A RESOURCE GUIDE

PUBLIC PRIVATE PARTNERSHIPS

UNDERSTANDING THE CHALLENGE

SECOND EDITION

CENTRE FOR CIVIC GOVERNANCE

Columbia INSTITUTE

Public-Private Partnerships:
Understanding the Challenge

Second Edition

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Executive Summary

Over the last few years public-private partnerships (P3s) have become an increasingly important topic for locally elected officials across Canada. Decades of underinvestment in infrastructure and tight operating budgets have forced local governments to constantly search for the best way to provide the services their citizens expect at the lowest cost. P3s are offered as a solution to this challenge, though not everyone agrees that P3s can deliver infrastructure and services at the lowest cost. Many critics argue that P3s can end up costing governments more in the long run. The central question for locally elected officials when contemplating a P3 is, will it ultimately serve the public interest?

This resource guide reviews a growing body of research about P3s. The record of P3s in Canada is decidedly mixed, and few P3s have been in operation long enough for anyone to be able to evaluate whether or not they offer greater value than governments taking on the project themselves. The aim of this guide is to provide locally elected councillors and school board trustees with the information and tools they need to understand how P3s work and identify key questions.

One point about P3s is clear: for locally elected officials and the staff they work with, P3s present a new set of challenges. At the heart of all P3s are intricate, complex contracts. Governments must hire outside consultants who have expertise in contract management, law and finance to help staff and locally elected officials evaluate proposals and negotiate final agreements. Even when a P3 has some chance of success, the long, complex and costly procurement process may outweigh any potential benefits.

Based on the available evidence we have identified eight points that locally elected officials may want to consider when deciding whether or not a P3 is right for their community:

1. *Need*. Could "on-time, on-budget" goals be reached through another procurement model, such as a design-build contract?
2. *Resources*. How long is the procurement process for a P3 expected to take? How much will it cost? Does the government have sufficient staff resources and in-house expertise to work on the procurement and negotiation of the P3 contract? If not, how much will hiring additional help cost? What happens if only one or two bidders respond?
3. *Risk*. What risks will the private sector take on? What risks will remain with the local government? Is it realistic to assume that the private partner will be able to manage the risks transferred to it at a lower cost than the government?
4. *Responsibility*. What will happen if the private partner fails to deliver on the agreed upon contract? Will the government still be on the hook to cover costs?
5. *Accountability*. How will the government monitor the contract? Can the government afford the additional monitoring costs? What will happen if service quality declines?
6. *Jobs*. How will the job security of current employees affected by the introduction of a P3 be protected?
7. *Flexibility*. If future public policy requires a change in the P3, will the government have the flexibility it needs to meet its goals?
8. *Exit Strategy*. If during the procurement or operation of a P3 it becomes evident that the P3 no longer serves the public interest, what is the government's exit strategy?

On balance, the research indicates that P3s can have significant downsides for the public interest. Money borrowed by the private sector is more expensive than money borrowed by governments, and those costs are passed along to the public. In addition to cost considerations, P3s present substantive issues for transparency and government oversight.

Commercial considerations can limit public oversight in procurement, and contract provisions may limit changes that may be necessary to safeguard public interest as new public policy imperatives evolve. Lengthy contracts require that the local government be able to predict public policy considerations decades down the road and effectively remove the service from public control.

Although quality public service is the goal for local governments, private enterprises must show a profit for shareholders, and the public sector remains on the hook for provision of services.

If local governments proceed down the P3 path, they are wise to do so only after a thorough review of the options.

Charley Beresford

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Introduction

The Columbia Institute's Centre for Civic Governance works to provide support to community leaders as they meet today's social, economic and environmental challenges. In 2007 we released the first version of this resource guide on public-private partnerships (P3s). In the two years since, governments at all levels have continued to explore the P3 model, and P3s continue to be a subject of much debate among the public and decision-makers.

Initially the guide was targeted to locally elected officials in British Columbia. British Columbia's provincial government is deeply invested in the success of P3s and had used the model in a number of large high-profile infrastructure projects. As part of this agenda the province was also beginning to push P3s at the municipal level. Any project over $20 million that received provincial funding had to be evaluated by Partnerships BC to see if the project could be done as a P3.[1]

The BC government continues to promote and pursue the P3 model. British Columbia is considered a trailblazer in industry circles, and other provinces have looked to British Columbia as they develop their own P3 policies. Additionally, the federal government is making a concerted effort to develop a national P3 market. The federal government's Building Canada Fund stipulates that any projects requesting $50 million or more must show that they have fully considered the P3 model. Like British Columbia, the federal government has also established a dedicated P3 office, PPP Canada Inc. Ontario and Quebec have also begun to actively pursue P3s.

Despite governments' enthusiasm, researchers and experts continue to raise serious questions about the supposed benefits of P3s.

"P3s represent a way of delivering public infrastructure that is fundamentally different from public procurement..."

- In September 2007 the Federation of Canadian Municipalities released a report on P3s and municipalities.[2] The author, Dr. Pierre J. Hamel, could not find consistent evidence that P3s are better than traditional procurement.
- In December 2007 world-renowned architect Moshe Safdie made headlines when he pulled out of the Montreal hospital project because it was slated to be built as a P3.[3] Safdie cited deep reservations about the quality of design in a P3, noting that the private consortium would have the final say over the design of the hospital.
- In late 2008 Ontario's auditor general released a report detailing the cost excesses incurred by building the Brampton Hospital as a P3.[4]
- In early 2009 Ron Parks, a forensic accountant in British Columbia, and his colleague examined four P3s in that province and found that the methods used to compare the costs of P3s with the costs of conventional procurement were biased in favour of the P3s.[5]

On top of the concerns raised by these reports, the global economic situation is having a dramatic impact on P3s. Tight credit markets mean that private financing is both harder to obtain and increasingly more expensive. While private financing has always cost more than public borrowing, proponents have argued that P3s are able to make up this difference by being more efficient and transferring risk to the private sector. In a constrained lending environment it will be much more difficult to make these arguments convincing.

P3s represent a way of delivering public infrastructure that is fundamentally different from public procurement, and their long contract periods mean they can have lasting effects for the communities that use them. Our goal in this version of the guide is to provide local leaders with information about the P3 model and resources for further research so that they

can make informed decisions. We've reviewed new information and evidence and integrated the findings into this guide. We have also provided an updated list of municipal P3 projects, including projects that were intended as P3s but were eventually either cancelled or developed as public projects.

Readers should note that for the most part, it is almost impossible to determine whether P3s are able to fulfill their promise of better, more efficient service delivery. P3s are still relatively young in Canada, so there are few examples or studies of operational P3s. However, the evidence that exists has shown us that when it comes to P3s, it is easy for things to go wrong. If there is one message we hope readers will take away from this guide, it's that any government entering into a P3 must do so cautiously, fully aware of the risks inherent in these arrangements.

SECTION 1

The Emergence and Evolution of Public- Private Partnerships

THIS SECTION TRACES the emergence and evolution of public-private partnerships in the United Kingdom and Canada. Although P3s are often promoted as a "rational" response to the need for infrastructure investment, it's important to understand some of the ideological assumptions and beliefs that underpin this model.

1.1 What are Public-Private Partnerships?

The private sector has always played a role in the provision of public infrastructure. Governments hire engineers and architects to design structures and contract with construction firms to carry out those designs. Commonly, this is done through a design-bid-build process in which governments procure design and construction services separately. This is commonly known as "public procurement" and is held as the antithesis to the P3 model.

In a P3 a government enters into a long-term contract with a group of companies (usually two or three) that have formed a consortium specifically for that project. In the most common form of a P3 the consortium takes on the responsibility of not only designing or building a facility but also operating, financing and sometimes even owning it for an extended period of time (often about thirty years). The various functions normally associated with providing a public facility and associated services are bundled into a

single long-term contract, and the consortium is responsible for obtaining financing. In return, the consortium receives regular payments.

In a P3 payments to the private party are usually based on availability, demand or a combination of both. In availability-based P3s the government pays the consortium a regular payment based on whether the facility is available and in the condition stipulated in the contract. For example, if the P3 is for a road, the consortium might receive payment if the road meets specified standards and is available for use. In demand-based arrangements, the consortium is allowed to charge users of the service. In the road example, the consortium could be allowed to charge a toll. In some cases the payment may combine both availability- and demand-based payments. The private party may be able to charge user fees, and the government may have committed to making regular payments as well.[6]

When we use the term public-private partnership in this publication, we are referring to projects that include the designing, building, financing and operation of a project (DBFO), unless otherwise specified. This category of P3 is the most widely used in Canada. In the DBFO P3 a government signs a long-term deal with a private party that agrees to take over the design, building, financing and operation of the infrastructure. In Canada this type of P3 is being used to build bridges, roads, hospitals, schools, water systems and recreation centres.

"The theoretical foundations of PFI and P3s are found in the public sector reform movement known as New Public Management."

1.2 United Kingdom: The Birthplace of Canadian P3s

The emergence and use of P3s can be traced to the United Kingdom. In 1992 the current program for P3s was introduced. Named the Private Finance Initiative (PFI), this program sought to get private enterprises involved in the provision of public services at the levels of both the central government and local governments.[7] Initially the PFI was applied to transportation projects, but later it was extended to other areas, including schools and hospitals. When the Blair government took power in 1997, it continued to use the PFI.[8] As of November 2008 the UK treasury lists 633 PFI projects throughout the United Kingdom.[9]

1.3 P3s and New Public Management

The theoretical foundations of PFI and P3s are found in the public sector reform movement known as New Public Management (NPM).[10] NPM became popular in a number of industrialized countries in the 1980s.[11] At the heart of this movement is a belief in the efficiency of the market and the inefficiency of the public sector. NPM advocates argue that the public sector lacks any incentive to limit its own size and scope, and as a result governments can become bloated and ineffective. To solve this problem, NPM adherents recommend applying market-based principles, such as competition, to the public sector to create the incentives needed for more efficient government.

Attempts to apply NPM principles have been made at all levels of government in Canada, including local governments.[12] NPM can be recognized by a set of buzzwords that include "innovation," "customer choice," "flexibility" and "competition."[13]

In the United Kingdom the government developed the PFI in order to apply market principles to the services that otherwise could not be privatized outright.[14] These were services with a high social value, and which there was general consensus that the state had an obligation to provide, such as health care and education. Following the basic tenets of NPM, P3 and PFI proponents believed that by transferring responsibility for the delivery of these services to the private sector, the public sector would be able to harness the market-based incentives it lacked.

Of course, this theory raises important questions. What are the costs to the public of this more "efficient" provision of services? Although the private sector has an incentive to reduce costs, does it lack an incentive to provide quality infrastructure? Driven by the need to maximize profit, the private partner may be tempted to reduce costs by cutting corners and reducing service quality.[15]

1.4 P3s in Canada

Throughout the 1990s various levels of government experimented with the P3 model, but for the most part their attempts remained ad hoc. A few early examples included Highway 407 in Ontario, schools in Nova Scotia and the Confederation Bridge connecting Prince Edward Island and New Brunswick. All of that began to change in the early 2000s, particularly in British Columbia when a new government was elected in 2001. Under the leadership of Premier Gordon Campbell the provincial government has embraced the model and fostered a reputation as a P3 pioneer. As of early 2009 Partnerships BC listed sixteen projects as underway with another five in procurement.[16]

The BC government took three key steps in its efforts to establish a P3 market in British Columbia.

"The BC government took three key steps in its efforts to establish a P3 market in British Columbia."

1. It established a dedicated P3 office, Partnerships BC.
2. It introduced and applied a new framework for managing all provincial capital assets. The Capital Asset Management Framework emphasizes a life-cycle approach to infrastructure projects. In and of itself the framework does not preclude the use of P3s for all projects, but it does require public servants to explore the P3 option.[17]
3. At the 2006 meeting of the Union of British Columbia Municipalities the premier announced that any project (even at the municipal level) with a value over $20 million that would receive provincial funding would have to be considered as a P3. In November 2008 the $20 million threshold was increased to $50 million.[18]

The federal government as well as other provincial governments have followed British Columbia's lead. Along with the establishment of a federal P3 office, the federal government stipulates that any project requesting $50 million or more from the Building Canada Fund must show that the P3 option has been fully considered. Quebec and Ontario have also established dedicated P3 offices and have a number of P3 projects underway while Alberta, Saskatchewan, New Brunswick and Nova Scotia have recently announced projects that will use the P3 model.

At the municipal level P3s have been used for recreation and event centres, bridges, civic facilities and waste facilities, as well as some water infrastructure. Appendix A contains a table of P3 projects undertaken by municipal and regional governments across the country. The list below contains some of the more prominent examples of local governments using P3s.

- The City of Ottawa has emerged as a champion of municipal P3s. It has a dedicated P3 office and has used P3s in over five projects. In 2007 the

Ottawa Citizen revealed that the municipality had to bail out two of these projects (see Box 3.3).[19]

- Winnipeg was one of the first municipalities to use P3s. In 1996 it used a P3 to design, build, finance and maintain the Charleswood Bridge. As of early 2009 the City was in the procurement stages of a P3 for the Disraeli Bridge and the Chief Peguis Trail.[20] In late 2008 the Winnipeg city council also adopted a report by the accounting firm Deloitte & Touche recommending the city seek a "strategic partner" for the design, construction, finance and operation of two water pollution control centers, as well as adopt the concept of a city-owned municipal corporate utility[21] to operate city-owned utilities, including water services.[22]
- In late 2008 the Calgary city council adopted its own P3 policy to help guide decisions about P3s.[23]
- In 2008 the Edmonton city council decided not to go ahead with a proposed P3 for a new recreation centre.[24] Also in 2008, Edmonton's auditor general released a report on the benefits and risks of P3s.
- As of early 2009 the council of St. John's, New Brunswick, was mired in debate about using a P3 to upgrade its water system.[25] On Vancouver Island in British Columbia, the Capital Regional District was in the midst of planning upgrades to its waste-water treatment system. The district must also show that it has fully considered using P3s for upgrading its wastewater treatment in order to receive promised funding from the provincial government.

