Questioning the assumptions of public private partnerships

On its web page PPP Canada pronounces that:

- Across Canada, governments have begun to recognize the value of engaging private-sector innovation to build more for less, where possible, and deliver savings that will help to fill the infrastructure gap.
- P3s provide on-time, on-budget projects which deliver effective infrastructure over their useful lives.
- P3s are a long-term performance-based approach for procuring public infrastructure where the private sector assumes a major share of the responsibility in terms of risk and financing for the delivery and the performance of the infrastructure, from design and structural planning, to long-term maintenance.
- Inadequate incentives and contractual discipline: contracts often do not include sufficient incentives for scope and cost discipline; cost-based contracts can, in fact, create perverse incentives for contractors to encourage change orders and cost increases.

P3s Cost Less than Traditional Procurement?

Quebec and Ontario (Auditors General) auditors have questioned the methodology for comparing P3s with more traditional procurement. One of the most important assumptions used by P3 promoters is that governments do not borrow money to finance projects. The Ontario Auditor General said:

> *In comparing the design and construction costs of the two options, [*William Osler Health Centre *(WOHC)] assumed that there would be no financing if the government undertook the project itself, but that the [P3] arrangement would be financed over 25 years. It justified this assumption by noting that in the past, hospitals were required to have their share of project costs available before the Ministry would approve any projects.*
>
> *Governments do have the capacity and the option of financing and typically obtain a lower debt interest rate than private-sector borrowers do. The province's 5.45% cost of borrowing at the time the agreement was executed was cheaper than the weighted average cost of capital charged by the private-sector consortium. Had the province financed the design and construction costs under the same terms as the private-sector partner but used its lower rate, we estimate that the savings in financing costs would be approximately $200 million ($107 million in 2004 dollars) over the term of the agreement.*[1]

Do P3s really transfer risk to the private sector?

[1] Auditor General of Ontario, 2008 Annual Report, Chapter 3.03 Brampton Civic Hospital Public-private Partnerships Project, page 115.

Auditors General in Quebec and Ontario have found that risk can be transferred in traditionally developed infrastructure projects and that P3 project analysis exaggerates the amount of risk involved.

Looking at a Quebec Hospital project, the Quebec Auditor General said:

> *Indeed, choosing a different conventional project delivery method - such as the turnkey approach - could also have improved public sector efficiency by giving a design and construction contract to a group of companies. It would also allow construction to be fast-tracked. In such a case, calls for tender are issued as soon as detailed plans and estimates for a lot are completed, thereby saving time.*[2]

Looking at an Ontario hospital project, the Ontario Auditor General said:

> *Another concern we had was the $67 million in transferred risks that was added to the November 2004 government design-and-build estimate. This amount was arrived at on the basis of the judgment and experience of management and consultants. Owing to the subjective nature of these estimates, it is virtually impossible to substantiate the validity and accuracy of the quantified amounts. We were concerned that the transferred risks for this project amounted to almost 13% of the November 2004 government design-and-build estimate of $525 million. In comparison, actual cost overruns (a major component of risk transfer) in the design and construction of the Peterborough Regional Health Centre - a hospital built under the traditional procurement approach during the same period - were about 5% of the total contract value.*[3]

Are P3s on time and on budget?

Once again, P3 promoters can only make these claims with an elaborate set of assumptions. P3s may be delivered "on time" within the terms of the contract, but they take much longer to deliver than traditionally procured projects. The government of British Columbia acknowledged this in 2008 when it raised the threshold for consideration of P3s from $20 million to $50 million saying:

> *As part of the government's commitment to <u>accelerate</u> capital infrastructure projects the threshold has been increased for any provincially-funded capital project to be considered as a public private partnership.*[4]

In terms of "on budget" virtually every P3 project has risen in cost substantially between the time of its announcement and the financial close of the project.

Do Traditional Projects lack "cost-discipline"?

[2] Rapport du Vérificateur général du Québec, paragraphe 5.67.
[3] Auditor General of Ontario, 2008, page 112
[4] http://www2.news.gov.bc.ca/news_releases_2005-2009/2008FIN0019-001677.pdf

Economist Dr. Marvin Shaffer examined the Partnerships BC methodology for cost discipline and makes the following observation:

> *Bonding and warranty arrangements can be used to ensure cost and performance guarantees are met in more traditionally procured processes – that risks the builders can manage are effectively transferred. The model PBC has recently turned to, whereby the winning bidder must provide some equity, but the balance of the capital cost is financed by government can also ensure long term performance guarantees are met. PBC recognizes this is a lower cost arrangement than their preferred P3, particularly with the recent turmoil in the private capital markets, but alternatives like this aren't even considered in its standard methodology.*
>
> *The point is that PBC's methodology makes no effort to determine the optimal procurement arrangement, one that minimizes cost to the taxpayer, while still achieving appropriate, cost-effective risk transfer and private sector participation in the project.*[5]

Do P3s provide value for money through competition?

Again, Auditors General have questioned this claim. With respect to a hospital project Ontario's Auditor General said:

> *There was no formal analysis of whether the market had sufficient capacity and was competitive enough to support a P3 arrangement for the project. Our review of available information suggested that only a limited number of construction contractors in the province are able or willing to undertake a project of this size. The same construction companies would be involved in the bidding and work regardless of whether WOHC followed the traditional procurement or P3 approach.*
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> *At the direction of the Ministry, WOHC was also asked to engage the private sector not only to design and build the new hospital, but also to provide maintenance and non-clinical services for it. As most private-sector companies specialize in providing either capital construction or operational support services, the mingling of the two further limited the number of companies qualified to deliver the P3 arrangement.*[6]

The current approach to P3 procurement has also been questioned by the construction industry itself. Canadian Construction Association Chair Dee Miller told Business in Vancouver Magazine that P3s so far:

> *…have worked only for a handful of very large Canadian construction firms. Ninety percent of Canadian construction industry, however, is made up of small and medium sized firms.*[7]

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[5] Shaffer, PhD, Marvin, Review of Partnerships BC's Methodology for Quantitative Procurement Options: Discussion Draft, November 2009, page 3, http://www.cupe.bc.ca/sites/default/files/nov_19_shaffer_oct_09_pbc_evaluation_methodology.pdf

[6] Auditor General of Ontario, 2008, page 108

[7] Martin, Brian, CCA Head sounds a warning, Business in Vancouver Magazine, Oct 11-17, 2011, page C16.