurred had they been mainly dependent on public funds.
- Transfer of risk – Risks can be allocated more efficiently by allocating to private sector the responsibility for managing and delivering services, and to the public sector the responsibility for policy and legislative frameworks. The PPP process has the capacity to apportion risk to the party best able to manage it, resulting in fewer contractual disputes.

Key features of the Guide

Some of the key issues dealt with in the Guide are:

Focus on output specifications

The public sector's requirements are to be specified as outputs required, allowing the private sector flexibility to devise innovative solutions over the whole life of the contract.

The PPP process has the capacity to apportion risk to the party best able to manage it, resulting in fewer contractual disputes.

Public Sector Comparator

The Guide identifies the Public Sector Comparator (PSC) as a critical part of the process. The construction of a PSC will be necessary to test whether any private investment proposal offers value for money in comparison with the most efficient form of public procurement. The PSC is the hypothetical cost of government delivering the project output specifications based on the most efficient public sector method of providing the defined output, taking account of the costs and risks which would be encountered in that style of procurement.

In contrast to other jurisdictions, the Guide provides that, in circumstances where no public money is involved because a project is financially free-standing, or where a firm decision has been made that the PPP approach is to be followed for policy or qualitative

reasons, no PSC need be conducted. However, the Guide states that client departments will still wish to establish value for money, especially if public land has been provided below market value.

While there are mixed opinions on whether the final PSC should be provided to bidders, the Hong Kong Government intends that the PSC will be publicly available by the time the request for proposals is issued, the rationale being that providing the PSC to bidders will discourage them from submitting tenders higher than what is in effect the project's financial ceiling.

Optimal risk allocation

The Guide recognises that appropriate allocation of risk between the public and private sectors is a key requirement for the achievement of value for money in PPP projects. Experience elsewhere indicates that risk transfer does not have to be total but rather should be optimal. If government attempts to impose excessive risk transfer on to the private sector, this will result in tenderers charging an excessively high premium or simply refusing to accept the risk altogether.

The Guide notes the public criticism in other countries where the private sector has generated 'windfall profits' from project refinancing.

Project management structure

An 'Intelligent Client Team' (ICT) will oversee project progress from start to completion, assisting, advising and reporting to the head of the department responsible for the project. The team may comprise of members from the client department, other departmental staff and private sector experts/advisers.

The refinancing of PPP projects

Given the prolonged duration of most PPP projects, financiers, project sponsors and governments will need to anticipate the likely requirements for any refinancing that may occur. During the life of the project, the project company may wish to replace or change the structure, nature or terms of the financing package. However, the Guide notes the public criticism in other countries where the private sector has generated

'windfall profits' from project refinancing. The Guide provides that refinancing gain clauses should be included in contracts, with the government's share likely to be taken as:

- a cash lump-sum at the time of the refinancing; and/or
- reduced service charges.

Technological changes and savings

Again, given the long-term nature of PPP contracts coupled with the rapid rate of technological obsolescence, the public sector will specify the output that it requires from technical equipment and the performance standards to be met, on the basis of known technologies and established standards. These standards will be set for a period for which the department is confident they will remain valid, for example, 10 years. The government may make it a contractual requirement that it shares any technical upgrade benefits with the private sector and any cost savings from technology changes. Whether such a provision is appropriate will depend on value for money considerations.

The Hong Kong Government appears keen to involve the private sector in the provision of social, as well as economic, infrastructure.

Probity

The Hong Kong Government states that the PPP process will be underpinned by probity practices to maintain the procedural integrity of the tender process. Client departments must implement systems, policies and procedures able to withstand public scrutiny and a probity auditor should be appointed to observe and review the tender process.

Exclusive mandate

In certain limited circumstances, the government may grant a private party an exclusive mandate to fully develop a proposal, on a non-competitive basis, which it has brought to government on an unsolicited

basis. It is assumed such circumstances would be rare, for example, where the intellectual property in the proposal is of such outstanding value that a competitive market for the service would not exist.

The client department would still have to ensure that value for money was being achieved and that alternative means to deliver the same end product did not exist.

Future project opportunities

In the March 2003 budget, the Hong Kong Financial Secretary stated that 'the format for private sector participation may cover design, build and operate, or other options involving private financing'. To date, major infrastructure facilities have been developed using the Build, Operate, Transfer approach. However, the Guide acknowledges the wealth of overseas experience in diverse sectors that has been delivered using a range of PPP transaction structures.

The Hong Kong Government appears keen to involve the private sector in the provision of social, as well as economic, infrastructure. There are a number of projects at different stages of development or which have had feasibility studies conducted.

The Hong Kong Government has also released a list of 11 pilot PPP leisure projects, which it intends to pursue. The Leisure and Cultural Services Department has been charged with implementing all 11 sports and recreation projects. Of these 11 projects it is likely that several small-scale projects will be bundled together to achieve economies of scale.



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