In late 2008 a representative of PPP Canada Inc. stated that the organization was going to focus on municipalities.[26] Indeed, the P3 industry has long viewed municipalities as an untapped market.[27] P3 proponents will often present P3s as a solution to the twin issues of narrow municipal tax bases and lack of infrastructure investment from senior levels of

government. In 2007 a report released by the Federation of Canadian Municipalities estimated that Canada's municipalities faced a $123-billion infrastructure deficit.[28]

TABLE 1.1 SELECTED PROVINCIAL AND FEDERAL P3 INITIATIVES*

Federal Government	• 2006: Federal government announces its intention to establish a dedicated office to encourage P3s in Canada. • 2007: Budget contains $1.26-billion national P3 fund. • 2007 onwards: All projects seeking over $50 million in funds from the Building Canada Fund and the Gateways and Border Crossings Fund have to show that they have fully considered the P3 option.
	• 2002: Government establishes Partnerships BC as a Crown corporation. • 2002: All ministries must use Capital Asset Management Framework (CAMF) guidelines, which encourage the exploration of P3s for new capital projects. • 2006: Premier announces that all projects over $20 million that are to receive provincial funding must show that they have fully considered the P3 option. • 2008: $20 million threshold increased to $50 million.
Alberta	• 2007: Build-maintain P3s signed for ring roads in Edmonton and Calgary. • 2008: Government announces it will use P3s to build eighteen new schools in Edmonton and Calgary.
Saskatchewan	• 2008: Government announces it was working on a P3 proposal for schools. • Late 2008: Government backs away from its idea to use P3s for schools. • 2009: Government establishes P3 secretariat.
Manitoba	• No indications of a P3 program at the provincial level.
Ontario	• Mid-1990s: Government attempts to find a private partner to finance, build and operate Highway 407 toll route. When it fails to find a partner, the province builds the route as a regular design-build contract then sells the operating concession to a consortium.[29] • 2001: Government announces that P3s w be used in two new hospital projects—the William Osler Health Centre in Brampton and the Royal Ottawa Hospital. • 2005: Government launches five-year infrastructure plan and establishes Infrastructure Ontario to "manage Ontario's major infrastructure projects using alternative financing and procurement methods."[30]

Quebec	• 2004: Government establishes Quebec Public-Private Partnership Agency as part of its "Modernization Plan." • 2005: Potential P3 projects announced in two Montreal university hospitals, construction and maintenance of two major toll highways and a concert hall in Montreal.
Nova Scotia	• 1997: Government launches a program to have all future schools built as P3s. The program results in more than thirty P3 schools, but is abandoned in 1999. • 2008: Government enters Memorandum of Understanding with Partnerships BC to have that organization review ten potential P3 projects. • 2008: Government selects three of these projects for further study. If Partnerships BC makes a strong case for them, they will go ahead as P3s.
New Brunswick	• Mid-1990s: Government establishes New Brunswick Highway Corporation to undertake new major highway projects using a P3 structure.[31] • 2009: Government announces plans to use P3s for schools, hospitals and courthouses.
Prince Edward Island	• 2007: Government announces it will look at using P3s for nursing homes. • 2008: Government announces that nursing homes will be built through public procurement instead.
Northwest Territories	• 2008: Government considers a P3 for Mackenzie Valley Highway

* Information for this table was gathered in March 2009. The table is not an exhaustive list of all initiatives.

1.5 P3s as Stimulus

In the face of a global economic crisis, a looming recession in Canada and the threat of a coalition government, the 2009 federal budget included infrastructure spending for the stated purpose of stimulating the economy.[32] In the budget it tabled, the federal government reiterated its $33 billion Building Canada Plan and announced new investments in green infrastructure, community projects, rehabilitation projects, recreational infrastructure and national recreation trails. The budget also announced that PPP Canada Inc. would be accepting applications for the P3 fund in 2009–10.[33]

Funding for infrastructure should have been welcome news for municipalities across the country. Over the years, higher levels of government have progressively shifted responsibilities onto lower levels. These years of downloading, plus an inadequate tax base, have made it difficult for municipalities to keep up with demand for facilities and services.

However, a number of municipalities were less than quick to rejoice at the news. Municipal officials pointed out that although the Building Canada Fund was announced in 2007, it had yet to actually fund any projects.[34]

In terms of using stimulus to promote P3s, the Building Canada Fund requires that for any project receiving $50 million or more, applicants must show that the P3 option has been fully considered. Yet if the goal of this spending is to create jobs and get projects going quickly, using P3s is the wrong approach because P3s take a much longer time to procure than publicly procured projects. Furthermore small and medium-sized construction companies located across Canada have reported that they are being excluded from P3s by multinational firms, which are the only firms large enough to

be able to bid on P3s. This means that infrastructure spending is going to large firms outside of Canada instead of supporting local economies.

BOX 1.1 LOCAL CONTRACTORS LEFT BEHIND BY P3s?

In a submission to British Columbia's Finance Minister, the BC and Yukon Territory Building and Construction Trades Council reported that P3s are hurting small and medium-sized contractors in British Columbia.[35] While the council supports P3s in principle, it has found that when the prime contractor (the contractor that was part of the initial P3 bid) refuses to break the construction aspect of the project into smaller parts, it precludes the participation of smaller firms. According to the submission, the council understands that in some cases it makes no sense to break down the parts, but that in a number of cases it does.[36]

The submission uncovers what appears to be a common abuse of the P3 model. Once the contract is awarded, there is no oversight into how the prime contractor awards bids for smaller contracts. The BC and Yukon Territory Building and Construction Trades Council states that in some cases the prime contractors are not tendering bids fairly or openly.

1.6 Conclusion

A number of governments in Canada now appear comfortable pursuing and promoting P3s for infrastructure. Unfortunately, it's impossible to know how these projects will perform over the long term.

Local governments are often portrayed as the last P3 holdout or, in the words of one lawyer who specializes in P3s, "the last bastion of bureaucratic

procurement."[37] With federal and provincial governments working to promote the P3 model, it may become more and more difficult for local governments to exercise autonomy in their decision-making.

SECTION 2

Private Finance and the Credit Crisis: An Uneasy Future

THE USE OF PRIVATE FINANCE is the linchpin of P3 arrangements. It's important to have a basic understanding of what private financing means for the provision of public infrastructure and how that financing is being challenged by current market conditions. While the previous section focused on the history of P3s, this section looks at the uneasy future facing this model.

2.1 Public Sector Accounting and Private Finance

The defining aspect of P3s is their use of private financing. In a P3 the consortium secures the financing for the project while the government agrees to pay the consortium a series of predetermined payments or allows the private sector to charge user fees. In a publicly procured project the government pays for the project from its revenue or by issuing debt.

The companies that come together to bid on P3s generally secure financing through "project finance," a financing technique unique to P3s and infrastructure. It is also known as "limited recourse financing." With project finance, lending is primarily based on the expected cash flow of P3s and to a limited extent on the assets of the project (as collateral). This is different than a corporate loan, wherein funds are lent based on the assets held by a company.[38] With the exception of the Royal Bank of Canada, very few Canadian banks have been involved in P3s.[39]

Equity is also used to finance projects, though there tends to be a high debt-to-equity ratio. In May 2008 one expert reported that the going ratio was about 92 per cent debt and 8 per cent equity.[40] In the past, companies involved in projects, as well as institutional investors (such as pension funds) and specialist infrastructure funds, have provided some equity.[41]

Private financing generally costs more than public borrowing for two main reasons.

1. Most governments enjoy favourable credit ratings, meaning they can borrow at lower rates than private companies.[42]
2. The equity component of private finance means these projects have to produce a return on investment.

Off-book financing

When P3s first became popular, they were seen as a way for governments to avoid debt on their balance sheets. For example, a 1996 study undertaken by the BC Ministry of Municipal Affairs and Housing found that one of the main reasons why local governments used P3s was because it provided them "access to an alternate source of financing which reduces the municipality's need to incur long term debt."[43]

Through off-book financing, governments entering P3s were able to appear as if they were building new infrastructure without incurring new debt. In some instances, governments attempted to keep debt off-book by structuring P3s as operating leases.[44] In accounting, leases are understood as either capital leases or operating leases. If a P3 is treated as a capital lease, then the government has to record the capital costs of the asset on its books with a corresponding liability. If a P3 is treated as an operating lease, then payments to the consortium are only recorded as they are incurred and no long-term liability appears in the government's financial statements.

"Through off-book financing, governments entering P3s were able to appear as if they were building new infrastructure without incurring new debt."

Generally the decision to treat a P3 as an operating or capital lease comes down to which party bears the majority of risks and rewards associated with an asset, regardless of legal ownership. Because P3 contracts often give governments the right to take over an asset if the private sector fails to deliver, and usually include provisions for transferring ownership at the end of the contract, accountants will often determine that the risks and rewards of the project lie with the government and should be treated as a capital lease.[45]

One of the reasons governments were so attracted to the off-book potential of P3s was because of the cash-based accounting methods that governments have only recently moved away from. Under cash-based accounting, the capital costs of new infrastructure projects were expensed when they were paid. This meant that investing in new capital infrastructure had a massive impact on a government's balance sheet. With P3s, the upfront capital costs and the operating costs are combined into a series of 'unitary payments' that governments pay throughout the life of the agreement. Thus, by entering a P3, governments were avoiding upfront capital costs.

In reality, governments were still taking on debt, it just wasn't showing up on the books.[46] This was problematic for a number of reasons, not least of which was the fact that the payments governments were committing to would eventually have an impact on budgets just as borrowing would, but it could take years before anyone realized the full extent of these obligations.

Beginning in the 1990s, most governments in Canada made the switch from cash-based to accrual accounting, and as of January 1, 2009, municipalities in Canada are required to adopt full accrual accounting practices.[47] In terms of P3s and private finance, the important difference between cash-based and accrual accounting is that with accrual accounting the costs of acquiring an asset are spread out over the life of the asset.[48] The accounting advantage that P3s had with the cash-based system should disappear

because the upfront costs of capital no longer appear on the books as if they were paid all at once.[50] However, according to the Canadian Council for Public Private Partnerships many government officials' decisions are still influenced by past cash-based accounting practices.[50]

Even with accrual accounting, there are still questions about how governments should record P3 payments. Because the capital and operating costs in a P3 are combined into a unitary payment it can be difficult to assign a cost to the capital asset. The Comptroller General in BC has ruled that capital costs must include construction costs, interest during construction and project management costs.[51] These costs show up on the government's books as any other capital asset. Meanwhile, the operating payments of the project are recorded as contractual obligations in a note accompanying financial statements.

2.2 New Rationales for Private Finance

Since it is generally deemed unacceptable to use P3s to hide debt, P3 proponents now argue that private financing frees up the government to spend money on other priorities.[52] There are two problems with this reasoning. First, in a P3 the government still has to pay over time for the infrastructure. By using P3s, governments may be freeing up today's tax dollars, but at the expense of tomorrow's.[53] Second, proponents have argued that when private finance is involved, the private partner in a P3 has more incentive to ensure that projects are delivered to the terms of the contract.[54] Yet in our research on P3s we found no evidence that the inclusion of private finance specifically resulted in more efficient or innovative projects.

Moreover, there is evidence that private finance will add to the costs of a project and that taxpayers will eventual pay these higher costs through

the life of the agreement.[55] The City of Vancouver demonstrated the advantage of public over private financing in early 2009 when it renegotiated the financing of its Olympic Village housing development at much lower rates than had been obtained privately by the private contractor. Although the original deal was not officially called a P3, it was similar to a P3 in that there had been an expectation that risk had been transferred to the private developer.

BOX 2.1 CITY OF VANCOUVER OLYMPIC VILLAGE AND WHISTLER OLYMPIC VILLAGE[56]

In 2010 Vancouver and Whistler will host the Winter Olympic Games. As part of their hosting duties, both Whistler and Vancouver are building housing complexes for athletes. In both cases these complexes include market and non-market housing. The market housing will be later sold to help recoup some of the costs of the developments.

In 2006 the City of Vancouver sold the development rights to an area of land called Southeast False Creek for $159 million to Millennium Southeast False Creek Properties. In turn, Millenium was responsible for securing financing for the development. Unable to secure a loan through a bank, Millennium turned to Fortress Investment Group, a New York–based hedge fund. Under the terms of the financing, the city provided security to the loan in the form of a completion guarantee and a payment guarantee.

Between the months of November and January 2009 the public found out that Millennium was experiencing significant construction cost overruns and that Fortress had refused to lend Millennium any more money.

In late January a city report revealed that after the soft and hard construction costs, the biggest cost of the development was the financing.[57] Under the terms of the agreement, Fortress received a minimum 9.5 per cent interest on the loan. With the credit crisis and the decline in interest rates, Fortress was receiving a 4.5 per cent to 7.5 per cent premium over market rates. In late February the city bought out the Fortress loan and sought to borrow money to lend to Millennium at a much more favourable interest rate to finish the project. Buying out the loan saved the City an estimated $90 million.[58]

Meanwhile, Whistler's Olympic Village project negotiated a loan of $100 million dollars with an interest rate of 1.585 per cent from the Municipal Finance Authority. Granted, this was a floating interest rate and was negotiated during a time of incredibly low rates, but it does point to the significant savings to be found through government financing as opposed to private financing.[59]

2.3 Private Finance and Tight Credit

The current credit crunch has had a major impact on P3 financing.[60] Tight credit markets mean that financing for these large projects is not only more expensive but also harder to secure. Previously, the private sector could raise capital in a number of ways, including commercial bank loans and bonds. With the current credit crisis, the bond market essentially vanished, and P3s now rely solely on banks, which by all accounts are more reluctant to enter into these long-term lending arrangements.[61] As the Canadian Council for Public-Private Partnerships writes, "Just when PPP was gaining strong momentum in Canada, along comes a market condition so challenging that no one is absolutely certain what impact it will have on the

Canadian PPP market. There are some who are concerned the restricted access to debt markets will slow things down or drive the costs up beyond proof value thresholds. There are others who speculate that when the dust settles, investment must go on and infrastructure's long term nature will provide a very attractive destination."[62]

Daniel Roth, Managing Director in Ernst & Young's Infrastructure Advisory practice writes that the credit crunch is also creating difficulties and delays in the procurement process.[63] Governments face greater transaction costs as deals take longer to complete. As well, because lenders are insisting on flexibility in the price of financing (such as the right to increase interest rates), bidders can't present a financial proposal in their bids. Thus, the competitive bid process, a key component of P3s, is undermined because governments aren't able to evaluate the financing aspect of the bids.

