



# ASKING THE RIGHT QUESTIONS:

## A GUIDE FOR MUNICIPALITIES CONSIDERING P3s



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# INTRODUCTION



This guide is designed to answer questions municipal councillors and civic officials might have about public-private partnerships (P3s or PPPs).

There is growing financial and political pressure on municipalities to use P3s to close the infrastructure gap and deliver services. Proponents of P3s stress their perceived benefits, and the manuals P3 advocates prepare reflect this optimism.

This guide asks questions that probe deeper into the costs and benefits of P3s, giving municipalities a better understanding of what they involve. Based on the answers to these questions, this guide urges municipalities to take a cautious stand, fully examine the evidence, and ask the right questions before considering entering into a P3.

# 1. HOW BIG IS THE INFRASTRUCTURE DEFICIT?

A 2007 study conducted for the Federation of Canadian Municipalities estimated the backlog in maintaining and upgrading existing infrastructure to be \$123 billion, broken down as follows:<sup>1</sup>

- \$31 billion – water and wastewater
- \$21.7 billion – transportation infrastructure (sidewalks, roads, bridges)
- \$22.8 billion – transit systems
- \$40.2 billion – cultural, social, community and recreational infrastructure
- \$7.7 billion – waste management

The growing need for investment in existing municipal infrastructure – and development of new infrastructure – coincides with an historic decline in federal infrastructure funding. The consensus is that the infrastructure deficit continues to grow. The issue is how best to finance, build, operate and maintain municipal infrastructure.

# 2. WHAT ROLE DO MUNICIPALITIES PLAY IN BUILDING AND MAINTAINING INFRASTRUCTURE?

Municipalities generally finance, own, operate and maintain infrastructure assets. When building new infrastructure, municipalities either use in-house expertise or hire outside consultants to design the facility. The project is then put out to competitive tender to be built by the private sector to the fixed design specifications. The municipality (or a firm hired by the municipality) monitors the private contractor's construction progress. On completion, the asset is handed over to the municipality. Infrastructure construction is financed either out of accumulated municipal reserve funds established for that purpose, out of operating revenue or, more usually, by issuing long-term debt.

# 3. WHAT ROLE DOES THE PRIVATE SECTOR PLAY IN INFRASTRUCTURE PROVISION?

The private sector already plays an important role in delivering municipal infrastructure. It may handle design work and construction monitoring if the municipality does not have in-house capacity. It handles all construction, as the public sector in Canada does not build infrastructure. The private sector bears prime responsibility, therefore, for projects being constructed on budget and on time.

In addition, private institutions such as pension funds, insurance firms and finance companies lend money to municipalities through municipal finance authorities or through the purchase of municipal bonds at relatively low interest rates.

# 4. WHAT ARE P3s?

P3s are multi-year, often multi-decade, contracts in which a corporation or consortium of corporations assumes responsibility for activities previously undertaken by the public sector. These responsibilities include direct financing of infrastructure, as well as management, operation, maintenance and/or ownership of facilities.

P3 models have varying degrees of private involvement (see Appendix One for an overview of the most common P3 models). At one level, the private sector may operate or maintain public sector infrastructure, delivering services within the municipality's prior budget and retaining a portion of any savings. At the other extreme, the private company may design, build, finance, own, operate and maintain the facility. In between, the private partner undertakes some combination of these tasks. In some cases, assets are sold to the private sector and then leased back over the life of the contract.

In P3s involving private financing, the private company contributes a certain proportion of equity – usually about 10 per cent – and the rest is loaned by banks and other financial institutions, which are often part of the consortium. The municipality makes regular payments to the private company to cover financing, operating and maintenance costs, as well as private sector profits.

Contracts range in length from 20 to 40 years (Ontario's Highway 407 is an extreme 99 year contract), though service contracts can be shorter. The attraction for the corporation or consortium is that private delivery of municipal infrastructure and services can be extremely profitable. The return on private equity can be as high as 15 to 20 per cent, and in some cases higher. Long-term high rates of return at a low risk guaranteed by the public sector are very attractive for private sector investors in the current economic climate.

## 5. ARE P3s A FORM OF PRIVATIZATION?

Infrastructure built as a P3 may also be owned by the private sector. This is the case in build-own-operate-transfer (BOOT) P3s, such as Winnipeg's Charleswood Bridge. However in most P3s, the public sector retains ownership, and takes over responsibility for operations at the end of the contract. The most common form of P3 in Canada is the design-build-finance-operate model (DBFO). While ownership is public, there is an unprecedented degree of private involvement in and control of public services and assets. It is for these reasons that some view P3s as a form of 'privatization by stealth'.

Often, the corporation or consortium in a P3 will seek to expand its influence to other aspects of municipal infrastructure or services. For example, Vivendi subsidiary US Filter, the corporation operating Moncton, New Brunswick's P3 water treatment plant, made an unsolicited bid to handle the city's water distribution system. The city rejected the bid based on independent analysis — commissioned in response to great public outcry — which recommended the city finance and manage the system upgrades itself.

## 6. WHO IS PROMOTING P3s?

The main promoter is the Canadian Council for Public-Private Partnerships (CCPPP). The members of this pro-P3 lobby group come from the various segments of the private sector that benefit from P3s, and from governments using them.

The federal crown corporation PPP Canada assesses, promotes and funds P3s, and is specifically targeting municipalities. Some provinces, including British Columbia, Ontario, Alberta and Quebec, have agencies or dedicated resources in provincial ministries to promote P3s.

P3s are most aggressively promoted by large multinational P3 corporations, financial investors, and the legal and accounting firms that profit most from them. Others, such as the construction industry, architects and engineers, have voiced concern and opposition to P3s for reasons discussed below.



## **7. HOW ARE P3s BEING PROMOTED?**

P3s have been promoted for various reasons over the years. They became popular two decades ago because public sector accounting practices allowed governments to undertake infrastructure investments without the capital cost appearing on their books. But auditors have since tightened up their accounting rules. More recently, a variety of claims have been made to promote P3s.

Proponents claim P3s help municipalities access private funding that would not otherwise be available, closing the infrastructure gap and allowing municipalities to spend scarce resources on other activities. Proponents also claim P3s build infrastructure more cheaply and on time, bring more efficient operation of infrastructure and provision of services, improve maintenance, and bring innovation and improved design – all motivated by the private sector pursuing profit in a competitive and budget-constrained environment. All these claims are highly debatable, as this guide will show.

## **8. HOW COMMON ARE P3s IN CANADA?**

Between 1985 and 2011, 200 P3s were planned or implemented in Canada (137 finalized), costing US\$71.6 billion.<sup>2</sup> This amounted to only a very small percentage of public investment during that period.<sup>3</sup> While the pace of P3s has picked up in the last 10 years, the vast majority of new infrastructure, between 80 and 90 per cent of all projects, was still provided in the conventional manner by the public sector.<sup>4</sup> However, there is a push to expand the use of P3s in several sectors, including municipal infrastructure and services.



# FINANCE, COSTS AND REVENUES



# 9. DO P3s INCREASE THE AVAILABILITY OF CAPITAL FINANCE FOR MUNICIPALITIES?

The short answer is no. All private-sector financing for P3s must be repaid. P3 leases or operating payments are effectively debt payments, so municipalities are simply switching one form of debt for another. Larry Blain, now chair of Partnerships BC, the provincial P3 agency, told the publication *Bond Buyer*, “Clearly all the money is coming from the government’... ‘It’s debt of the province, whether you borrow it as bonds, or contract over a 35-year period.”<sup>5</sup> As Pierre Hamel wrote in a 2007 report commissioned by the Federation of Canadian Municipalities, “P3s are not a cure-all or miracle treatment for all situations. They do not offer municipalities a magic solution to the real problem of financing infrastructure, the primary and often only real challenge facing local governments.”<sup>6</sup>

PPP Canada does contribute up to 25 per cent of capital costs for some eligible, usually large, projects. But the \$1.2 billion P3 Canada Fund comes from federal money that could be available for infrastructure spending without the necessity of P3s.

# 10. DO P3s RAISE MONEY MORE CHEAPLY THAN MUNICIPALITIES?

Private P3 financing almost always has a higher interest rate and is usually paid back over a longer term than direct municipal borrowing. Moncton’s water treatment plant has lease terms that are the equivalent of a 10 per cent yearly interest rate, while Moncton could have borrowed directly at 5.85 per cent. Privately financing the plant’s \$23 million capital cost means Moncton is paying an extra \$14.4 million in debt costs over the 20-year contract (or \$8.4 million in 1999 terms, when the deal was struck) – money that could have been saved if the city had financed the plant itself at a much lower interest rate.

# 11. DO P3s INCREASE OR REDUCE LONG-TERM FINANCIAL FLEXIBILITY?

P3s significantly reduce the long-term financial flexibility of municipalities, for several reasons:

- they tie up municipal funding for more years, on average, than publicly-financed projects;
- they cost more financially;
- they guarantee maintenance funding for specific projects only;
- they commit infrastructure to specific tasks for long periods, even though demand may change; and
- they prevent municipalities from refinancing debt, because the debt is held by the private sector.

In the case of the Charleswood Bridge, the City of Winnipeg is still paying 11.05 per cent in yearly interest to the private sector, while its own costs of borrowing have fallen to well under six per cent.

# 12. HOW DO P3s IMPACT A MUNICIPALITY'S BALANCE SHEET AND DEBT RATING?

Municipalities can be drawn to P3s by the prospect of getting infrastructure financing and debt off their books. Early P3s attempted to keep debt payments off public balance sheets and protect public sector credit ratings by replacing public infrastructure borrowing with annual lease payments that repaid private sector borrowing out of public operating budgets (so-called *operating leases*). The Charleswood Bridge and the Confederation Bridge between Prince Edward Island and New Brunswick were designed to be 'off-book.' However in both cases auditors later required them to be accounted for as debt because, under accounting rules, payments to the private consortia were deemed to be *capital leases*.<sup>7</sup>

Some P3s have been able to keep debt obligations off the books through various financial manoeuvres, but recent tightening up of accounting rules under the International Financial Reporting System will make it even more difficult to avoid putting the implied debt of P3s on the books of municipalities. In addition, the related movement to accrual accounting by municipalities since 2009 allows municipalities to spread the costs of capital assets over many years, in much the same way as P3 operating leases. Previously, under cash accounting, the full value of an asset had to be shown in the year of purchase. This change eradicates any accounting advantage of P3s.

Regardless of how they are treated by accountants, all P3 payments properly belong on the books of municipalities. All P3 contracts, including operating leases, are a form of debt. They are a contractual agreement to pay set amounts of money at set times into the future and are treated as debt by bond rating agencies.

## **13. IF THE P3 INVOLVES A SALE/LEASEBACK, AT WHAT COST?**

To overcome short-term budget difficulties, governments are sometimes tempted to sell buildings and other assets to the private sector and lease them back. Cash received from the sale may be used to reduce debt or finance new infrastructure

However, the rent paid to lease the buildings must include the higher interest costs of private borrowing. Adding up these lease payments in present-day dollars shows that the government is paying much more than the one-time payment it is receiving for the asset. The public sector's debt position and long-term cash flow situation have, therefore, deteriorated even if the short-run cash flow situation has improved.

## **14. WHAT ABOUT THE TRANSACTION COSTS OF P3s?**

The legal, technical and administrative requirements of P3s are acknowledged to be much greater than under conventional public sector procurement. P3s involve complex bidding, corporate and financial arrangements. They also require legal documentation pertaining to financing, design, build, operation and maintenance arrangements, as well as outlining the long-term project handover. Legal documents alone can run into hundreds of pages.

The transaction costs of these requirements range between two and five per cent of project capital cost, compared with 0.5 to three per cent for conventional contracts. The average P3 transaction cost is more than twice as high as for conventional projects (3.5 per cent versus 1.7 per cent).<sup>8</sup> The size of these costs has led Vining and Boardman to conclude that "the potential benefits of P3s are often outweighed by high contracting costs."<sup>9</sup>

# 15. HOW MIGHT P3s AFFECT PUBLIC SECTOR REVENUES?

P3s can create new sources of revenue, usually by shifting costs onto the public through increased user fees. These fees are then used to pay P3 leases or operating charges. An example is highway tolls, which shift costs from general tax revenues onto specific users through tolls. Depending on the severity of traffic problems and the availability of toll-free alternative routes, the public may accept the new tolls, as in the case of Highway 407, or may not, as in the case of the Fredericton-Moncton Highway. In the latter case, tolls paid directly by drivers using the highway were abolished after public protest. They were replaced by “shadow tolls,” still based on road usage but paid to the private consortium out of general tax revenues.

When recreation facilities are built as P3s, the private partner may take over food and concession operations and payments for ice time — revenue previously earned by the local council or by community groups — often raising fees in the process. This was the case in Penticton’s South Okanagan Event Centre P3. Concessions were privatized, fees were raised substantially, and money raised by volunteer groups through concessions to allow low-income children to play hockey was cut.<sup>10</sup>

# 16. WHO BENEFITS FROM REFINANCING OF P3 CONTRACTS?

Once the risky construction phase of a P3 is over, projects are often refinanced. This can dramatically increase profit, because borrowing becomes cheaper. The public sector will not benefit from the refinancing unless the contract specifically provides for it. In the United Kingdom, contracts provide for a 30/70 public-private split of refinancing savings. But, based on publicly-available information, most contracts in Canada don’t have such a requirement. Since P3 contracts are hidden behind commercial confidentiality rules, it is almost always impossible to calculate the private sector’s profit, or how it would increase after refinancing.

At the refinancing stage, project managers often make large profits by “flipping” ownership to other private companies. Sometimes projects are flipped many times, as in the case of the Abbotsford Hospital in B.C. This makes it impossible for the public sector to know exactly with whom they will be partnering, causing relationship and continuity problems. It is common in the UK — and happening increasingly in Canada — that the final owner is located in an offshore tax haven.

# 17. WHAT ABOUT THE RENEGOTIATION RISK WELL INTO THE CONTRACT?

P3 contracts are often renegotiated even before the projects are completed, as has happened with some B.C. hospitals. This may happen because the public sector changes its specifications, because of cost overruns, or because expected revenue streams do not materialize. Renegotiations well into the life of a P3 can be expensive for the public sector because, at that stage, there is no competitive process and the public sector is vulnerable to service disruption. If the public sector is perceived to be open to renegotiations further down the line, the private consortium might deliberately underbid for the initial contract.

P3s are a relatively recent phenomenon in Canada and their contracts extend well into the future, so it may be too soon to assess the public sector's exposure to possible contract renegotiation. But it is a real risk, as experience in Latin America<sup>11</sup> in particular has shown, one that the public sector must be aware of.