BOX 2.2 A RETURN TO PUBLIC FINANCING IN BRITISH COLUMBIA[64]

In British Columbia, the Port Mann Bridge/Highway 1 project is a controversial P3 that aims to replace one of greater Vancouver's main commuter bridges and upgrade a 37-kilometer stretch of highway. The BC government has always planned to undertake this project as a P3.

The deal was to be finalized in early January 2009. The private consortium, which had already been selected, and the project were behind schedule. On January 14 the Minister of Transportation announced that he was giving the consortium until early February to close the deal. The media reported that the consortium was having difficulty pulling together financing. It became clear that the private financing P3s rely on was becoming more and more difficult to obtain.

Thomas Ross, a senior associate dean at the University of British Columbia, was quoted in the Vancouver Sun saying, "It may be that some of them [P3s] are difficult to finance in these times, and it may be that the only people that can really borrow are governments, so we go back to the more traditional model of procurement until financial markets settle down."[65]

A little over a week later the BC government announced it would provide one-third of the financing needed for the project. At that point the government gave the impression that for all intents and purposes the deal was done. Then in late February the Transportation Minister announced that the province would finance the $3.3 billion project itself. The province spun this as a good-news story, stating that it had secured a fixed-price contract for the construction of the bridge so the province would not be on the hook for any cost overruns. This poses the question, why not just build these projects through regular design-bid-build or design-build fixed-price contracts to begin with, avoiding the additional burden of long-term agreements?

To aid the flow of credit, the 2009 federal budget included the "Extraordinary Financing Framework," under which the government will provide as much as $200 billion to encourage financing and credit. How and if this funding will support the Canadian P3 market remains to be seen, but since Canadian banks have, to date, played a very limited role in the P3 market, it may make no difference at all.

2.4 Conclusion

Since the mid-2000s there has been a shift among most provincial governments and the federal government toward the greater use of P3s. However, this movement's momentum may be stalled by the credit crisis.

Nevertheless, governments will likely continue to promote P3s. In his paper for the Federation of Canadian Municipalities, Dr. Pierre Hamel notes that P3s aren't really a solution to the problem of infrastructure finance. He writes, "In this respect, we would emphasize that in promoting P3s, one of the objectives pursued by government is to create new business opportunities for investors."[66] In light of the global economic crisis many predict that markets are going to see a "flight to quality" among investors. Infrastructure may thus prove to be a highly attractive investment.

SECTION 3

Understanding P3s

P3S REPRESENT A FUNDAMENTALLY different way for governments to deliver infrastructure projects and related services. Not only do they require heavy involvement and reliance on the private sector, but the procurement process, the detailed contracts, the methods used to allocate risk and the additional costs involved present new challenges to local governments.

In this section we review some of the terminology and logic used when discussing P3s. We begin by looking at how P3s are defined, and encourage readers to think critically about what P3s actually are versus the language used to cast them in a favourable hue.

The following section first looks at the procurement process surrounding these arrangements—a process that tends to be long and expensive. P3 adherents will often claim that P3s are on time and on budget, but these proponents usually only take into account the period after the contract is signed. Considering the procurement period (when the cost of the project often goes up) would make it harder to claim that P3s are on time or on budget.[67]

Next we take up the idea of risk transfer. P3 proponents argue that the main benefit of P3s is that they allow governments to transfer risk to the private sector. Unfortunately, research has shown that risk transfer is often exaggerated and governments have not been very successful at transferring certain types of risk to the private sector.

Finally we look at how P3s are generally presented to the public and how the cost-advantage arguments for these deals are made. Often governments will release "Value for Money" assessments that show why the P3 is

"In Canada the most common type of P3 is the design-build-finance-operate/maintain model as well as the design-build-operate model."

cheaper than public procurement. We look at the elements of these reports, including the public sector comparator and discount rates used to calculate the net present value of future payments. We end by briefly looking at contracts and additional costs of P3s and how trade agreements might impact municipalities entering these arrangements.

3.1 Definitions

"Public-private partnership" is a common term that has been used to describe a number of arrangements in which governments partner with non-governmental bodies, be they voluntary sector or private sector organizations. Yescombe writes that public-private partnerships became a familiar term in the United States in the 1960s when it was used to describe urban renewal projects that had private sector involvement.[68] Indeed, the term is common in discussions about affordable housing.

In this publication the term public-private partnership and its abbreviation, P3, refers to a specific type of arrangement that involves a long-term agreement between a private sector party and a government in which the private sector party designs, builds, finances and operates public infrastructure in exchange for some form of payment. In this sense the term P3 refers to a specific way of delivering infrastructure that involves private companies. Theoretically, the government oversees the project while the private partner takes over its delivery.

The literature on P3s identifies seven major roles private partners can take on in P3 arrangements: finance, design, building, operation and/or maintenance, leaseback, transfer and ownership.[69]

In Canada the most common type of P3 is the design-build-finance-operate/maintain model as well as the design-build-operate model. Ontario

is also using a model called build-finance for many of its Alternative Financing and Procurement (AFP) projects, while a number of municipalities have used an operate-maintain model for waste and waste-water projects. P3 proponents argue that by bundling these functions into one contract, the private sector has more room to innovate and seek out efficiencies.[70] For example, if a P3 assigns the design, construction and operation to the private sector, then the private sector will ensure that the project is designed and built in such a way that allows for efficient service delivery once it's operational. However, the flip side of this argument is that these projects are being designed to a slim set of requirements, and the consortia are more interested in finding ways to build and operate the projects as cheaply as possible rather than designing facilities that meet the needs of communities. This is a particularly important point for social infrastructure projects such as hospitals and schools.

BOX 3.1 ARCHITECTURE AND P3s

In 2006 the Montreal University Health Centre announced that world-renowned architect Moshe Safdie would be one of the innovators behind the hospital's master plan.

In 2007 Safdie made headlines when he unceremoniously quit the project. The architect stated that the Quebec government's decision to undertake the project as a P3 was "highly problematic."[71] In Safdie's experience the design process is compromised in a P3 because the international consortium responsible is more interested in saving money than in innovation. Lisa Rochon of the *Globe and Mail* wrote, "Forget about capturing magical light, or weaving an interesting rhythm of built

form along the street. Under the newly imposed regimes now taking Canada by storm an architect's role is reduced to compiling binders full of bubble diagrams and measured distances between a nursing station and a patient's room. The stupidity is such that even Safdie was being asked to compile output specifications—not design."[72]

In his article for *Canadian Architect*, Brian Watkinson writes of unrealistic expectations being placed on architects as a result of builders attempting to transfer all design risk onto the architects.[73] Watkinson also reiterates Safdie's concerns about design, noting that the early Private Finance Initiative schools and hospitals were so unattractive that politicians were too embarrassed to stand in front of them for the ribbon-cutting ceremony. One of the main problems for architects working on P3 projects is the limited (if any) access they have to the people who will eventually be using these facilities. Watkinson writes, "Close interaction with users, which most architects consider essential in the design process, is replaced by reference to a performance-based statement of requirements that is prepared on behalf of those users." Back in Montreal a coalition of neighbourhood groups reported that their input is being ignored in the process to build the new superhospital despite a formal pact they had with the hospital to work together.[74]

Who are the 'partners' that governments deal with in P3s?

In a typical P3 arrangement there are a few key players that compose the "private partner." Typically two or three companies, also known as the project companies or investors, will come together, forming a consortium to bid on a project. Usually the consortium will form a special purpose vehicle,

which limits the exposure of the companies and essentially becomes the private partner in the P3. The other important players are the lenders—usually a bank—and the subcontractors that actually carry out the work of the P3.

BOX 3.2 ABBOTSFORD HOSPITAL AND CANCER CENTRE: ONE PARTNER, MANY OWNERS

As an example of what governments might expect when they enter P3s, we can look at British Columbia's flagship hospital P3: the Abbotsford Hospital and Cancer Centre. Access Health Abbotsford was selected as the preferred bidder for the project in 2004. At that time Access Health Abbotsford included Johnson Controls and Sodexo for facilities management, PCL Constructors for construction and ABN AMRO bank for financing. In March 2006 a newsletter for the hospital announced that the Macquarie Group had purchased 81 per cent of the equity investment in Access Health Abbotsford from ABN AMRO and would be responsible for the overall management of the project.[75] Then in January 2007 Laing Investments acquired an 81 per cent interest in Access Health Abbostford and since then has taken over management responsibility.

Before the hospital even admitted its first patient, the private consortium had changed hands twice.

Thinking critically about P3 definitions

The growth of P3s has been matched by growth in public awareness and debate. The public generally agrees that governments must exercise caution when entering them. Those with a vested interest in promoting P3s will often use words that have positive connotations. It's prudent, therefore, to be aware of language that defines these arrangements.

"In P3s, the two parties have very different goals, and only the private partner makes a profit."

Proponents of P3s often use terms like "cooperative" or "mutually advantageous," which serve to reinforce a positive image of P3s. For instance, the definition used by the Canadian Council for Public-Private Partnerships, a member-sponsored organization involved in the promotion of P3s, is:

> A cooperative venture between the public and private sectors, built on the expertise of each partner, that best meets clearly defined public needs through the appropriate allocation of resources, risks and rewards.[76]

The notion of trust also frequently appears in the P3 literature. In his description of a P3 that "successfully" built a school in Abbotsford, former superintendent Elmer Froese writes that "P3s are held together by trust and an alertness to the interests of other partners. These factors of full trust and reciprocal benefits are fundamental. There is no room for exploitative agendas or side deals."[77] However, this particular P3 fell apart during the negotiation stage and ended up proceeding as a conventional public undertaking after the Ministry of Education bought out the school.

Even the concept of partnering suggests compatible goals, shared benefits and costs, long-term relationships and a sense of commitment. In fact, P3s are not actually partnerships in the legal sense of the word. In the legal sense, partnerships consist of two or more persons who agree "to undertake a business venture as co-owners, with the intent to make a profit."[78] In P3s, the two parties have very different goals, and only the private partner makes a profit.

3.2 The P3 Procurement Process

Industry experts often advise that the key to successful P3s is a strong procurement process. The procurement or tendering process comprises the steps taken by a government to select a preferred bidder to carry out a P3. Good procurement is believed to be key to ensuring that value for money is achieved since it is during the procurement stage that competition among bidders will lead to the ideal mix of price, innovation, quality and risk transfer.[79]

However, the long procurement processes that preface P3s represent a nagging problem that deters potential bidders and compromises the benefits of competition.

Transparency is also a key concern in the procurement process. In May 2008 *Business in Vancouver* conducted a survey of BC business leaders.[80] For the most part respondents were in favour of P3s, except when it came to the question of transparency. Fifty-five per cent of respondents said P3s are not transparent about procurement, funding and operation.

The procurement process generally occurs in two main stages: the initial pre-negotiation stage, in which governments select their preferred bidder; and the negotiating stage, in which governments and the preferred bidder negotiate the final contract. Aside from taking a long time, the procurement process can be very expensive for both governments and bidders.

P3 procurement framework

The following procurement framework was taken from a paper by Alberta Infrastructure and Transportation.[81] It serves as a useful overview of the stages local governments can expect if they go the P3 route. According to this framework the procurement process will take anywhere from one year

"Aside from taking a long time, the procurement process can be very expensive for both governments and bidders."

to sixty-eight weeks to complete, assuming that nothing goes wrong. In reality the procurement of P3s often suffers from both cost and time overruns. A 2004 study from the United Kingdom examined thirty-two cases and found that in 98 per cent of them, the procurement process took anywhere from 11 to 166 per cent longer than expected while cost overruns were in the range of 25 to 200 per cent more than expected.[82]

Request for Qualifications (RFQ)

- Duration is 12–16 weeks.
- After issuing an RFQ, governments receive and evaluate submissions it receives from respondents.
- The end result will be a short list of respondents.

Request for Proposals (RFP)

- Duration is 32–40 weeks.
- Governments ask short-listed respondents to submit proposals for evaluation.
- Governments provide feedback on the proposals.
- Governments ask respondents to submit detailed proposals for evaluation.
- Governments and respondents develop draft project agreements.
- Governments select a P3 partner.

Contract Finalization

- Duration is 8–12 weeks.
- The final P3 agreement is negotiated.

Generally a project management team is established to oversee the process. This team includes external advisors and consultants.

Local governments might also issue a request for expressions of inter-

est (RFEI) along with or in place of an RFQ. RFEIs are usually issued when governments have only a general idea of what they want to achieve through a P3 and no idea of how to achieve the end goal.[83] RFQs, however, are issued when the project goals are well defined and the government wants to know if any private contractors are interested in the project and possess the requisite qualifications.[84] Of course, it should be noted that in both cases the government's focus is on the outputs it desires, not the precise inputs. Theoretically this allows the private sector to come up with innovative methods of delivering these outputs.

Length and cost

The complexity of the procurement process is an important factor for local governments to consider. Local governments often lack the staff needed to plan, negotiate and monitor a contract that is suited to local circumstances and must spend significant resources acquiring the expertise and advice required. A 2007 report from the UK National Audit Office found that the average cost of external advice in procuring Private Finance Initiative deals was just over £3 million per project—over 6 million Canadian dollars.[85] In British Columbia the Abbotsford Hospital P3 procurement cost $16 million, in contrast to the $8 million it would have cost if it were procured as a public project.[86]

In Cornwall, Ontario, the local paper reported mounting costs associated with procuring a recreation centre as a P3. Costs included $95,000 to Ernst & Young for services related to the project, including preparing documents and exploring the possibility of a P3, as well as $125,000 to a Toronto law firm for help preparing the agreements and documents required in a P3 deal.[87] In Halifax the consultant fees associated with preparing an RFP for a four-pad arena came to $128,640.[88]

Another example comes from the Resort Municipality of Whistler.