# VALUE FOR MONEY AND RISK TRANSFER





# 18. DO P3s DELIVER VALUE FOR MONEY?

P3s have been justified on the basis that they provide “value for money,” or VfM. Value for money is based on an analysis of “the lowest combination of capital, operating and maintenance costs over the life of a project.”<sup>12</sup> P3 proponents claim to include considerations such as employment, economic development, the environment, and health and safety. In reality, cost minimization is the real meaning of VfM, and the evaluation process is far from transparent or objective.

A VfM assessment compares the costs of delivering a project through a P3 or conventionally. If the P3 costs are lower, the project proceeds as a P3. Without such a calculation, and unless there is no possibility of proceeding with a conventional project, there is absolutely no basis for choosing the P3 model.

Yet, there are several examples of Canadian P3s which have not been justified with VfM assessments. These include the Charleswood Bridge, the redevelopment of Ottawa’s Lansdowne Park, the New Brunswick deal with Shannex Inc. to provide 216 new nursing home beds, and the Amicus long-term care facility deal in Saskatoon.

To calculate VfM, a public sector comparator (PSC) must first be developed. This shows, in detail, the costs and benefits of public sector procurement, including an assessment of the risks over the lifetime of the project. The costs of the P3 will be compared to this comprehensive financial model. While this may sound straightforward, it is not.

- The two projects being compared should be of the same capacity and offer the same quality of service. In the case of the Moncton water treatment plant, P3 promoters claim the P3 saved \$10 million in capital costs. But the public sector comparator was of a much larger plant and no evaluation was made using comparable plants, nor of what might happen in the future when additional capacity was required.
- There should be “competitive neutrality” between the public sector and P3 proposals, meaning that each should be treated the same in some important areas. P3 proponents want private bid costs lowered (or the PSC raised) to factor in taxes on a P3 that would not be paid in conventional procurement, such as sales, payroll or land taxes.
- Other impacts, such as on employment, economic development, the environment, and health and safety should be considered, but rarely are.
- P3s must be put out for open, public and competitive tendering. This is key to establishing a P3’s lifetime costs, and is a major pillar of the claims that P3s deliver superior efficiency and VfM. It is also crucial for the transparency and openness of the VfM process, and for reducing the possibility of fraud and corruption. Yet in recent years, several high-profile Canadian P3s have been sole-sourced, without tender (See Question 32, below)

- P3 tendering often involves little or no competition. This was the case with the Abbotsford Hospital (where a VfM assessment was carried out only after the contract was signed)<sup>13</sup> and the over \$2 billion Centre hospitalier de l'Université de Montréal project.<sup>14</sup> Large municipal projects such as the Disraeli Freeway extension in Winnipeg have ended up with only two bidders. It is generally accepted that a minimum of three bidders is required in a competitive process. The size, complexity and financial commitment involved in P3s exclude participation by small and medium-sized local construction firms and suppliers, reducing competition.
- Cost comparisons that estimate the total amount spent over the life of the contract generally skew the results in favour of P3s. Future costs or benefits of a project can be converted into today's money by "discounting" the sums involved, based on the argument that future sums are worth less than sums today because time is money. The higher the discount rate and the further into the future the cost or benefit appears, the lower its present value.

While inflation is not the same as discounting, the impact of inflation does show how discounting works. With two per cent inflation, a dollar a year from now will be worth 98 cents. Using a seven per cent discount rate a dollar will be worth 93 cents a year from now and will continue to decline rapidly into the future.

The choice of discount rate is, therefore, crucial. But there is no agreed-upon rate in Canada. Some argue the discount rate should be low, reflecting the obligation of society to meet the needs of future generations who will bear the costs of P3s. At the other extreme, some argue it should be equal to the private sector's cost of borrowing. Other models use the public sector's borrowing costs, usually between the two extremes.

In Canada, the discount rates that are used tend to be high. This benefits P3s, because public sector comparators tend to "front-end load" costs at the beginning of a project life-cycle, while P3 models load costs onto the end. High discount rates favour P3s, and create the illusion of value for money, by shrinking back-end costs in terms of present value, compared to the public model. A relatively small change in the discount rate can radically alter the overall VfM of a P3. In the case of the Abbotsford Hospital, a six per cent discount rate was used to show VfM of \$39 million, but that would have fallen to \$13 million had a five per cent discount rate been used.

VfM assessments must be unbiased, without predetermined conclusions. In today's political climate that is difficult to achieve, as national and provincial P3 agencies put pressure on municipalities. While head of Partnerships BC, which advises municipalities on VfM calculations, Larry Blain was quoted as saying that "[p]ublic sector comparators won't do you much good anyways, because I can make the public sector as bad as we want to, in order to make the private sector look good."<sup>15</sup>

In addition, it is difficult to find objective consultants to prepare VfM assessments. The large consulting firms are all committed to P3s, heavily involved in the projects themselves and, even when not, are active members of the CCPPP. In the case of Vancouver's \$2 billion Canada Line project, only KPMG was deemed "sufficiently independent of the process to provide the level of credibility, objectivity, and transparency" required to prepare the PSC,<sup>16</sup> but KPMG had direct links to individual members of the bidding consortia and a publicly-expressed bias in favour of P3s.<sup>17</sup>

As Stuart Murray of the Canadian Centre for Policy Alternatives argues, "[t]he major accounting firms now make so much money on P3 projects, it seems unlikely they would ever speak against them."<sup>18</sup> So municipalities considering P3s must either find smaller, more impartial consultants, or build in-house capacity to independently evaluate value for money.

## 19. HOW IMPORTANT IS RISK IN P3 VfM ASSESSMENTS?

Given that private financing is more expensive, that the private sector always builds public sector projects whether or not they are P3s, and that P3s have higher transaction costs, how can P3s be seen to deliver value for money?

The central justification claims that P3s shift important risks from the public to the private sector. The other claim is that the private sector is more efficient in operating and maintaining projects — an argument that will be addressed later.

While the degree and type of risk will vary, the main risks for municipal P3 projects are likely to be project risk during construction (due to costing errors, construction delays, or environmental and technical problems) and the ongoing risk that revenue to support the project will be less than planned (known as demand risk). A full list of risks is outlined in Appendix Two.

The project risk is closely related to the financial structure of the P3. The project company may not receive any payments until the project is complete or substantially complete. Borrowed money, usually about 90 per cent of the capital cost, carries a high risk premium. Owners' equity, usually about 10 per cent of the capital cost, is also often most exposed during this phase.

This exposure of equity and the need to meet debt commitments is used to explain project risk shifting to the private sector. The private sector has a strong incentive to bring projects in on time and on budget. Once the construction phase is completed, this risk declines dramatically. Debt is often refinanced at lower rates and owner equity is often "flipped." The public sector must quantify the project risk and enter into contracts that clearly shift as much risk as possible onto the private sector.

The demand or revenue risk is important when lease payments are linked to the level of use of a P3 asset or service. Leases to pay off highway P3s might be linked to the number of vehicles using the highway and the size of the toll. The lease payments for a water treatment plant may be linked to water rates and consumption levels. If either usage or price estimates are incorrect, there will be revenue shortfalls. The question then becomes, who makes up the difference? Again, these risks need to be quantified and P3 contracts need to specify the degree to which the private sector will assume risks previously carried almost entirely by the public sector.