"The complexity of the procurement process is an important factor for local governments to consider."

Throughout 2005 and 2006 Whistler pursued a design-build-operate (DBO) P3 to upgrade its waste-water treatment plant. In 2006 the DBO approach was eventually abandoned in favour of using a design-bid-build approach instead. As part of the discussion leading up to that decision, the municipal council directed staff to report on the costs associated with the DBO process, through the following resolution:

> "That Council direct staff to prepare a report for Council that summarizes all costs to date and projected for the sewage treatment plant project associated with the DBO process including:
>
> - Payments to Partnerships BC
> - Legal fees associated with drafting the Request for Qualifications
> - Legal fees associated with drafting the Request for Proposals
> - Legal fees associated with drafting the Partnering Agreement
> - Costs for project team members to attend Council meetings
> - Legal fees associated with an opinion on international trade agreements
> - Costs for the Blue Ribbon Panel
> - Costs for Whistler's procurement consultants
> - The Fairness Auditor
> - The Conflict of Interest Adjudicator
> - A Value for Money Auditor
> - Payments to unsuccessful proponents

- The Alternative Approval Process, including legal fees
- Any other substantial costs associated with this procurement process, and
- Any other costs associated with the private operation of the plant for the next 12 years over and above what would usually be incurred with operation of the plant for example, reporting requirements, resolution of disputes."[89]

The costs the staff reported back are summarized in Table 3.1.

TABLE 3.1 COSTS ASSOCIATED WITH DBO PROCESS FOR WHISTLER'S SEWAGE TREATMENT PLANT

Options analysis	
Partnerships BC	$55,131
Blue ribbon panel	$52,975
Request for qualifications	
Legal fees	$2,363
Project management	$92,320
Partnerships BC	$55,331
Engineering	$82,395
Request for proposals	
Legal fees	$52,085
Project management	$191,135
Partnerships BC	$133,502
Engineering	$172,387

Partnering agreement	
Legal fees	$31,677
Project management	$115,952
Partnerships BC	$102,252
Engineering	$56,178
Fairness auditor	$4,268
Legal opinion: international trade agreements	$2,090
Conflict of interest adjudicator	$13,179
Public communications consultants	$56,091
Project management legal fees	$24,135
Alternative approval process	
Legal fees	$9,166
Public survey	$19,200
Communications	$44,155
TOTAL	**$1,367,967**

Source: Engineering and Public Works, Resort Municipality of Whistler (2006)

For the private sector the costs of bidding on a project are also quite high and can be a disincentive to potential bidders. To help offset these costs, some governments will offer honoraria to bidders, though anecdotal evidence suggests these honoraria don't come close to covering costs.[90] As well, the high costs of bidding make it so that only a few very large companies can actually afford to bid on P3 projects.

3.3 Risk Transfer

One of the most common arguments used to promote P3s is that the public sector will attain value for money by transferring the optimal amount of risk to the consortium. According to Thomas Ross, an expert on P3s, risk transfer in and of itself is not a good reason to do a P3.[91] Rather, he writes, the goal of a P3 should be to transfer risk to the party best able to manage it at the minimal cost. For Ross, risk transfer is all about creating the incentives necessary to ensure that a private sector contractor does what it's supposed to do.

Before the procurement process potential risks should be identified, quantified and allocated to the sector best able to manage them at the least cost. Theoretically, the greater the involvement of the private sector in a project, the greater the risks the private sector will be able to take on, because it will have more control. In return for taking on these risks, the consortium can expect to be compensated at a level that matches the level of risk it takes on.[92] In other words, the consortium charges a premium for accepting risk.

In evaluating P3 projects already underway, it can be difficult to determine whether or not governments received additional value through the transfer of risk. For example, if the private sector is responsible for bearing the risk of construction delays, but that risk never materializes, then it can be difficult to determine if the premium the government paid to the private sector was worth it. The final report of the UK Commission on P3s noted that "when things go right the private sector appears to make significant financial gains. When things go wrong it appears difficult to impose very significant penalties on private contractors."[93]

The one risk that the private sector cannot take on is statutory risk.[94]

This means that no matter what, the public sector is ultimately responsible for the provision of the infrastructure and related services being provided by a P3. Experience has shown that when the private sector is unable to manage risk (such as financial or user risk), the public sector has been forced to step in and bail it out.[95]

BOX 3.3 RECREATION CENTRE BAILOUTS: OTTAWA AND CRANBROOK

Arenas, skating rinks, pools, arts centres and libraries—these compose the vital social infrastructure that every town and city relies on. Like our roads and schools, investment in these facilities has not kept pace over the years. The Federation of Canadian Municipalities estimates that it will take $40 billion to fill the gaps.[96] Cash-strapped municipalities are scrambling to find ways to upgrade or build new social facilities, and a number have turned to P3s. In these P3s the consortium generally agrees to design, build, finance and operate a facility in exchange for the right to collect user fees. As the cases below demonstrate, when the operator has unreasonable revenue expectations, the municipality is forced to step in and bail it out.

OTTAWA

When it comes to using P3s at the municipal level, Ottawa has earned the dubious distinction of a leader. It lists six projects on its P3 website.[97]

In 2007 the *Ottawa Citizen* obtained copies of a confidential report detailing the failures of two projects, the Bell Sensplex and the Ray Friel Centre.[98]

Bell Sensplex: City responsible for debt, on the hook for operating deficits

The Bell Sensplex is a partnership between the City of Ottawa and Ottawa Community Ice Partners (OCIP). Under the terms of the thirty-year design-build-finance-operate agreement, the city guaranteed the debt, waived property taxes and development charges, and agreed to purchase 2,400 hours of ice time annually.[99]

OCIP first started to experience problems in 2004 because of construction delays. The 2004–05 NHL lockout added to its woes. By April 2007 the group had yet to break even in any year and was requesting additional funding from the city to the tune of $400,000 a year over the next three years.

Ray Friel Complex: City terminates partnership

In the case of the Ray Friel Complex, the report said that the company responsible for the centre had overestimated its revenues and underestimated its operating costs. With few options available to the city, the report recommended the city take over the facility and the company's $12-million debt.

CRANBROOK

Ottawa's story will be familiar to municipal officials from the town of Cranbrook, British Columbia. In Cranbrook a P3 to build a new recreation complex had to be terminated when the partner underestimated its operating costs and overestimated its revenues. The P3 experiment there left the city on the hook for millions and the highest debt level of any BC municipality.[100] Taking over the facility turned out to be more difficult than expected, and it took nearly three years to negotiate the termination of the contract.[101]

Types of risk

A number of types of risk are associated with any long-term public project. The table on the next page lists some of the more common risks P3s address. Each project has its own specific risk profile, though (see Section 4 for details about sector-specific P3s).

TABLE 3.2 POTENTIAL RISKS IN INFRASTRUCTURE PROJECTS AND SERVICES

Project risk	The capital costs of the project might turn out to be greater than estimated, or the project might take longer to complete than anticipated.
Operating risk	The operating costs of the project might turn out to be greater than estimated.
Demand risk	The demand for a project or the number of users for a project may be lower than expected. This will have an impact on the revenue stream of the private partner.
Technical risk	The project might not work as well as expected or might suffer some sort of failure, either of which would impose the need for spending on other projects.
Financing risk	The costs of acquiring the money needed to undertake and/or operate the project might be higher than estimated.
Regulatory risk	Changes in regulations that necessitate future modifications, such as new safety standards, might impose costs on the project over its lifetime.
Public policy risk	Changes in public policy might reduce the need for the project. Imagine building a highway to relieve congestion and subsequently raising gasoline taxes to encourage transit use.
Political/legal risk	The government may determine the project is not in the public interest and either force modifications or cancel the project. Alternatively, legal objections brought either by public, market or civil actors might handicap the project.

Source: Daniel Cohn (2004) citing Akkawi (2001)

"When governments enter P3s, they take on the risk of the inflexibility inherent in the P3 contract."

When projects are procured as P3s, they also create a new risk for governments: the risk of inflexibility.

When governments enter P3s, they take on the risk of the inflexibility inherent in the P3 contract.[102] There is no way all parties can predict all eventualities when they enter a P3 agreement, yet P3s are structured in such a way that they limit the ability of governments to adapt to changing circumstances. For example, over the last decade declining enrolment in public schools has been a trend across Canada, including New Brunswick. As the New Brunswick government considers using P3s to build schools, it should also consider the risks of changing demographics. Although the P3 contract may span twenty to thirty years, demand for these facilities may change. Amending or cancelling a P3 contract early will inevitably be very expensive for government. Similar observations have been made about P3s in the health care field, a field that is constantly changing through advances in research and technology.[103]

Identifying and allocating risk

Since risk transfer is supposed to be the main benefit of a P3, it's vital that governments undertake detailed assessments of the potential risks present in projects. There is nothing inherently wrong with identifying and considering the risks involved in undertaking infrastructure projects. In fact, it stands to reason that fully accounting for risks can help the public sector make better decisions about the potential costs and benefits of various projects.

In a paper written on the topic of risk allocation in P3s, Ross Coates, Mary Koyl and John Langford identify five steps in the risk-management

framework used in the development of a highway P3 in British Columbia: risk planning, identifying risks, analyzing risks, risk response and development, and monitoring and controlling.[104] During the analysis-of-risk stage, risk may be quantified according to the probability of that risk occurring times the potential impact it could have. The allocation of risk occurs during the analysis and risk response development stage.

In a P3 risks are supposed to be allocated to the sector best able to cost-effectively manage them. As an example, the table below shows how risks were supposed to be allocated in the Abbotsford Regional Hospital and Cancer Centre project. To date there is no evidence showing whether or not this risk was actually transferred.

Risks relating to:	**Public (cancer centre)**	**Private (Access Health Abbotsford)**
Financing		X
Design (clinical functionality)	X	
Design (fitness for purpose)		X
Construction (schedule and cost)		X
Equipment procurement and installation	X	X
Facilities management services (standards and cost)		X
Maintenance/latent defects		X
Relief events (for example earthquake or flood)	X	X

Source: Partnerships BC

"As with everything else related to P3s, the process of effective risk transfer is complex, costly and controversial."

Interestingly, the risks that are allocated to the private partner (the SPV) rarely stay with that partner. Lenders to a P3 view risks retained by the partner as risks to themselves. In the end what usually happens is that the SPV transfers all the risk to the subcontractors. While this might mean that risk has been transferred away from the government, having to monitor numerous subcontractors presents a new set of challenges, especially for municipalities.[105]

Issues with risk transfer

As with everything else related to P3s, the process of effective risk transfer is complex, costly and controversial. In the case of P3 schools in the United Kingdom, for example, the Accounts Commission had serious reservations about the risk transfer estimates being produced; they found the process used to determine the probability and value of risk to be entirely subjective.[106] Canadian academic Daniel Cohn writes, "The methodologies employed in the calculation of risks and the monetary value associated with any transfer of risk are always complex, subjective, and often less than transparent; they are also sometimes proprietary secrets."[107]

Cohn's claim is especially crucial in the case of local governments. Writing of the Australian experience, Ronald Aspin points out that "when it comes to engaging in public-private partnerships it would appear local government is the most vulnerable to exploitation by a better skilled and more experienced private sector in terms of recognizing and allocating risk." He goes on to write, "it is the very fact of their small size and finances that makes them [local government] vulnerable as they do not have the capacity to carry 'in-house' the sort of specialist expertise necessary in the lead up to a partnership formation, and the cost of contracting these expert advisors can be prohibitive."[108] This speaks to the high transaction costs associated with P3s (see the section on transaction cost).

In addition to these problems, research has shown that the ability to transfer certain types of risk to the private sector has been exaggerated. In their analysis of P3 projects in Canada, Vining and Boardman discovered that governments have in fact not been very successful at transferring user or revenue risks to the private sector, especially in cases where there is high revenue uncertainty.[109] In their study of the Private Finance Initiative in schools in the United Kingdom, Ball, Heafey and King also found that the private sector was reluctant to take on demand risk.[110]

BOX 3.4 CANADA LINE PROJECT AND GOLDEN EARS BRIDGE: USER RISK STAYS WITH THE LOCAL TRANSIT AUTHORITY

The Canada Line is a rapid-rail transit project that connects downtown Vancouver with the Vancouver International Airport. The project is being procured as a design-build-finance-operate P3. TransLink (the governing body responsible for transit in and around Vancouver) made the decision to use a P3 for the project after the provincial governments made it clear that to do otherwise would be tantamount to turning down funding from the province.

One of the issues with transit P3s is that in order to calculate revenues, planners depend on ridership forecasts that are notoriously difficult to formulate.[111] A multitude of factors can affect ridership, and it can be difficult to attribute these factors to either party to assign responsibility.

In the case of the Canada Line, TransLink took on 90 per cent of the risk associated with shortfalls in ridership. What this essentially means is

that if demand or use is lower than expected, TransLink has to pay 90 per cent of the gap to the private sector.[112]

A similar deal has been made for the Golden Ears Bridge P3. In this case TransLink will collect tolls from bridge users and has agreed to regular set payments to the consortium for the operation and maintenance of the bridge. Ostensibly these payments will come out of the toll revenues, but if the toll revenue falls short, TransLink still has to pay the consortium the full amount.[113]

A study by Edwards et al. for the Association of Certified Chartered Accountants in the United Kingdom was even more critical in its assessment of risk transfer. After noting that there appeared to be a lack of empirical evidence proving the appropriate allocation of risk, the authors write, "There is, however, evidence to show that the Government has not always succeeded in transferring risk to the private sector, thus incurring extra costs for the public sector when the private sector contractor has failed to deliver the services as specified in the contract."[114]

Edwards et al. did find that the private sector was relatively successful at delivering projects on time and on budget, however, they credited this success to the longer pre-negotiating phase leading up to P3s. During this phase governments may take the time to clearly define what they expect from a project, allowing the private sector to decide exactly how and if they are going to be able to deliver it. This pre-negotiation phase leads to detailed contracts that contain fixed prices, penalties and bonuses. The authors found no evidence that P3s were more successful at delivering projects on time and on budget because they were P3s per se. Rather, it appeared they succeeded because of the way the contracts were written. They write, "Such

conditions could equally be applied to projects financed in the conventional manner, begging the question of why such conditions were not previously made."[115]

3.4 Comparing P3s to Public Procurement

In order to justify P3s to the public, governments will often produce what are known as 'value for money' reports, or assessments, which show how the costs of the P3 compare to the costs of a publicly procured alternative. In this section we look at how these comparisons are put together and discuss some of the methodological issues researchers have raised about these reports.

Value for Money Reports

Value for Money (VFM) is a concept or phrase often used to justify the development of P3s. VFM implies that P3s are a better use of taxpayer dollars if the overall benefits to the public are greater than the benefits of conventional public procurement. Partnerships BC describes VFM as "a broad term that captures both quantitative factors, such as costs, and qualitative factors, such as service quality and protection of public interest."[116] P3 proponents often argue that VFM will be achieved in a number of ways. P3s are touted as providing greater access to private knowledge, efficiency and innovation, price certainty, guaranteed service levels and the optimum allocation of risk. In P3s these factors are believed to counterbalance the higher cost of borrowing for the private sector compared to the rates available to governments.

In order to show that P3s are providing VFM governments will often release VFM reports that compare the costs of delivering the project publicly versus a P3. VFM reports compare the P3's costs with a hypothetical

"Because private financing always costs more than public sector borrowing, VFM reports need to show that the P3 saves money because of the risk it transfers to the private partner."

model of how much the project would cost if it were pursued through public procurement. This model is called the public sector comparator and is discussed below. One of the most important elements in this comparison is the value of risk. Because private financing always costs more than public sector borrowing, VFM reports need to show that the P3 saves money because of the risk it transfers to the private partner.

In his report on P3s in British Columbia, Stuart Murray examined these VFM reports and noted problems with their use of discount rates and risk transfer, as well as the timing of their release. In terms of timing, Murray notes that VFM reports are usually released after P3s have 'passed the point of no return' when contracts have been signed.[117] This late release prevents public scrutiny before P3 contracts are signed. Similarly, in Ontario, initial VFM assessments are withheld from the public.[118] This practice contradicts recommendations made in other public documents. For example, a recent discussion paper on P3s in municipal water services written for the Government of Canada's Policy Research Initiative recommends that the community should be involved in the procurement process from the beginning and that the contracts, let alone the reports explaining the contracts, should be made public before they are signed.[119]

Public Sector Comparator

Although governments have some idea of what P3s will cost over the life of the agreement, it is much more difficult for them to know how much it will cost to design, build, finance and operate a facility themselves for the next 30 to 40 years. And yet to determine if a P3 really does offer value for money they need some estimate of the costs associated with public procurement.

Public sector comparators (PSCs) are key to making the case for P3s since they are the benchmark against which P3s will be measured. Industry

Canada stresses that PSCs should be developed "early on in the planning process at the highest level" because of their importance for determining if a P3 actually produces value for money.[120]

In calculating how much a project will cost when done publicly, the PSC takes into account the capital costs as well as the full life cycle costs associated with the operation, maintenance and financing of a project. The PSC also takes into account the risks associated with a given project. The value of the risk that the P3 contract will transfer to the private sector is then added to the PSC as a cost. The assumption here is that if the government doesn't choose the P3 route, it will be taking on that risk itself, and therefore the PSC should reflect this.

In a paper released by the Canadian Centre for Policy Alternatives, Sheila Block examined value for money assessments produced by Infrastructure Ontario for hospital projects.[121] Block found issues related to transparency as well as methodological problems with the way the assessments were produced. Specifically, Block raised concerns about the price of risk added to the PSC. In the assessments, Infrastructure Ontario assigns a monetary value to the risk that is supposed to be transferred to the private consortia and then adds that amount to the PSC as a cost. On the P3 side, the assessment also shows the cost of the premium that the private sector will charge for taking on the risk as well as for financing. However, the premium amount falls far below the price of the risk added to the PSC. As Block points out, the assumption that Infrastructure Ontario appears to be making is that the price private consortia charge for taking on risk is much less than the value of that risk. Given the evidence about the costs of transferring risk to the private sector, this seems highly unlikely.[122]

Problems with PSCs were also found in the United Kingdom. The UK House of Commons Public Accounts Committee stated that: "The accuracy

"The choice of discount rate will greatly affect the net present cost of the public sector comparator compared to the costs of the P3.."

of public sector comparators is limited. They are prone to error because of the complexity of the financial modeling that is often used. They are also dependent on uncertain forecasts. This places a limit on the accuracy which can be achieved, however much work or analysis may be done. Further work takes time and money without necessarily adding to the value of the public sector comparator as a decision tool. There is also a risk that the users of the public sector believe that it is more accurate than it could ever be."[123]

Discount Rates

Whether a government uses the P3 route or chooses to use public procurement, the costs of the project will probably not occur all at once. In a P3, the costs associated with the design, building, financing and operation are incurred over the life of the contract in the form of annual payments to the private contractor. In a publicly procured project, the timing of the capital and operating costs may vary depending on how the governments chooses to finance the project. In order to compare the costs of the P3 with the costs of public procurement, the future costs of both are expressed as a net present value (or net present cost). To calculate the net present value, a discount rate is applied to future costs.

Discount rate refers to the rate at which money is expected to devalue over time. In other words it is an inflation factor. The choice of discount rate will greatly affect the net present cost of the public sector comparator compared to the costs of the P3. The higher the discount rate, the better future costs look in today's dollars. Because the costs of a P3 occur steadily over time and well into the future, the higher the discount rate used, the better the P3 will look in comparison with a conventionally procured project. For example, using a discount rate of 6 per cent, Partnerships BC showed that it would save $39 million by using a P3 for the Abbotsford Hospital. If a dis-

count rate of 4.5 per cent had been used there would have been no savings from the P3. If a discount rate of less than 4.5 per cent had been used,the public sector option would have looked cheaper.[124]

To calculate how much a P3 will cost in total, all of the future lease payments are added up and then discounted to account for the declining value of money. Over time, the monthly amount agreed to will actually be worth less. As an example, let us assume that an individual agrees to lease a car for $1,000 every month over the next ten years. If she wanted to know how much all of those payments would cost in today's dollar, she would add up all of those payments and apply a discount rate to take into account the fact that , because of inflation, $1,000 is worth more today than $1,000 will be in the future.

In British Columbia the issue of discount rates is important because Partnerships BC has been using a varied discount rate in its value for money reports. For example, the Bennett Bridge Report used a discount rate of 8 per cent [125], the Sea-to-Sky Highway Project used a discount rate of 7.5 per cent[126] and the Abbotsford Regional Hospital and Cancer Care Centre and the RAV Line used a rate of 6 per cent.[127] The rate of 6 per cent was used in the UK as well, until the Spring of 2003, when after rigorous analysis, the government lowered the rate to 3.5 per cent.[128]

One of the debates around the proper discount rate centers on whether the discount rate should reflect the private sector's cost of capital or the government's lower cost of borrowing. This is an international debate and as of yet there is surprisingly little consensus on the matter.

When companies decide whether or not to invest in projects, they use a calculation called the Weighted Average Cost of Capital (WACC)[129]. Companies derive their capital from two sources: equity and debt. The cost of capital is the expected return to equity and debt that investors and lend-

"In British Columbia the issue of discount rates is important because Partnerships BC has been using a varied discount rate in its value for money reports.."

ers expect. The returns to equity include a risk premium –a calculation of the returns investors expect in exchange for taking on the risk of investing in a company. Meanwhile the cost of debt is the current market rate paid by the company on its debt. The WACC is expressed as a percentage and used as the discount rate to determine the net present value of an investment. It helps investors know if potential projects will offer an adequate rate of return.

In British Columbia, Partnerships BC has used the private consortium's WACC as the discount rate for calculating the net present value of the P3 versus the PSC instead of the government's cost of borrowing. In his paper examining the Sea-to-Sky Highway value for money report, Dr. Marvin Shaffer takes issue with this method. Shaffer argues that when Partnerships BC uses the WACC to determine the public sector comparator's discount rate, it implicitly assumes that the government's cost of borrowing is the same as the cost of capital for the private sector.[130] He notes that although Partnerships BC recognizes that the private sector pays a higher cost to borrow, they argue that this is because of the risk that the private sector takes on when it enters a P3. According to this logic, the discount rate that is applied to the public sector comparator should reflect the same project risk.[131] However, Shaffer argues that because Partnerships BC also adds a risk transfer amount as an additional cost in the public sector comparator, they are effectively double counting risk.[132] After reviewing four P3 projects in BC, forensic accountant Ron Parks agreed with Shaffer that Partnerships BC's practice of applying a discount rate that reflects the private sector's cost of borrowing effectively double counts risk.[133] Parks concludes that this method biases the calculations in favour of P3 projects.

In contrast to BC, the Ontario government has chosen to use a discount rate pegged at the government's rate of borrowing.[134] However, Infrastructure Ontario's methodology for calculating value for money is not without its own issues.

In conclusion, there are serious questions about the methodology used to show that value for money will be achieved using a P3. Given all of these issues, decision-makers should be cautious about relying on statements and reports claiming that P3s produce greater value for money.

3.5 Contracts and Costs

In this section we discuss two interrelated features of P3s: the contracts and the additional costs relating to those contracts. Assuming everything goes smoothly with the procurement process and value for money is proven, governments still have to deal with complex contracts and additional transaction and monitoring costs.

The P3 contract

One of the defining features of P3s are the "copious, detailed contracts typically exist[ing] within a complex legal and financial environment, often crossing several legal domains."[135] P3 contracts generally include project agreements, performance specifications and financial agreements.[136]

In their paper "PPP Contractual Issues—Big Promises and Unfinished Business," Graeme Hodge and Diana Bowman note that P3 arrangements differ from conventional government contracts because of their longer time frames, larger financial flows, risk and reward sharing, and the involvement of the private sector in the financing arrangements.[137] The long-term nature of the contracts means that all of the parties have to attempt to identify, anticipate and address all potential future contingencies. And yet, the

"Complicated contracts add additional time and expense to what is already a costly procurement process for P3s."

contracts also have to be flexible enough to allow for unforeseen changes in technology or other factors that may arise.

Complicated contracts add additional time and expense to what is already a costly procurement process for P3s. In recognition of this fact, the UK treasury has recommended that P3s not be used for projects with a capital value of less than £20 million.[138] The treasury found that since the transaction costs and bid and procurement times (two to two-and-a-half years) were roughly the same for small projects as for large projects, the costs for smaller projects were disproportionately high.[139]

Another emerging issue has to do with the performance specifications of the contracts. Performance specifications detail the performance requirements of the private contractor. Payment to the private sector is conditioned on the private sector meeting these requirements. This is the main mechanism through which P3s are said to be accountable to the public. Unfortunately, recent findings from the United Kingdom have shown that in practice, monitoring and holding private partners to these performance specifications is actually quite costly and difficult to achieve.[140] Additionally, any details not specified in the contract become the responsibility of the government, since it is the government that ultimately carries the responsibility for the service.

Transaction and monitoring costs

"Transaction costs" are defined simply as, "The costs other than the money price that are incurred in trading goods and services."[141] Every time an individual or a group attempts to buy or trade a good, they have to spend time finding out if there is someone who wishes to trade the good, inform them of said opportunity and then negotiate the terms of the trade. In the case of P3s, transaction costs include attracting private interests to the project,

negotiating a highly detailed contract, monitoring the agreement once it is in place and, if the partners are not adhering to the agreement, taking the appropriate action. In his report on the costs of P3 schools in Alberta, Hugh MacKenzie writes that transaction-related legal, financial and accounting analysis costs are typically about 4 per cent of the capital costs of a P3 project, for both the consortium and the government.[142]

All of this costs governments time, energy and money—especially fees paid to lawyers and other advisers. These transaction costs can be especially significant for local governments that have a small revenue base and require the assistance of outside analysts and experts. Despite the fact that transaction costs can be quite substantial, they are often not considered in comparing the costs of P3s to the costs of public procurement.

In addition to these initial extra costs associated with negotiating a contract, P3s require government resources for long-term appraisal, monitoring and evaluation of the contracts once they are operational. In their examination of operational Private Finance Initiative roads and hospitals in the United Kingdom, Edwards et al. found that "the costs of monitoring appear to have been greater than was anticipated and in time this is likely to increase the public sector's costs and thereby reduce VFM [Value for Money]."[143]

Unanticipated monitoring requirements have been an issue in Ottawa's use of P3s. In 2006 the City of Ottawa's Office of the Auditor General undertook an evaluation of the City's P3 process.[144] The auditor general found a lack of formal monitoring of P3 contracts. A 2006 survey of the Canadian P3 market by Ernst and Young Orenda also indicated that within the City of Ottawa there was reluctance to assign the resources needed to monitor P3s. "With his experience of five P3 projects in Ottawa, Réjean Chartrand said the operational phase can be difficult for government management to understand. In their current mindset, conventional city projects fall into well-understood and well-

staffed management systems, but the P3s are different. 'This has been a tough sell for us, to convince the city we need a full-time resource to monitor five parks and recreation facilities,' Chartrand said. 'In fact, we have been unable to secure that resource, even though conventional facilities each have an on-site management person and each person would have staff resources.'"[145]

BOX 3.5 THE IMPACT OF TRANSACTION COSTS ON THE BENEFITS OF P3S—FINDINGS FROM A UNIVERSITY OF BRITISH COLUMBIA P3 PROJECT STUDY

In their study of early P3 projects in Canada, professors Aiden Vining and Anthony Boardman examine ten cases. The authors look at the goals governments hope to achieve through the use of P3s and whether P3s have been effective at delivering lower-cost infrastructure to the public.

The authors begin with a positive theory perspective of how governments and private sector actors behave. The authors assume that the goals of governments are to minimize the upfront costs that appear on budgets and any potential political costs. For private sector actors, the authors assume the goals are profit maximization and risk minimization. Because the two parties have such divergent goals and P3s represent complex contracts, the transaction costs of negotiating (and often renegotiating) a contract are probably going to be high.