P3 VfM assessments are on the websites of Infrastructure Ontario and Partnerships BC. For Ontario, the assessments show, very clearly, that risk transfer alone supposedly gives P3s value for money over conventional procurement. The Credit Valley Hospital is said to deliver VfM of \$26 million, based on risk transfer valued at \$39.7 million. Durham Regional Court House shows VfM of \$49 million, while risk transfer is said to be \$132 million. The Ministry of Government Services Data Centre shows VfM of \$64 million and risk transfer of \$150 million. How risk transfer could possibly amount to so much for such pedestrian buildings as a court house (39.5 per cent of final P3 cost) and a data centre (42.6 per cent of final P3 cost) is not explained – the public is simply expected to believe it.

A similar methodology has been used in Winnipeg. The Chief Peguis Trail is said by Deloitte & Touche to have a VfM of \$31 million and risk transfer is said to amount to \$51.4 million, or over a third of the P3 cost of \$147.8 million. In this case, about \$14 million is said to be shifted on account of project planning and approval risks, just under \$10 million for design and construction risks and almost \$27 million – or more than the other risks put together – for operations, maintenance and lifecycle risks. These numbers are very hard to believe, but neither the public nor the city council is allowed to see how they were arrived at or to challenge them.

## **20. IF RISK ASSESSMENT IS CRUCIAL TO VfM CALCULATIONS, HOW IS IT MEASURED?**

Increasingly in Canada, the method of estimating risk used by Infrastructure Ontario, the Ontario government agency assessing and promoting P3s, seems to be gaining ground. Their treatment draws on a consultant's report which is said to have examined 60 different risks involved in infrastructure investment and measured their probability and likely impact. However, there was no evidence provided for these generic estimates of different types of risk, and calculations done for specific projects are not made public

In the case of the Disraeli Bridge, consultants Deloitte & Touche have refused to disclose their risk data on the grounds of commercial confidentiality, despite requests and appeals through City of Winnipeg Access to Information rules. However, the P3 was justified purely on the basis of risk calculations. There is no independent verification of risk transfer assumptions being made in P3 VfM assessments across the country. Yet risk transfer is held up as the main reason to engage in a P3.

In the UK, where P3s have a much longer track record, the British Association of Chartered Certified Accountants and Manchester Business School recently concluded that “the general case for private finance is not proven.” Their study finds any benefits of private financing, risk transfer and improved decision-making are “too nebulous to allow certainty that they are outweighing the known additional costs that arise on average from the cost of capital, transaction costs, and flexibility.”<sup>19</sup> Reviewing the global experience of P3s over the past 30 years, the report concludes that “[v]alue for money is difficult to establish convincingly, owing to the higher costs associated with private finance and the high premium payable for risk transfer, and there are important accountability issues around the commitments made to providers of private finance.”<sup>20</sup>

Very little is known about risk transfer because there have been few serious studies of the subject. In one review, Vining and Boardman conclude that “[a]lthough risk transfer is a major posited goal of many public-sector governments.... our review of the Canadian evidence suggests that, in negotiating (and re-negotiating) P3s, government has often failed to achieve significant risk transfer, especially that which is related to use-risk.”<sup>21</sup> They go on to state that “[i]n infrastructure projects, it rarely makes sense to try to transfer large amounts of risk to the private sector.”<sup>22</sup> A 2010 study of key Canadian P3s also found they generally performed poorly on risk transfer.<sup>23</sup>

Evaluating risk transfer is also difficult because P3 contracts are subject to cost overruns, reductions in scope, and delays, all sometimes hidden in contract renegotiation. Pro-P3 claims also neglect to take into account the much longer time needed to negotiate contracts, making on-time delivery a flexible concept. Finally, given the long life of most P3s, contracts may be renegotiated many years into the project, rendering earlier VfM calculations redundant.

## **21.** DOES PROJECT RISK TRANSFER REQUIRE P3s?

Project risk, covering planning, design and construction, is often the main risk in infrastructure projects. Transferring the risk of cost overruns and project delays to the private sector is a central justification of P3s. But there are ways of shifting project risk in conventional procurement. Small contractors, who normally undertake municipal projects, see no need for P3s to deal with this risk.

John Knappett, a small B.C. contractor, has argued that “[o]ur firm has completed hundreds of public sector projects in BC over the past 25 years and we have seldom been late and never over budget. I know that because when we bid on a Stipulated Sum Contract, we have a contracted fixed budget and an attached schedule to the Contract. If we are late the Province has penalties it can assess and if we are over budget we must absorb the cost at no fee to the Province.”<sup>24</sup>

Project risk can be shifted onto private contractors in conventional procurement through penalties or requirements for insurance. While there are also some problems with projects limited to a combination of design and building (Design/Build), this is another way in which risk can be transferred without private financing or long-term private operation of public facilities.

## **22. ARE MUNICIPALITIES CAPABLE OF ASSESSING AND MINIMIZING RISKS?**

Appropriate and accurate assessment of risks is difficult in most situations, and generally beyond the capacity of most municipalities. At the same time, unbiased advice is hard to find. In the case of the South Okanagan Event Centre, both project and revenue risks were inadequately estimated, and the P3 contract did not ensure risk transfer to the private partner. The result left the City of Penticton responsible for cost overruns of \$25 million on an original projected cost of \$56 million. The city also had to cover annual revenue shortfalls caused by poor projections and rising user fees. According to city officials, from the point of view of the private partner, this was “a can’t-lose contract.”<sup>25</sup> Similar cost overruns and revenue shortfalls have plagued several other municipal P3 projects.<sup>26</sup>

Ultimately, governments are responsible for providing public services. If a P3 operator fails or backs out because profits aren’t high enough, all these risks revert to the public sector and are often magnified. Yet, this is rarely accounted for in risk assessments.

# 23. IF RISK IS NOT TRANSFERRED IN P3 PROJECTS, WHAT IS THE LIKELY IMPACT ON MUNICIPALITIES?

Failure to actually transfer project and demand risk can have serious consequences. Penticton has paid a high price for capital cost overruns, and has to cover on-going annual operating deficits for the South Okanagan Event Centre. These unforeseen deficits have placed an incredible financial burden on the city.

The Event Centre is slated to lose \$1.6 million in 2012, forcing the city budget into a projected deficit of \$1.2 million as of January 2012. Failure to transfer risk has led to cuts in other services and pressure on Event Centre staffing and wages. Further cuts or dipping into reserve funds will be needed to balance the 2012 budget. A P3 recreation complex in Cranbrook also suffered from cost overruns and revenue shortfalls. The project was eventually taken back into public hands, leaving the municipality with the biggest debt burden among B.C. municipalities.<sup>27</sup>

While failure to transfer revenue or demand risk will be readily apparent, leading usually to pressure on the public sector to make up the difference, failure to transfer project risk in more complex projects may be hidden. In the long run, however, it will take the form of higher payments to private companies.



# QUALITY OF PUBLIC SERVICES AND THE PUBLIC INTEREST





# 24. DO P3s ENSURE HIGHER-QUALITY SERVICE AND MAINTENANCE?

Proponents of P3s argue the private sector improves the quality of service delivery. The assumption is that competition and the incentive and penalty structure that P3s are said to offer make the private sector more efficient. P3 advocates also argue that P3 maintenance contracts give a long-term guarantee that public assets will be kept in better shape than is often the case in conventional projects.

As the International Monetary Fund has put it, “[m]uch of the case for PPPs rests on the relative efficiency of the private sector.” Yet, “[i]t cannot be taken for granted that PPPs are more efficient than public investment and government supply of services ... While there is an extensive literature on this subject, the theory is ambiguous and the empirical evidence is mixed.”<sup>28</sup> In fact, a review of the literature “points strongly to the conclusion that there is no systematic intrinsic advantage to private sector operation in terms of efficiency. Equally, there is no evidence to assume that a public sector operator is intrinsically less efficient and effective.”<sup>29</sup>

The argument for superior maintenance is also flawed. There is no question more needs to be done to maintain municipal assets. But municipalities should not pay a premium to put in place an inflexible long-term commitment to maintaining P3 assets. In doing so, they give up the discretion to allocate maintenance dollars where they are most needed in a budget year. It is especially problematic that the public does not know the dollar value of maintenance guarantees for P3 projects. Such information is kept confidential, supposedly for commercial reasons, yet it is available for all public sector projects. This difference in treatment of maintenance budgets makes no sense in terms of transparency and accountability.

# 25. DO P3s OFFER MORE INNOVATION AND BETTER DESIGN OF PUBLIC INFRASTRUCTURE?

P3 proponents argue that private sector involvement generates more innovation and better design of public projects, because of the need to be innovative under fixed budgets. There is little evidence that this is the case. Even if it were, municipalities can enter into fixed price or design-build contracts without engaging in a P3 for financing, ownership, operations or maintenance. Moreover, architects find that by bundling design with construction, P3s sacrifice creatively aesthetic design for cost minimization.

In the case of Vancouver's Canada Line SkyTrain project, part of the private sector's "innovation" was to project increased revenue from running more mid-day trains, and to decrease costs by building fewer stations. This change was not permitted in the estimate of public sector comparator costs.

## 26. WILL CITIZENS PAY MORE?

Sometimes, the need to cover a P3's higher borrowing and transaction costs (as well as to make money for the private partners, which is not an issue in public projects) will lead to a direct increase in the cost of the service provided. This can be reflected in the introduction of, or increases in, road tolls, water rates, arena fees or fees for using schools after hours.

The high premium paid for the private partner to accept risk often means that citizens will pay more for infrastructure or services delivered through a P3 model than through conventional methods — even if risk is successfully transferred. These higher payments will be hidden in P3 contract costs that will weigh on municipal budgets for many years into the future.

## 27. WHAT IMPACT DO P3s HAVE ON WORKERS?

Often, when the private sector claims to be more efficient than the public sector, this really means cutting labour costs by laying off workers, using non-unionized instead of unionized labour, cutting wages, pensions and other benefits, or reducing hours or conditions of work. This is particularly common in service delivery P3s, where the private partner is handed a budget or part of a budget to deliver services previously delivered by the public sector in return for a share in any savings it can generate.

In the case of the Hamilton-Wentworth water and sewage system, the private corporation laid off half the staff, reducing the operating budget by close to 40 per cent.<sup>30</sup> The result was a catastrophic reduction in service quality. Cuts in public sector staff were also a key feature of the Ontario Business Transformation Project and the Urban Shared Services hospital food project in Winnipeg, both of which had serious operating problems as a result.

Other Canadian P3s have saved money by using non-unionized labour where unionized workers would otherwise have been employed with better wages, benefits and working conditions. This was the case with the Evergreen Park School, the Fredericton-Moncton Highway, the Moncton water treatment plant, and the Moncton water distribution system proposal. Where this is the case, municipalities can reasonably expect strong opposition from public sector workers and their unions.

# 28. HOW DO P3s AFFECT LOCAL COMMUNITIES?

P3s can have harmful effects on local communities which are not always apparent when contracts are signed. Cuts to wages and jobs have ripple effects on local businesses and quality of life. The insertion of a profit factor into service delivery can shift spending from the community to business centres elsewhere in the country or even abroad. In the United Kingdom and with increasing numbers of Canadian projects, equity flips have meant ownership of P3s ends up in offshore tax havens.

Small local contractors, who rely heavily on municipal and other local contracts, say P3s are squeezing them out of business. The Vancouver Island Construction Association, the B.C. and Canadian construction associations and the Independent Contractors and Businesses Association have all raised concerns about P3s. They feel there are too few bidders on P3 projects, and value for money calculations are biased. Together with the Merit Contractors Association of Alberta and the Alberta Construction Association, they have also objected to P3 bundling of small projects to achieve economies of scale. They fear that if larger P3 projects using big, out-of-province construction firms become dominant, local construction expertise and capacity to build and maintain schools, hospitals, roads and bridges might be at risk.

Municipalities should be particularly sensitive to the environmental risks of P3s. The workforce cuts in the Hamilton-Wentworth water and sewage project led to untreated sewage polluting Hamilton harbour. The P3 contract was so poorly put together that the regional government ended up paying the cleanup costs. A study of Whistler, B.C.'s cancelled plans for P3 wastewater treatment found the deal's cost savings came in part from trucking sewage waste through numerous ecologically-sensitive watersheds. The municipality remained responsible for any spills and cleanup costs.<sup>31</sup> Not all municipal projects carry this kind of risk, but the ones that do should not be exposed to further risk through corners being cut for the sake of profit.

# 29. DO P3s IMPROVE TRANSPARENCY AND ACCOUNTABILITY?

Proponents of P3s argue they make spending on public services and infrastructure more transparent and accountable, as they open up all stages of the project to competitive bidding and outside review. The direct involvement of banks and other financial institutions in P3s is said to add a layer of accountability, compared to conventional projects. In P3s, the private partner is also supposed to be locked into contracts to meet certain performance levels, with mandatory financial penalties if they are not met.

In practice, however, P3s may not lead to more transparency, as P3 contracts are often protected by commercial confidentiality and exempt from freedom of information legislation. While P3 agencies in B.C. and Ontario are making more information public, including P3 contracts and VfM assessments, any numbers which are needed to fully evaluate the projects are either left out or deliberately redacted. In B.C., essential financial information about P3s has been withheld on the basis that it is a “cabinet secret.” Published information is of limited value in terms of either transparency or accountability of P3 projects.

Consultants providing so-called impartial advice also hide behind commercial confidentiality. They will not allow access to assumptions that are vital for their conclusions, such as the source of their risk calculations. Furthermore, their VfM reviews often come with qualifications that render the entire assessment highly questionable. In their assessment of the Brampton Youth Justice Facility, PricewaterhouseCoopers concludes that the P3 would yield value for money compared to the conventional delivery model. But PricewaterhouseCoopers qualifies this by saying “[w]e did not audit or attempt to independently verify the accuracy or completeness of the information or assumptions underlying the PSC, which were provided by [Infrastructure Ontario], and/or the successful proponent’s final offer, nor have we audited or reviewed the successful proponent’s financial model.”<sup>32</sup>

P3s also severely restrict democratic accountability by tying the hands of future municipal governments, as far ahead as 30 years or more. Even more troublesome, promoters of P3s in Canada have on occasion made contributions to the political campaigns of sympathetic councillors, as in the case of the Hamilton-Wentworth water and sewage system<sup>33</sup> and, apparently, the Lansdowne Park development in Ottawa.<sup>34</sup> Though not illegal, such contributions are highly questionable.

Finally, it is common practice to withhold information from citizens and prevent public input into decisions about P3s. Citizens are rarely permitted to formally express their views on whether they want a project managed as a P3. In the few cases where the public has been given formal input or the issue has gone to a public vote, citizens have rejected P3s. Citizens in Victoria, B.C. used public meetings to oppose a P3 for a new sewage project. In 2011, 75 per cent of voters in Abbotsford, B.C. voted down a P3 water project.