In their examination of the case studies, the authors find that in most cases governments do end up incurring high transaction costs. In the authors' words, "One surprisingly common occurrence is the dissolution of the P3 more quickly than envisioned in the original contract, either through government buy-out, redesign of the contract, bankruptcy of

the private entity, or some mix of these. A more common outcome, however, is protracted conflict, with high contracting costs borne by one party, or both."[146]

The authors contend that P3s are only successful in situations where governments do not attempt to transfer user risk to the private sector, only the private sector has the kind of specialized knowledge needed for the project and governments are able to transfer construction risk at a fixed price. Given these findings, the authors conclude that the cases of successful P3s were in fact not P3s at all, since the government did not transfer risk to the private sector. Instead, successful "P3s" are closer to traditional construction contracts.

3.6 Trade Agreements

In Canada there has been some debate about the effect of trade agreements on municipal governments when they enter P3s. Specifically, legal expert Steven Shrybman has argued that international agreements such as NAFTA and GATS as well as more recent internal agreements such as the Trade Investment Labour Mobility Agreement (TILMA) between Alberta and BC pose new risks for governments entering P3s. Shrybman points out that the rights of investors embedded in these agreements mean that when municipal governments enter P3s, they could be exposing themselves to an additional set of risks.[147]

In the context of these trade agreements, Shrybman lists the following risks to local governments entering P3s:

- If a local government decides to terminate P3 contract, the action could be considered expropriation and serve as the basis of an investor-state claim that would then be resolved according to international law.

- Local governments will lose the right to insist on purchasing preferences (e.g. local procurement).
- Environmental and health regulations of local governments may be exposed to trade challenges and foreign investor claims.
- Contractual provisions that seek to limit the sale of interest in a P3 may be negated.[148]

In terms of the internal trade agreements, Shrybman also warns of the possibility that new rules may be used to limit governments' ability to exit P3s. Shrybman writes, "In fact, international investment rules that are analogous to but less expansive than those set out in TILMA have been invoked to either limit the scope of public sector service delivery or to claim damages when governments seek to terminate privatizations schemes that fail."[149]

SECTION 4

P3s in Different Sectors

IN CANADA P3S ARE BEING USED in a number of different sectors and by all orders of government. In this section we look at five sectors and briefly outline the specific risks of P3s in each. We also look at some of the implications for services offered in each sector by P3s. For instance in the health care sector, how might using a P3 affect the delivery of health services? Are there specific risks that we know accompany health care P3s?

4.1 Health

In Ontario, Quebec and British Columbia the health sector has become a key entry point for P3s. To date British Columbia has or is in the process of using P3s to procure six hospitals, and Quebec is attempting to use P3s for hospitals in Montreal and province-wide. Ontario, though, takes the lead with nineteen P3 hospital redevelopments under construction and another seven close to contract finalization.[150]

As with all such projects, when P3s are used in the health sector, there are serious concerns about cost and the risks inherent in partnering. In December 2008 Ontario's auditor general released a report that found that the province's first P3 hospital experiment in Brampton had cost the public $200 million more than if the province had financed the project itself.[151]

Experience from the United Kingdom suggests that the P3 model may have serious affects on the operation of hospitals and the quality of care provided.

"In terms of day-to-day operations, the authors found that the PFI had created more bureaucracy within the hospital."

In a hospital P3 the private sector generally takes over what are known as "ancillary services." These are services outside of core medical services and might include food, cleaning and patient services.

The best source of evidence about how P3s affect hospital operations comes from the United Kingdom. In *Evaluating the Operation of PFI in Roads and Hospitals,* Edwards et al. studied the operation of one Private Finance Initiative hospital.[152] Their findings weren't all negative. The authors did report that under the PFI, new buildings were delivered on time and operated as expected, and the PFI did provide much-needed investment in these buildings, as well as linens. However, in terms of day-to-day operations, the authors found that the PFI had created more bureaucracy within the hospital. All of the contractors and subcontractors operate under legal contracts that require formal structures to manage the direct and indirect relationships. Among the problems this added bureaucracy created, the authors found the following:

- The PFI led to an increased number of meetings, especially in light of the fact that some service providers were not directly answerable to the health authority. Therefore, meetings were required between the private sector partner, the service provider and the health authority to work out any issues that arise.
- Because of the complex relationships, the authors also found that there was sometimes a lack of clarity about who was responsible for what under the terms of the contract.
- Finally, the authors noted the difficulties staff experienced in monitoring the service providers.

4.2 K–12 Education

One of the most famous P3 failures comes from Nova Scotia. Between 1994 and 1999 the provincial government attempted to build fifty-five schools using the P3 model. The program was eventually cancelled in 1999, though by that time thirty-eight schools had already been built as P3s. The P3 model cost the taxpayers of Nova Scotia an additional $32 million.[153] In addition, contract disputes have meant additional costs for the province. New Brunswick also used the P3 model to build the Evergreen School in the mid-1990s. New Brunswick's Auditor General found that that P3 school had cost taxpayers $900,000 more than if the province had undertaken the school as conventional public project.[154]

For a while few provincial governments seemed interested in repeating Nova Scotia's mistakes. Recently, though, P3 schools have made a comeback. The most ambitious project is in Alberta, where the provincial government will use P3s to build eighteen new schools. New Brunswick is also procuring two schools as P3s.[155]

Besides serving as a space for educating students, schools are community hubs, offering opportunities for community groups to make use of them. However, the contracts that govern these arrangements may not allow for this kind of flexibility in use. For example, in Calgary, parents were surprised to learn that daycares and preschools would not be allowed to use the schools during school hours. According to a letter from the Deputy Education Minister, these additional uses could impact the contract because they could require extra building requirements.[156] This speaks to the risk of inflexibility that accompanies P3s.

The schools that were built as P3s in Nova Scotia have now been operational for nearly ten years. They therefore provide a window into how school

P3 contracts work after they are signed. In this case the government's motivation for using P3s was to get the debt off the books.[157] As a result, Nova Scotians are now saddled with thirty-eight schools of questionable value. In her piece *The Devil in the Details*, Erika Shaker writes of a number of problems with Nova Scotia's P3 schools, including delayed building repairs; the decision about where new schools would be located was based on the preferences of the consortiums, not the needs of the local community; and increased fees for community groups looking to rent school facilities.[158]

Additionally, Shaker notes that in 2003 the Province of Nova Scotia and Scotia Learning Centres (a consortium that owns and operates thirteen schools in Nova Scotia) had to go to arbitration over a number of issues:

- In response to expensive rates for renting facilities, the province attempted to argue that Scotia Learning Centres should not be allowed to charge community members whatever they wanted for school facilities. The arbitrator ruled that Scotia Learning Centres had the right to charge whatever price they wanted.
- There was a dispute over which party was responsible for paying for repairs arising from vandalism. The arbitrator ruled that it was the province's responsibility if the vandalism occurred during school hours or extracurricular activities, while Scotia Learning Centres was responsible for vandalism that occurred at other times.
- Another issue had to do with technology. Scotia Learning Centres argued that it should not bear the cost of technology support, since in other P3 schools the operators did not bear these costs.[159] This issue required further negotiation and was eventually resolved in 2005. Under the 2005 agreement, the schools regained control of funds set aside to upgrade technology. As well, the province paid Scotia Learning Centres $2.3 million for technology support services it had already provided.

- During arbitration, the province argued that the schools should be able to keep revenues earned from cafeteria and vending machine sales. However, the arbitrator ruled that SLC had full control over concessions and was entitled to 35 per cent of the profit raised from cafeterias, vending machines and rentals.[160] This issue was subject to further negotiation and resolved in 2005 when a new agreement gave schools 100 per cent of these revenues.

As with hospitals, one of the big concerns for trustees and local school districts with P3s is the effect of the structure of the P3 on operations. There is every reason to believe that when contractors and subcontractors take over responsibility for some aspects of a school's operation, the lines of accountability will be complicated, and that the P3 will add more layers of bureaucracy to the district's operations.

4.3 Recreation Centres

One of the most prominent types of P3 for municipalities is the recreation or event centre. This category includes multiplexes and arenas.

With recreation centre P3s, a private consortium will often have the right to charge user fees for the facility. Problems with these deals have come about when the private consortium has overestimated revenues and underestimated its operating expenses. This is what happened in the case of Cranbrook, and the government ended up having to take over the facility. Because of the demise of the contract and the additional debt burden Cranbrook was forced to accept, the city's borrowing power was reduced.[161] Not all recreation centre P3s have ended this way, but enough have run into these kinds of problems that municipalities should exercise caution when entering into them. Ottawa recently had to provide additional

"Even when a recreation P3 appears to be working perfectly, questions still exist about the overall benefit to the taxpayer."

funding to two of its recreational P3s when the private operators ran into financial difficulties (see Box 3.3).

Even when a recreation P3 appears to be working perfectly, questions still exist about the overall benefit to the taxpayer. When a municipal government decides to enter into a P3 to build a recreation centre, it essentially hands over revenue rights to the private operator. It also changes the nature of the facility. The facility's primary purpose is no longer first and foremost to serve the needs of the community, but rather to ensure a profit for the private partner.

4.4 Water/Sewage

Since the early 2000s a number of municipalities have contemplated the use of P3s for their water utilities, including water treatment plants and sewage treatment plants. With aging water and waste-water systems, those working to promote P3s see this as a lucrative market. To date a handful of municipalities have taken the P3 route, though a number have contemplated then rejected the use of P3s for their water infrastructure. These cases include the Resort Municipality of Whistler, Kamloops, Halifax and the Greater Vancouver Regional District. As of early 2009 P3s were being considered in Saint John, New Brunswick, for water treatment, and in Vancouver Island's Capital Regional District for its wastewater system. Additionally, Winnipeg City council recently accepted a report by Deloitte & Touche that recommended the city seek a "strategic partner" for the design, construction, finance and operation of two water-pollution control centres, as well as adopt the concept of a city-owned municipal corporate utility to operate city-owned utilities, including water services.[162]

In 2006 the federal government's Policy Research Initiative released a discussion paper on P3s and municipal drinking-water infrastructure by Meriem Aït Ouyahia.[163] While the paper raises the common concerns of P3s generally (divergent goals between private sector actors and governments, costs and difficulties in negotiating and monitoring complex contracts etc.) it also raises some specific concerns about the nature of water infrastructure and P3s.

- Ouyahia found little evidence proving or disproving the theory that private ownership will lead to greater efficiencies in water services. Instead, she suggests that competition may lead to greater efficiencies. However, there is limited competition in the water sector. The author notes that the international water sector is dominated by two French multinationals. In Canada the private operation of water utilities is dominated by EPCOR.
- The majority of costs associated with water are derived from fixed capital assets. Because the capital costs of water infrastructure are so high, a private company will only be able to obtain a return on its investment over a long period of time. In the case of a municipal or regional government with a stable population and stagnant demand for water services, profit will have to be obtained through price increases.
- Between 70 and 80 per cent of the assets in water infrastructure are underground. This can make it very difficult for governments and private sector partners to know the current condition of these assets before a P3 is signed. Furthermore, underground assets can make it difficult for governments to assess the quality of work.
- The collection, treatment, storage, distribution and use of water can give rise to a number of externalities. Externalities can be broadly understood as costs or benefits arising from activities that impact individuals not directly involved in the activities themselves (a common example of an

"According to a 2007 article in Business Week magazine, investors believe these deals have the perfect mix of high yield and low risk"

externality is pollution). With water there are a number of potential long-term health and environmental externalities that could arise from the activity of supplying water. Regulation and monitoring will therefore be of the utmost importance in a water P3, and local governments will have to develop the tools and capacity to effectively regulate and monitor the private partner.

4.5 Transportation

In Canada and the United States P3s are often found in transportation infrastructure, including roads and bridges. For the private sector there is an intrinsic appeal in investing in these projects. Through tolls or payments from governments, investors are guaranteed a steady stream of revenue over the life of the contract. According to a 2007 article in *Business Week* magazine, investors believe these deals have the perfect mix of high yield and low risk.[164] The article states, "In the past year, banks and private investment firms have fallen in love with public infrastructure. They're smitten by the rich cash flows that roads, bridges, airports, parking garages, and shipping ports generate—and the monopolistic advantages that keep those cash flows as steady as a beating heart."

One of the earliest P3 projects in Canada was the Highway 407 Express Toll Route outside of Toronto. The deal was a mess from the start. The province could not find a private partner willing to take on the financing, construction, operating and revenue risk associated with the project. Eventually the province financed the project itself and took on the first year's operating risk before selling the concession to a Canadian-Spanish-Australian consortium in 1999. Between 1999 and 2006 tolls were raised six times. The government attempted to take legal action against the consortium, however

an independent arbitrator ruled that the private operator was under no obligation to consult the government before raising tolls.[165]

This is one of the major difficulties with transportation P3s: either the government relinquishes any say in toll rates to the private consortium or the consortium demands some sort of revenue guarantee. Since forecasting the level of traffic is notoriously difficult to do, most consortiums will prefer some sort of revenue guarantee from the government. Governments are therefore often required to pay "shadow tolls" to the private sector.

Aside from these problems, there are also concerns about P3s and traffic management. Climate change is a serious issue, and a number of municipalities have taken proactive steps toward increasing the use of public transportation. In an ideal situation tolls would be used to discourage people from driving, and any revenue would be used to fund public transportation. P3s contracts can restrict governments' ability to carry out such a plan. Furthermore, if a government decides in the future that it wants to change the roads to influence traffic patterns, they could face high penalties as a result of these long-term contracts.[166]

4.6 Conclusion

Aside from the risks inherent in the P3 model, governments may also want to consider some sector-specific risks before entering P3 arrangements. In Appendix A we have compiled a list of various local projects that were either procured as P3s or were intended as P3s but later cancelled. We would encourage locally elected officials, before entering a P3, to contact their colleagues in communities that have experience with the model.

SECTION 5

Discussion

This section leads into a broader discussion about public-private partnerships P3s. What are the significant lessons to be learned from the experiences with P3s both abroad and at home? What is the underlying theory of P3s and how has this theory been challenged? How accountable are P3s? What are the advantages and disadvantages associated with their implementation?