# P3s, MUNICIPALITIES AND ALTERNATIVES



# 30. ARE P3s APPROPRIATE FOR MUNICIPALITIES?

As this guide has documented, there are serious concerns about transparency, loss of local control, and the inflexibility of multi-decade P3 deals. In addition, PPP Canada's own 2009-2014 corporate plan acknowledges some of municipalities' key concerns with P3s: the complexity and cost at the procurement and contract stage – issues felt most acutely by small communities; the long-term expense of higher private-sector financing costs; the erosion of in-house expertise and capacity; and the need to maintain and upgrade existing infrastructure.<sup>35</sup> There is a general acknowledgement, even by their proponents, that P3s are not appropriate for small municipalities. There are several reasons:

- Transaction costs are expensive and cannot be justified in small projects;
- Small municipalities are no match for large international corporations when it comes to negotiating contracts;
- Turnover of councillors and staff means that the institutional memory of municipalities is not strong enough to properly supervise and monitor P3 contracts that span decades; and
- Large private companies lose economies of scale on small projects and tend not to compete for them.

Even large municipalities have had difficulty with P3 contracts, such as cost overruns (the Canada Line in Vancouver), failure to shift demand risk (B.C.'s Golden Ears Bridge), and heavy subsidies and bailouts (for example, in several Ottawa recreation P3s).

# 31. WHAT CAPACITY DOES THE MUNICIPAL SECTOR HAVE TO MONITOR P3s?

P3 agreements are unlike any other arrangement that municipalities engage in. They are complex and there can often be disagreements and disputes which may require arbitration or legal action. P3s can also be very demanding in terms of ongoing monitoring and evaluation of private sector performance over the lifetime of the agreement.

There has not been any systematic evaluation of the record of Canadian municipalities in monitoring and evaluating P3s, nor of their capacity to do so effectively. The exception is Ottawa, where the city auditor found that P3 contracts were not being formally monitored. The reason appeared to be that while there was an established, funded and staffed process for monitoring conventionally-procured projects, there was none for P3s and the council was reluctant to put the necessary resources into this task.<sup>36</sup>

The experience of school boards, many of which are comparable to municipalities in terms of size and staff expertise, provides insight into the task that municipalities face in monitoring P3s. In Nova Scotia, the highly-controversial P3 schools established in the 1990s have been beset with ongoing contract monitoring problems. The provincial auditor has documented numerous overpayments to corporations and underpayment to school boards. There were ambiguities in contracts, an absence of systems to check compliance with contracts, ignorance of what contracts contained, and a lack of institutional memory as public sector staff turned over or retired.<sup>37</sup> It would not be surprising if municipalities encountered similar problems with P3 contracts.

## 32. WHAT DO THE PROFESSIONALS SAY ABOUT P3s?

Several professional groups have cautioned against the use of P3s – including engineers, architects and auditors. Engineers have criticized P3s which include design-build because they lose control over project quality to contractors. Quebec government engineers were vocal against developing Autoroute 30 as a P3, citing excessive and under-recorded consultancy fees, fictional cost savings, unrealistic risk assessment and incorrect provision for inflation.<sup>38</sup>

Architects have also raised cautions, complaining about high “pursuit” costs (front-end transaction costs of seeking to win P3 bids), their costs not being covered for unsuccessful bids, and cash flow problems. Any cost pressures that arise from a P3 involving design-build or from building delays are often pushed back onto architects, who are not able to absorb them. They also complain about the “frantic pace” of design-build activity which is bundled into a P3. Each of these pressures raises “quality challenges,” given fixed construction budgets. Even without these pressures, architects are critical of P3 projects. They say P3s favour cost saving over aesthetic appeal, and often make it difficult for architects to interact with final users of the facilities.<sup>39</sup>

Federal and provincial government auditors have long been critical of Canadian P3s. They have raised and continue to raise concerns about:

- dubious accounting approaches that attempt to place P3s off-book (Winnipeg, Charleswood Bridge; Canada, Confederation Bridge; Alberta, long-term care homes);
- sole sourcing and non-competitive bidding (Ontario, Business Transformation Project; New Brunswick, Shannex nursing homes; Saskatchewan, Amicus long-term care);
- the lack of adequate public sector comparators, and/or failure to demonstrate or deliver value for money or risk transfer (Nova Scotia, schools; New Brunswick, Evergreen School, Eleanor W. Graham Middle School and Moncton North School, Fredericton-Moncton Highway; Alberta, long-term care homes, Southeast Edmonton Ring Road; Quebec, data processing; Ontario, Brampton Hospital);
- excessive costs of private borrowing (New Brunswick, Fredericton-Moncton Highway, Evergreen School; Nova Scotia, Highway 104; Canada, Confederation Bridge);

- poor contract specification and inadequate systems of monitoring and compliance (Ottawa, all P3s; Nova Scotia, schools; Ontario, Business Transformation Project, Brampton Hospital; British Columbia, Academic Ambulatory Care Centre).

Criticism of questionable P3 practices by auditors general has had an impact on formalizing P3 procedures in Canada but, as the list above shows, even very recent P3s have been found lacking. The real problem is that federal and provincial auditors only get to critique P3s after they have been implemented. What is needed is a transparent and accountable institutional process that stops questionable projects before they are implemented.

## 33. HOW EASY IS IT TO DISENGAGE FROM P3s?

If a municipality decides to withdraw from a P3 before the end of the contract, it will be very expensive. The private sector engages in long-term P3 arrangements because of the high returns on equity investment, and the higher than normal returns to holders of debt. They will need to be compensated if these returns are threatened. The level of compensation can be very high.

In the case of the Charleswood Bridge, researchers used freedom of information provisions to obtain details of the City of Winnipeg's costs to purchase the bridge before the expiry of the 30-year contract. In one of the options, the city would pay the discounted present value of the outstanding lease payments and option to purchase in year 30. In 2008, this would have amounted to a buy-out cost of approximately \$17.5 million. The bridge cost less than \$10 million to build, and the city had already made \$15.5 million in lease payments between 1995 and 2008.<sup>40</sup>

Even disengagement before a P3 gets off the ground can be expensive. In Ottawa, a city council decision to cancel a light rail P3 project in 2006 led to a \$175 million claim for breach of contract from Siemens, and an eventual settlement of \$37 million.<sup>41</sup>

In considering P3 contracts, therefore, municipalities should also consider possible exit strategies if the P3 does not live up to expectations. It is better that disengagement take place before the municipality has actually signed the contract, which means that municipalities should proceed cautiously in the negotiating stage, retaining as much discretion and flexibility as possible. But if the project goes ahead, the municipality should seek to protect the public interest by minimizing the length of the contract, stipulating periodic performance reviews, and negotiating release clauses that are mutually acceptable and sensible.

There is a danger that international trade and investment agreements may present problems for municipalities attempting to cancel a P3 or take services back into public hands. These deals include the North American Free Trade Agreement (NAFTA), the World Trade Organization's Government Procurement Agreement, the Trade, Investment and Labour Mobility Agreement (TILMA) between



Alberta and B.C., the New West Partnership between B.C., Alberta and Saskatchewan, and the Comprehensive Economic and Trade Agreement (CETA) being negotiated between Canada and the European Union. Under NAFTA and the proposed CETA, U.S. and European corporations have the right to sue for lost future profits. These investor rights challenges target the federal government and not the municipality, placing the municipality under extreme pressure from the federal government not to cancel.

## 34. ARE THERE ALTERNATIVES TO P3s FOR MUNICIPALITIES?

Municipalities continue to provide most infrastructure and services through conventional public sector procurement, without using P3s. The recent financial crisis has made P3 financing more expensive and has reduced the value for money of P3s. This has created increased pressure for the public sector to use P3s but contribute more financing to make them more attractive to the private sector.

The appropriate response to the concerns raised in this guide is for municipalities to retreat from P3s and focus on improving conventional delivery. This may mean greater use of design-build techniques with appropriate quality safeguards, improved planning and management of capital projects, and greater use of fixed price contracts with appropriate penalties and incentives. This will inevitably entail improving the planning and monitoring capacity of municipalities in these areas, strengthening staffing expertise and staffing levels, rather than cutting them back.

Municipal borrowing costs can be significantly reduced by borrowing through pooled infrastructure funds as is done through the Municipal Finance Authority in B.C. and its counterparts in Ontario, Nova Scotia, New Brunswick and Newfoundland and Labrador. The idea of a Green Infrastructure Fund financed through the issue of bonds by senior levels of government is also worth investigating.

Local governments should also continue to encourage the federal government to step up to its infrastructure financing responsibilities. Municipalities are very limited in their revenue sources. At the same time, local infrastructure projects encourage economic development across the country. They are in the national interest. The federal government must renew and improve its infrastructure funding for Canada's cities and communities. Communities also need access to sustainable and growing revenue sources.

A number of communities have passed resolutions calling on the federal government not to tie its infrastructure funding to P3s. Restricting federal infrastructure funding to P3 projects limits the autonomy of local governments. The federal P3 fund should be eliminated and the money should be redirected to projects which keep community assets public.



# CONCLUSION



# TEN ESSENTIAL QUESTIONS TO ASK

The bottom line is that municipalities should be wary of pursuing P3s. They are neither the best, nor the only option.

For municipalities that do choose to consider a P3, the following 10 questions are crucial in terms of protecting public services, local democracy and the public interest. Mayors and councillors should raise the following questions if staff, consultants, or provincial or federal P3 agencies propose public-private partnerships to deliver local infrastructure projects:

1. Will there be full public consultation about the project, including the question of whether the project should be publicly or privately delivered?
2. Will elected officials be fully informed about the alternatives and be able to speak freely about the information they receive concerning development of the P3?
3. Have the full, lifetime costs of delivering the project through a P3 been calculated and compared to public alternatives delivering the same level and quality of service and will the detailed information and calculations be made public?
4. How important are assumptions of risk transfer in the P3 proposal and could any promised risk transfer instead be delivered through a public procurement process that involved a fixed price contract?
5. Will the municipality be responsible for guaranteeing the private sector's revenues? Who will be liable for cost over-runs, or project deficiencies?
6. Does the municipality have the capacity and resources to properly evaluate, administer and monitor a contract of the length, scale and complexity of the P3?
7. Does the P3 permit the municipality the flexibility to make future changes in service delivery or other public policy decisions, to end the P3 in the procurement stage and to terminate the contract if it is not meeting the public interest?
8. Are any private consultants involved in the project truly independent? Are they members of the Canadian Council for Public-Private Partnerships. Do they represent potential P3 bidders in any way? Have they profited in any projects from the delivery of P3s?
9. What impact will the P3 have on the local economy and on workers' jobs, pay and benefits?
10. What are the prospects of small and medium-sized local businesses bidding on the project?



# APPENDIX ONE



## **COMMON TYPES OF P3s**

P3s are multi-decade contracts for private delivery and management of public services or infrastructure. The private sector has always played an important role in conventional public sector procurement, designing and constructing public infrastructure. However, in P3 contracts the private sector's control extends into financing, management, operations and/or ownership of public infrastructure and services. P3s are a form of privatization, and lead to higher costs, lower quality and loss of public control. The long-term financial obligations of P3s are a form of debt which may be hidden from the public.

Some common types of P3s include:

### **OPERATION AND MAINTENANCE (O & M)**

A private corporation or consortium of corporations is under contract to operate, maintain and/or manage a public facility for a specified term.

### **DESIGN-BUILD-OPERATE (DBO)**

The private sector enters into a single contract to both design and construct a facility, and then operate and maintain the facility for a specified term.

### **DESIGN-FINANCE-BUILD-LEASE (DFBL)**

The private sector is contracted to design, finance and build a new facility, which it then leases to the government or public agency. The public sector makes scheduled lease payments. At the end of the lease term, the public sector may re-lease the facility or purchase it at the cost of any remaining unpaid balance in the lease or, in extreme cases, at the fair market price. The facility may be operated by either the private or the public sector during the lease term.

### **DESIGN-BUILD-FINANCE-TRANSFER-OPERATE (BTO)**

The public sector contracts with a private corporation or group of corporations to design, finance and construct a facility. Once completed, ownership is transferred (by sale or some other arrangement) to the public sector. The public sector then leases the facility back to the private sector, which operates the facility. Usually, the lease is of a long-term nature so that the private partner has an opportunity to recover its investment and its desired rate of return.

### **DESIGN-BUILD-FINANCE-OPERATE-TRANSFER (BOT)**

The public sector contracts with the private sector for the financing, design, construction and operation of a new project for a specified time (known as the concession period). During the concession period, which is often over 20 years, the private sector owns and operates the facility, earning a return on its investment through a lease arrangement with the public sector, or through user charges. At the end of the period, the public sector generally takes possession of the facility (though it could decide not to continue using the facility), possibly at a cost, and has the option of running the facility itself, giving another contract to the original private sector partner, or awarding a contract to another private corporation.

### **DESIGN-BUILD-OWN-OPERATE (BOO)**

The public sector either transfers ownership and responsibility of an existing facility to the private sector, or contracts with the private sector to design, build, own and operate a new facility. In either situation, legal title to the facility remains with the private sector, and there is no obligation for the public sector to buy the facility.



## APPENDIX TWO



## **TYPES OF RISK**

<b>Project risk</b>	The project will be more costly to develop than originally planned through factors such as construction delays, environmental or technological difficulties, and costing errors.
<b>Operating risk</b>	The project will not operate as planned, with consequent cost over-runs.
<b>Market or appropriations risk (demand risk)</b>	Revenues to support the project(s) will be less than planned. The nature of the revenue stream plays a role in determining the level of such risk.
<b>Technical risk</b>	Ranges from nominal to material depending on the nature and location of the project and the service levels and technology required.
<b>Financing risk</b>	Financiers assign a risk premium to the project, which can contribute significant additional financing costs. If the risks identified by the financiers cannot be mitigated, the transaction may not proceed. Mitigating interest rate or debt service cost risk over the life of the financing for the project is particularly critical. In addition, if the term of initial financing is shorter than the contract/concession term, refinancing risk will have to be addressed.
<b>Regulatory risk</b>	Changes in regulation may result in additional costs or reduced benefits to the user, which may represent a serious risk for roads projects that require environmental impact assessments, or for projects where current or future regulation can affect the stated mandate.
<b>Public policy risk</b>	The nature of public services provided is not in accordance with the public's wishes. Development of specific public policy objectives will be critical in assisting private sector partners to design partnering options that address the achievement of these objectives.
<b>Environmental risk</b>	The risk of environmental damage from the project, including risks to occupational health and safety.
<b>Legal/political risk</b>	This arises from the fact that projects typically require some level of legislative support, creating an embedded political risk for the project.
<b>Force majeure</b>	Risk associated with, or arising from, what might be described as "Acts of God."
<b>Residual value risk</b>	Relates to the market price of the asset at the end of the lease.