5.1 P3s: Theory and Practice

The use of P3s in the United Kingdom, as well as in British Columbia, is based on the thesis that P3s offer a number of advantages over conventional public procurement. P3 proponents argue that P3s provide better value for money to taxpayers because they bring private sector innovation and efficiency to governments via the competitive marketplace. Integrated planning in the design, building and operation of a project is also thought to allow contractors greater room to innovate.

P3 proponents also maintain that public-private partnership arrangements allow the public sector to transfer risks to the private sector. This point is especially important. Since the cost of private financing is always higher than the cost of public borrowing, it is the assumption of the ability to transfer risk that often makes P3s appear less costly.

Actual experience has cast doubt on the ability of P3s to deliver these benefits. For instance, the belief that the private sector will be more innovative and efficient than the public sector because it has to compete with

other companies overlooks the fact that the high costs of bidding on P3 projects actually deter companies from bidding.[167] In some cases, such as the Abbotsford Hospital and Cancer Centre, there was only one final bidder. Therefore, the project lost the potential benefits of competition. A lack of bidders has also been a problem for the Private Finance Initiative in the United Kingdom. As Michael Pollitt writes, "There are often only a small number of bidders for PFI projects, and the statistics on which companies are actually involved in PFI deals reveal that a small number of firms act as legal advisors, financial advisors, contractors, funders, technical advisors, property advisors and facilities managers to PFI projects. This has given rise to the suspicion that competition is more apparent than real in the bidding process."[168]

Nor does integrated planning always lead to greater innovation. According to a report by the Ontario Association of Architects, the record of P3s leading to greater innovation has been "mixed." The report states, "Many architects felt that their ability to innovate was severely constrained in P3s." The report's authors argue quite pointedly that "you can't innovate in a [price] competitive environment."[169]

Risk transfer has also been called into question. In reality, experience has disproven the ability to transfer risk over the long term, especially in the case of user risk.[170] In Vining and Boardman's investigation of P3 projects across Canada, the authors discovered that while short-term construction risks may, in some cases, be transferred to the private sector, the long-term risks associated with usage and revenue have been much more difficult to transfer.[171]

Furthermore, in British Columbia there have been discrepancies between the initial estimate released to the public of the costs of a project and the final costs of some P3s. After the P3 has been negotiated behind

closed doors in a drawn-out process, new figures are presented to the public. Unfortunately, at that point the deal is already finalized, and the public has no opportunity to have a say in the matter. The table below demonstrates the magnitude of the discrepancies.

TABLE 5.1 DIFFERENCE BETWEEN INITIAL ESTIMATE AND ACTUAL COST OF P3S

Project	Initial Estimate	P3 Estimate
Abbotsford Hospital and Cancer Centre	$211,000,000	$355,000,000
Canada Line	$1,550,000,000	$2,000,000,000
Golden Ears Bridge	$600,000,000	$808,000,000
Sea-to-Sky Highway Project	$600,000,000	$789,000,000
William Bennett Bridge	$100,000,000	$170,000,000

Source: Reynolds (2007)[172]

Finally, governments are relying heavily on public sector comparators and value for money reports to justify their use of P3s. Research has shown how easy it is to skew these reports, and decision-makers should not rely on them. The high transaction costs associated with long and complex negotiations add further complications.

All of this strongly suggests that public-private partnerships are having a difficult time living up to their expectations. This has serious implications, considering that P3s essentially commit public funds to decades-long contracts.

5.2 Accountability

As the Institute for Public Policy Research in the United Kingdom notes, since P3s are responsible for delivering publicly funded services they must be accountable and responsive to the public.[173] Questions about accountability permeate the debate surrounding P3s.

In British Columbia the practice of keeping the value for money reports out of the public domain until well after the point of no return raises serious questions about due process and transparency during the procurement process. Reasons such as "commercial confidentiality" and "proprietary rights" are most often used to explain why the public, and even decision-makers themselves, cannot know the terms of these agreements, despite the fact that public funds are being committed for long periods of time. While the need to protect trade secrets and negotiating positions does legitimately keep some documents out of the public domain, the Institute for Public Policy Research argues that this secrecy must not come at the expense of the public's right to know and the proper disclosure of information.[174]

Aside from this procedural defect, P3s threaten to interfere with governments' ability to respond to the public, because of the long-term nature of the contracts. These long-term contracts essentially mean that the hands of future governments are tied, even in the face of changing circumstances and emerging issues. For instance, consensus is emerging that climate change mitigation and sustainability are issues that governments should be working on. Governments need to have the capacity to pursue these objectives.

P3 proponents will argue that P3s are actually more accountable than conventional procurement because the contracts tie payment to performance. However, the investigation by Edwards et al. into the actual performance of P3s in roads and hospitals in the United Kingdom found that in practice, evalua-

tion of P3 projects tends to create a new set of problems.[175] The investigation found that planning of the performance monitoring systems tended to be weak, leading to increasing workloads in terms of the management of projects. It also found that the self-monitoring systems in place required high levels of trust between the two partners, but that this trust was not always present. As a result the public sector ended up having to carry out more monitoring than expected.

All told, these findings lead to the conclusion that the enforcement of accountability mechanisms in P3s are actually quite difficult and costly.

5.3 Benefits and Disadvantages

The following table listing advantages and disadvantages of P3s was produced by the National Audit Office and reprinted in a report by the UK House of Commons Committee of Public Accounts.[176] Aside from listing the main benefits and disadvantages of P3s, it clearly demonstrates that for every benefit a P3 offers, there is a potential disadvantage. The table correlates the advantages with potential disadvantages and, though this list is by no means exhaustive, it does demonstrate the importance of close, critical examination of any P3 proposal to ensure that the public interest is protected.

TABLE 5.2 BENEFITS AND DISADVANTAGES OF P3S

Benefits	Disadvantages
Price certainty can be greater. The government and contractor agree on the annual unitary payment for the services to be provided. This should usually only change as a result of agreed-upon circumstances.	The government is tied into a long-term contract (often around thirty years). Needs change over time, so the contract may become unsuitable for changing needs during the contract life.
The P3 transfers responsibility for assets to the contractor. The government is not involved in providing services that may not be part of its core business.	The government's needs may change. Management of these variations may require renegotiation of contract terms and prices.
The P3 brings the scope for innovation in service delivery. The contractor has incentives to introduce innovative ways to meet the department's needs.	Drawbacks may arise if, for example, innovative methods of service quality lead to a decrease in the level or quality of service.
Often the unitary payment will not start until the contractor meets a specified benchmark, for example, when a building is operational. This gives the contractor an incentive to encourage timely delivery of quality service.	The unitary payment will include charges for the contractor's acceptance of risks, such as for construction and service delivery, which may not materialize.
The contract provides greater incentives to manage risks over the life of the contract than under traditional procurement. A reduced quality of service would require compensation to be paid to the government.	The contractor may not manage transferred risks well, or governments may believe they have transferred core business risks that actually remain with them.
A long-term P3 contract encourages the contractor and the government to consider costs over the whole life of the contract, rather than considering the construction and operational periods separately. This can lead to efficiencies through synergies between design and construction and the project's later operation and maintenance. The contractor takes the risk of getting the design and the construction wrong.	The whole-life costs will be paid through the unitary payment, which will be based on the contractor arranging financing at commercial rates that tend to be higher than government borrowing rates.

Source: House of Commons, Committee of National Accounts

SECTION 6

Protecting the Public Interest

IN 1999 THE CANADIAN Mortgage and Housing Corporation (CMHC) released the findings of its research on P3s in municipal infrastructure.[177] It found that municipalities were generally underprepared for the task of entering into a P3 arrangement. The CMHC therefore recommended that municipalities take three basic steps before engaging in the actual P3 procurement process.

STEPS TO DETERMINE WHETHER OR NOT A P3 IS THE BEST OPTION:

1. Clear understanding of what the project is to achieve.
2. Development of the PSC and the business case
3. Public consultation

1. Clear understanding of what the municipality intends the project to achieve.

According to the CMHC municipalities should, as a first step, identify the optimal technical solution to whatever problem they are trying to solve. It is only after this solution is identified that the municipality should consider a public-private partnership. In determining the best solution to the problem, local officials should also take into account broader objectives, including those related to sustainability and the integration of social, economic and environmental concerns, as well as the objectives contained in other official plans and policies, including sustainability plans.

2. Preparation of the public sector comparator and development of the business case

The CMHC recommended that municipalities prepare "shadow bids" to eventually compare the costs of the P3 proposals with the costs associated with public procurement. These shadow bids are essentially the same thing as a public sector comparator.

Since the public sector comparator is the benchmark against which the P3 project is evaluated, it should be developed early on in the process and be used to inform an initial business case outline for why a project should proceed as a P3. In this regard the treasury of the United Kingdom recommends "reforming the Public Sector Comparator into an early rigorous economic appraisal of an individual project at the stage an outline business case is produced, *prior* to the procurement of the project to allow projects to proceed down alternative procurement routes where they offer better value for money" (emphasis added).[178]

Of course, the public sector comparator in and of itself is only of limited use, and local officials should pay attention to the risk premiums added to the private sector comparator and the rates of interest being applied.

In addition to the public sector comparator, municipalities should develop a business case before tendering the P3 contract, and that business case should inform the decision to use a particular procurement option. It should include an assessment of the benefits, costs and risks associated with a P3 versus public procurement.

In British Columbia's Capital Asset Management Framework guidelines, the provincial government also recommends the preparation of a business case for any significant capital projects before procurement.[179] According to the guidelines, the business case should include:

- a description of the service challenge or program;

"The municipality should include the community in the decision-making process and present all of the possible options."

- an analysis or development of preferred options (including the public sector comparator);
- an evaluation of the options;
- recommendations; and
- a proposed implementation strategy.

3. Public consultation

As the CMHC writes, "Ultimately, it is the users of a service that determine its value to the community."[180] The municipality should include the community in the decision-making process and present all of the possible options. This will lead to a decision that the community stands behind, and will increase accountability and trust in the process.

Public-private partnerships are renowned for using "commercial confidentiality" as justification to carry out the P3 process behind closed doors. Given the significant commitment governments are taking on behalf of taxpayers, they must create opportunities for public oversight. They must consult members of the public and staff, and provide many opportunities to participate in a real and meaningful way *before and during* the procurement process. This will help to ensure that the project responds to local circumstances.

BOX 6.1 DISCUSSION POINTS

1. *Need.* Could "on-time, on-budget" goals be reached through another procurement model, such as a design-build contract?
2. *Resources.* How long is the procurement process for a P3 expected to take? How much will it cost? Does the government have sufficient staff resources and in-house expertise to work on the procurement and negotiation of the P3 contract? If not, how much will hiring additional help cost? What happens if only one or two bidders respond?
3. *Risk*. What risks will the private sector take on? What risks will remain with the local government? Is it realistic to assume that the private partner will be able to manage the risks transferred to it at a lower cost than the government?
4. *Responsibility*. What will happen if the private partner fails to deliver on the agreed upon contract? Will the government still be on the hook to cover costs?
5. *Accountability*. How will the government monitor the contract? Can the government afford the additional monitoring costs? What will happen if service quality declines?
6. *Jobs*. How will the job security of current employees affected by the introduction of a P3 be protected?
7. *Flexibility*. If future public policy requires a change in the P3, will the government have the flexibility it needs to meet its goals?
8. *Exit Strategy.* If during the procurement or operation of a P3 it becomes evident that the P3 no longer serves the public interest, what is the government's exit strategy?

Where P3s constitute long-term commitments on behalf of taxpayers, they need to be approached cautiously and implemented only after a rigorous evaluation process that includes public input, a business case and a fair comparison with conventional public provision.

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APPENDIX A

MUNICIPAL, REGIONAL AND SCHOOL DISTRICT P3 PROJECTS IN CANADA[1]

Municipality, regional district or school district	Project	Start date	Type of P3	Length of contract	Lead company
British Columbia					
City of Kelowna[2]	Sports and entertainment centre: "Prospera Place"	1998	Design-build-finance-operate-maintain	30 years	RG Properties
District of Port Hardy[3]	Water and waste-water treatment system	1999	Operate and maintain	20 years	EPCOR Water Services Incorporated
City of Victoria[4]	Multipurpose facility: "Save-On-Foods Centre"	2002	Design-build-operate	30 years (3 consecutive 10-year agreements)	RG Properties
City of Chilliwack[5]	Arena complex: "Prospera Centre"	2003	Design-build-finance-operate	25 years	Chiefs Development Group (same owners as Langley Development Group).
City of Vancouver[6]	Landfill gas cogeneration	2003	Build-own-operate	20 years	Maxim Power Corp.
District of Sooke[7]	Waste-water treatment and collection	2004	Design-build-operate	5 years	EPCOR Water Services Incorporated
City of Langford[8]	Sewer system	2004	Operate and maintain existing sewer system; construct and own new sewer system	21 years (with an option to renew for another 21 years)	Corix Utilities

City of Penticton[9]	Events centre	2006	Two contracts: Design-Build & Operate	Operating contract: 20 years	Global Spectrum
Township of Langley[10]	Events centre	2007	Design-build-finance-operate—although operations contract had yet to be finalized in December 2008[11]		Langley Development Group[12]
Alberta					
Town of Canmore[13]	Water utility management agreement[14]	2000	Operate-maintain	10 years	Epcor Water Services Inc.
City of Calgary[15]	Light rail transit system	2001	Build-own-operate	10 years	Vision Quest Windelectric Inc. and Enmax Energy Corporation
Town of Okotoks[16]	Waste-water treatment plant	2005	Design-build-operate (Epcor also took over operation and maintenance of water and wastewater utility)[17]	20 years	Epcor Water Services Inc.
Manitoba					
City of Winnipeg[18]	Charleswood Bridge	1995	Build-lease-operate-transfer; design- build	30 years	DBF Limited (Ernst Hansch Construction Ltd., Wardrop Engineering and RBC Dominion Securities)
City of Winnipeg[19]	East District Police Station	2007	Finance-build-operate	30 years	Bird Construction and Huntington Real Estate Investment Trust[20]
City of Winnipeg[21]	Disraeli Bridges	RFP issued December 2008	Design-build-finance-maintain	N/A	N/A

City of Winnipeg[22]	Chief Peguis Trail Extension	RFQ submission deadline: April 2009	Design-build-finance-maintain	30 years	N/A
Ontario					
City of Guelph[23]	Sports and entertainment complex	1998	Design-build-finance-operate	35 years	Nustadia Developments In.c
City of Brampton[24]	Centre for sports and entertainment: "Powerade Centre"	1998	Design-build-finance-operate	34 years	Brampton Sports Centre Inc. (Realstar Group Inc. and Edilcan Development Corp.)
Regional Municipality of Waterloo[25]	Landfill gas power project	1999	Design-build- operate	22 years	Toromont Energy Ltd.
Regional Municipality of Peel[26]	Algonquin-Peel energy from waste facility	2002	Design-build-own-operate	20 years	Algonquin Power
City of London[27]	John Labatt Event Centre	2002	Design-build-finance-operate-maintain	50 years	London Civic Centre Limited Partnership (Global Spectrum LLP, EllisDon Construction Ltd. and Stadium Consultants International)
City of Ottawa[28]	Sports dome: "Superdome"	2003	Design-build- operate-maintain	25 year (5 year renewal option)	Thunderbird Management Services Inc.
City of Ottawa[29]	Ottawa Paramedic Service Headquarters	2004	Design-build-finance-operate	30 years	Forum Leasehold Partners Inc.