*Source: Loxley and Loxley, 2010, p. 35.*



## ABOUT THE AUTHOR

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Together with his son Salim, he is the author of *Public Service, Private Profits; The Political Economy of Public-Private Partnerships in Canada*.



# ENDNOTES

- <sup>1</sup> Mirza, Saeed, 2007, *Danger Ahead: The Coming Collapse of Canada's Municipal Infrastructure*. Federation of Canadian Municipalities, Ottawa.
- <sup>2</sup> Public Works Finance database, 2012.
- <sup>3</sup> This was equal to about 5.3 per cent of total public sector expenditure on capital and repairs during this period.
- <sup>4</sup> Iacobacci, Mario, 2010, *Dispelling the Myths: A Pan-Canadian Assessment of Public-Private Partnerships for Infrastructure Investments*. The Conference Board of Canada, Ottawa, p. i.
- <sup>5</sup> *Bond Buyer*, 2007, "Trends In The Region: It's Quality, Not Quantity: Eying the Big Picture of California's Big Debt," October 5.
- <sup>6</sup> Hamel, Pierre J., 2007, *Public-Private Partnerships (P3s) and Municipalities: Beyond Principles, a Brief Overview of Practices*. Institut national de la recherche scientifique, Montreal.
- <sup>7</sup> This means that they met the following requirements: i) that there is a reasonable assurance that the government will own the leased property by the end of the lease, ii) that it will receive substantially all the economic benefits to be derived from the property over the life span of the lease, and iii) that the private partner would recover its investment and earn a return as a result of the lease. For P3s to be eligible for off-book accounting these requirements would not be met and payments for them would qualify as *operating leases*.
- <sup>8</sup> The source is Iacobacci, 2010, p.29. There are errors in Iacobacci's calculations. What he describes as public sector transaction costs are actually private sector transaction costs and hence public sector transaction costs must be derived by deducting from these the data he presents on incremental transaction costs. This can be verified by reviewing any individual project's transactions costs on the Infrastructure Ontario website, e.g. [www.infrastructureontario.ca/What-We-Do/Projects/Project-Profiles/Roy-McMurtry-Youth-Centre/](http://www.infrastructureontario.ca/What-We-Do/Projects/Project-Profiles/Roy-McMurtry-Youth-Centre/)
- <sup>9</sup> Vining, Aidan, and Anthony Boardman, 2008, "Public-Private Partnerships in Canada: Theory and Evidence." *Canadian Public Administration* 51, March, p.9.
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- <sup>11</sup> Guasch, Laffont and Straub (2002) calculate that 74 per cent of transport concessions (DBFO) and 55 per cent of water concessions in Latin America were renegotiated during the 1990s. Guasch, J. Luis, Jean-Jacques Laffont and Stephane Straub (2002) *Renegotiation of Concession Contracts in Latin America*. World Bank, Washington, D.C.
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- <sup>18</sup> Murray, 2006, p.32.
- <sup>19</sup> Winch, Graham M., 2012, "Thirty years of private finance in the United Kingdom," Chapter 13 in Graham M. Winch, Masamitsu Onishi and Sandra Schmidt (eds) 2012, *Taking Stock of PPP and PFI Around the World*, The Association of Chartered Certified Accountants, February, p. 122.
- <sup>20</sup> Graham Winch and Masamitsu Onishi, 2012, "The private finance of public infrastructure," Chapter 2 in Winch et al, 2012, p.15.
- <sup>21</sup> Vining and Boardman, 2008, p. 10.
- <sup>22</sup> Vining and Boardman, 2008, p. 9.
- <sup>23</sup> Loxley, John with Salim Loxley, 2010, *Public Service, Private Profits; The Political Economy of Public-Private Partnerships in Canada*. Fernwood Publishing, Halifax and Winnipeg, pp. 91-183.
- <sup>24</sup> Knappett, John, 2009, 'P3's: (Or "No Country for Old Contractors")', [http://www.cupe.bc.ca/sites/default/files/knappett-no-country-old-contractors\\_0.pdf](http://www.cupe.bc.ca/sites/default/files/knappett-no-country-old-contractors_0.pdf).

- <sup>25</sup> Roff, 2010, p.9.
- <sup>26</sup> Some examples of municipal P3s or aborted P3s with cost overruns are the Southeast False Creek Olympic Village deal with Millennium Southeast False Creek Properties, the Save-on-Foods Centre, in Victoria, B.C., and the town centre project in Maple Ridge, B.C.
- <sup>27</sup> Columbia Institute, 2009, *Public-Private Partnerships: Understanding the Challenges: A Resource Guide*. Vancouver, B.C. p. 50.
- <sup>28</sup> International Monetary Fund, 2004, *Public-Private Partnerships*. Washington D.C., pp. 3 and 14.
- <sup>29</sup> Hall, David and Emanuele Lobina, 2005, *The relative efficiency of public and private sector water*, Public Services International Research Unit, Business School, University of Greenwich, September, p.5.
- <sup>30</sup> Loxley and Loxley, 2010, pp. 171-180.
- <sup>31</sup> Roff, Robin Jane, 2009, *The benefits of public procurement: A case study of Whistler's wastewater treatment plant*. CUPE.
- <sup>32</sup> Infrastructure Ontario, *Roy McMurtry Youth Centre. Value For Money Assessment*. (Toronto, 2007), p.1. [www.infrastructureontario.ca/en/projects/cys/gtayouth/files/YouthJusticeFacilityValueforMoney-FINAL English.pdf](http://www.infrastructureontario.ca/en/projects/cys/gtayouth/files/YouthJusticeFacilityValueforMoney-FINAL%20English.pdf)
- <sup>33</sup> Loxley and Loxley, 2010, pp. 176-177.
- <sup>34</sup> Krawchenko, Tamara and Christopher Stoney, 2011, "Public Private Partnerships and the Public Interest": A Case Study of Ottawa's Lansdowne Park Development, *ANSERJ, Canadian Journal of Nonprofit and Social Economy Research*, Vol. 2, No 2, Fall, p. 85.
- <sup>35</sup> PPP Canada *Summary Corporate Plan for the 2009-2014 planning period*. Ottawa, p. 12.
- <sup>36</sup> Columbia Institute. 2009, p. 66.
- <sup>37</sup> Auditor General Nova Scotia, 2010. Annual Report. Chapter 3. Education: Contract Management of Public-Private Partnership Schools. Halifax. [www.oag-ns.ca/feb2010/full0210.pdf](http://www.oag-ns.ca/feb2010/full0210.pdf)
- <sup>38</sup> *Le Devoir*, November 7, 2008, p.A2; and November 19, 2008, p.A1.
- <sup>39</sup> Watkinson, Brian. 2008. "P3 For You and Me." *Canadian Architect*, April.
- <sup>40</sup> Loxley and Loxley, 2010, p. 115.
- <sup>41</sup> Hamel, 2007, p. 56; and Gray, Ken, 2011, 'Siemens not on light-rail bid shortlist', *Ottawa Citizen* online edition October 21.