City of Ottawa[30]	Bell Sensplex	2004	Design-build-finance-operate	30 years	Ottawa Community Ice Partners (Morley-Hoppner Group, Capital Sports Management Inc., Ottawa Senators Hockey Club, CB Richard Ellis Ltd. and Ottawa Senators Alumni).
Town of Goderich[31]	Water and waste-water system	2005	Operate-maintain	5 years (with option for 5-year renewal)	Veolia Water Canada Inc.
Regional Municipality of Peel[32]	Britannia landfill gas to electricity project	2005	Design-build-finance-operate	10 years (with two 5-year extensions)	Integrated Gas Recovery Services
Municipality of Brockton[33]	Water and waste-water system	2006	Operate-maintain	5 years	Veolia Water Canada Inc.
City of Ottawa[34]	Shenkman Arts and OrleansTown Centre	2007	Design-build-finance-operate-maintain	30 years	Orleans Town Centre Partnership (Forum Leasehold Partners, Aecon Buildings, Johnson Controls/BLJC and Lemay and Doyle Architects)
Nova Scotia					
Halifax Regional Municipality[35]	Arena	Negotiations expected to be finalized in spring 2009	Design-build-operate	N/A	Halifax Sports Complex Partners
New Brunswick					
City of Moncton[36]	Water treatment facility	1999	Design-build-finance-operate	20 years	USF Canada

CANCELLED P3 PROJECTS				
Municipality, regional district or school district	Project	Date P3 was cancelled	Type of P3	Reason for cancellation
British Columbia				
Abbotsford School District[37]	Auguston Traditional Elementary School	2000	Design-build-own-transfer	After much negotiation between the project managers, the Ministry of Finance and the district, the government decided to go with a design-build model instead of the original design-build-own-transfer model. The abandonment of the lease was due to concerns raised about: • which party would be responsible for the maintenance of the structure; • insurance; • future school expansion; and • the costs that would have been incurred simply to make the lease work.
Greater Vancouver Regional District[38]	Seymour water filtration plant	June 2001	Design-build-operate	Concerns were raised regarding the implications of having a foreign company operate the plant, given NAFTA's investor-state provisions.
Kamloops[39]	Water treatment system	July 2001	Not specified	Concerns about NAFTA as well as the time it would take to explore the P3 option.
Cranbrook[40]	Recreational complex	1999 (private partner withdrew in 2004)	Design-build-finance-operate	The company Cranbrook partnered with was unable to manage the revenue risks of the project. It complained that the costs were much higher than expected while its revenue was lower.
Regional District of Nanaimo[41]	Rural water systems	August 2005	Operate	No main reason why the district decided against a P3 was reported. There was significant public outcry against the deal, though.[42]

Whistler[43]	Waste-water treatment	June 2006	Design-build-operate	Through an alternative approval process, over 1,800 residents of Whistler voiced their opposition to this project. Concerns included cost, lack of control and risk to the environment.
Maple Ridge[44]	Core project	2002	Not specified	The deal was determined to be illegal by the BC Court of Appeal because the district had not held a referendum. It was determined that where a lease payment does constitute a public liability, the district should have held a referendum before proceeding.
Nelson[45]	Recreation complex	2002	Design-build-finance-operate	The city decided to borrow from the Municipal Finance Authority at lower costs than could be secured by any of the private sector proposals.
Alberta				
SouthWest Recreation Centre	Edmonton	2008		During negotiation the deal fell apart when the private consortium was unable to provide the amenities the city wanted within the given budget.[46]
Ontario				
Hamilton–Wentworth[47]	Water and waste-water treatment	2004	Operate-maintain	The P3 approach was abandoned in 2004 after the original 10-year agreement expired. Natalie Mehra cites maintenance problems, legal disputes, high costs and poor risk transfer as reasons for its abandonment.
Ottawa [48]	Light rail	2006	Design-build-operate-maintain	According to Hilton and Stoney, the project had become very controversial. At the heart of the controversy was the contract the city had signed with Siemens and the high level of secrecy surrounding it, which in turn led to public distrust in the project.

Ottawa[49]	Ray Friel Centre	2007	Design-build-operate-maintain	The company responsible for managing the centre reported that it had underestimated the costs of running the facility. As well, a consultant's report found that the company was underperforming. In November 2007 council voted to take over the centre and assume the $12-million debt associated with the facility.
Nova Scotia				
Regional Municipality of Halifax	Wastewater/ harbour cleanup	2003	Not specified	Halifax backed out of the deal after the private company it was negotiating with refused to take over the risk of meeting environmental standards.[50]

1 These tables are based on information made available in reports, in newspapers and on municipal websites. It is impossible to know if the list is complete or not, since there is no single authority that keeps track of all P3 projects in Canada.

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44 Stuart Murray, *Value for Money: Cautionary Lessons about P3s from British Columbia* (Vancouver, Canadian Centre for Policy Alternatives: 2006).

45 Natalie Mehra, *Flawed, Failed, Abandoned: 100 P3s Canadian and International Evidence* (Ontario Health Coaltion: 2005).

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Appendix B

Resources

Reports and Studies

Pierre Hamel

Public-Private Parnterships (P3s) and Municipalities: Beyond Principles, a Brief Overview of Practices
Groupe de Recherche sur l'Innovation Municipale, 2007
www.fcm.ca
Produced for the Federation of Canadian Municipalities, this report examines the arguments used to back up the recent P3 push by senior levels of governments.

Blair, Mackay, Mynett Valuations Inc.

Evaluation of Public Private Partnerships: Costing and Evaluation Methodology
Prepared for Canadian Union of Public Employees, 2009
www.cupe.bc.ca/files/bw-final-report.pdf
In early 2009 Ron Parks, a forensic accountant in British Columbia, and his colleague examined four P3s in that province and found that the methods used to compare the costs of P3s with the costs of conventional procurement were biased in favour of the P3s.

House of Commons, Committee of Public Accounts

Delivering Better Value for Money from the Private Finance Initiative
Twenty-eighth report of session 2002–03
www.publications.parliament.uk/pa/cm200203/cmselect/cmpubacc/764/764.pdf
For anyone interested in P3s, this is a very important document. It goes through all the dangers of assuming P3s are a better option than conventional procurement methods. It also reviews the issues that emerged from the United Kingdom's P3 program.

National Audit Office (UK)

Improving the PFI Tendering Process
Report by the Comptroller and Auditor General HC 149 Session 2006–07
www.nao.org.uk/publications/nao_reports/06-07/0607149.pdf
This report outlines some of the problems that are still occurring during the tendering phases of projects under the PFI in the United Kingdom and makes recommendations for solving these problems.

Pam Edwards, Jean Shaoul, Anne Stafford and Lorna Ablaster
Evaluating the Operation of PFI in Roads and Hospitals
Association of Chartered Certified Accountants UK, 2004 www.accaglobal.com/pubs/publicinterest/activities/research/research_archive/rr-084-001.pdf
The authors of this report used secondary research and interviews to evaluate the actual performance of P3s in hospitals and roads. This is an important study in that it goes beyond simply examining the decision-making processes of P3s and looks instead at how they operate once in place.

Aiden Vining and Anthony Boardman
Public-Private Partnerships: Theory and Evidence.
University of British Columbia P3 Project, December 2006
http://csgb.ubc.ca/p3_about.html
This paper develops a social cost-benefit test of P3s. This means looking at all the costs associated with P3s, including production costs, negative externalities and transaction costs. It uses ten case studies of P3 infrastructure projects and evaluates them based on whether or not they actually do provide enough benefits to outweigh all of their social costs. The authors find that the costs associated with most P3s often outweigh any of the potential benefits.

The True Cost of P3s
Canadian Centre for Policy Alternatives, April 2003
http://policyalternatives.ca/documents/Popular_Primers/bottom_line_p3.pdf
This primer introduces the concept of P3 in plain, easy-to-understand language.

Blair Redlin
High Risk: An Analysis of Proposed Public-Private Partnership for the Richmond/Airport–Vancouver Rapid Transit Project
Canadian Centre for Policy Alternatives, May 2003
www.policyalternatives.ca
This report was written when TransLink directors were deciding how to proceed with the Canada Line. In it, Redlin looked at the details of the proposed P3, specifically at the proposed risk structure.

Marvin Shaffer

The Real Cost of the Sea-to-Sky P3: A Critical Review of Partnerships BC's Value for Money Assessment
Canadian Centre for Policy Alternatives, September 2006
www.policyalternatives.ca
Shaffer is an adjunct professor with Simon Fraser University's Public Policy Program. In this paper he looks at Partnerships BC's Value for Money analysis of the Sea-to-Sky Highway Improvement Project. He determines that the analysis actually misrepresented the expected costs of undertaking the project as a public project versus a P3.

Stuart Murray

Value for Money? Cautionary Lessons about P3s from British Columbia.
Canadian Centre for Policy Alternatives, June 2006
www.policyalternatives.ca
This 2006 paper carefully and critically examines the use of P3s in British Columbia, making use of specific case studies. It includes an overview of public-private partnerships, a look at the rationales supporting P3s and information on how companies profit from P3s.

Daniel Cohn

Transformative Change and Measuring Success: Public-Private Partnerships in British Columbia, 2001–2005
Revue Gouvernance. Volume 3, Issue 2, December 2006
www.revuegouvernance.ca
Revue Gouvernance is a free online journal with a range of interesting articles written by Canadian academics. In this piece Cohn evaluates the development and outcomes of the current P3 policies in British Columbia, an interesting history and examination of the current situation.

Auditor General Reports

Edmonton Auditor General

P3 Benefits & Risks
www.edmonton.ca/city_government/documents/CityGov/08246_P3_Benefits_and_Risks.pdf
In this very balanced report, Edmonton's Office of the Auditor General provides general information to help council members decide whether P3s are right for Edmonton.

Ontario Auditor General

2008 Annual Report, Section 3.03: Brampton Civic Hospital Public-Private Partnership Project
www.auditor.on.ca/en/reports_2008_en.htm
In late 2008 Ontario's auditor general released the findings of its much-anticipated audit of the procurement process surrounding Ontario's first P3 hospital, the Brampton Civic Hospital.

Nova Scotia Auditor General

Department of Education and Culture: O'Connell Drive Elementary School Lease
www.oag-ns.ca/oconll/oclc3.htm
In 1998 Nova Scotia's auditor general audited Nova Scotia's first P3 school, O'Connell Drive Elementary School. Though the province wanted to use P3s for new schools to keep debt off-book, the auditor general found that the school should have been accounted for as a capital lease, since the majority of the risks and benefits remained with the province.

New Brunswick Auditor General:

1998 Auditor's General Report.
www.gnb.ca/oag-bvg/1998/1998-e.asp
Chapters 13 and 14 deal specifically with two of that province's P3s: The Fredericton-Moncton Highway and Evergreen School.

Websites

Canadian Council for Public-Private Partnerships

www.pppcouncil.ca
This organization is a pro-P3 entity created to help encourage P3s. It is a good source for gaining a better understanding of why some believe P3s to be superior to public procurement.

CUPE (Canadian Union of Public Employees)

http://cupe.ca/p3s
CUPE has compiled a comprehensive collection of P3 articles, research papers and news briefs. These pieces not only deal with P3s in Canada but also internationally. Topics range from the effect of P3s on municipal services to the effect of P3s on women.

See especially:
The Drive to Privatize - http://cupe.ca/britishcolumbia/p3sdrivetoprivatize
This research brief on the topic of P3s was produced for municipalities and school boards in British Columbia.

UNISON (United Kingdom)

www.unison.org.uk/pfi/index.asp
UNISON is the United Kingdom's largest public sector union. This Website has excellent information about the Private Finance Initiative experience there.

Books

Public-Private Partnerships: Principle of Policy and Finance

E.R. Yescombe
Boston: Elsevier/Butterworth-Heinemann, 2007
This authoritative text introduces readers to many of the technical aspects of P3s, including their financial and legal structures.

The Challenge of Public-Private Partnerships

Edited by Graeme Hodge and Carsten Greve
Cheltenham, UK: Edward Elgar, 2004

Public-Private Partnerships: Policy and Experience

Edited by Abby Ghobadian, David Gallear, Nicholas O'Regan and Howard Viney
New York: Palgrave MacMillan, 2004

Both of these recent books are compilations of research pieces that discuss different aspects of the international P3 experience. The authors are well-respected researchers and experts on P3s.

PUBLIC PRIVATE PARTNERSHIPS
UNDERSTANDING THE CHALLENGE

Are P3s a true partnership for the public and private sectors? Or are they a way to provide profits to the private sector, leaving long-term pain for the paying public?

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