

Investing in the future: Financing municipal infrastructure



CUPE





Office of the Auditor General of Ontario
Bureau du vérificateur général de l'Ontario

An Overview of the Ontario Auditor General's 2014 Report on Infrastructure Ontario – Alternative Financing and Procurement

Presentation for the Panel on
“Investing in the Future: Financing Municipal Infrastructure”
at the FCM Annual Conference and Trade Show

Bonnie Lysyk, Auditor General of Ontario
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Overview

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About the Auditor General

- The Auditor General is an independent Officer of the Legislative Assembly in Ontario, appointed under the *Auditor General Act*
- Our role is to provide information to the Legislature to help Members ensure taxpayer funds are prudently spent and government administrators follow sound business practices
- We encourage improvements in public service delivery and provide assurance that financial accounts are fairly presented



Value-For-Money (VFM) Auditing

- Assesses economy, efficiency and effectiveness
- Typically, we audit against best practices or generally accepted ‘industry’ standards
- Financial statement audits reveal **what funds are spent on**
- VFM audits reveal **whether funds are well spent**, and identify opportunities to improve service-delivery or reduce costs
- Since 2006, VFM audits have been conducted for organizations in the broader public sector (e.g. hospitals, schools, etc.) and Crown Corporations



Background of AFP Use in Ontario

- Under traditional procurement, the government manages, finances, and oversees construction of infrastructure projects
- Under P3s, governments transfer some responsibilities (including financing), and accompanying risks, to private-sector partners
- P3s – Public-Private-Partnerships are referred to as Alternative Financing and Procurements (AFPs) in Ontario
- Different types of AFPs (e.g., BF to DBFM)
- In Ontario, payments for most projects are made when projects are substantially complete



Background of AFP Use in Ontario

- AFPs began appearing in Ontario in 2001. The first projects were Brampton/Ottawa hospitals.
- Infrastructure Ontario (IO) was incorporated in 2005 to initially deliver large-scale, complex infrastructure projects using AFPs – 160 employees work on AFP Projects
- IO and AFP were key to the government’s 2005 infrastructure investment plan “Renew Ontario”
- 2011 – “Building Together: Jobs and Prosperity for Ontarians” to guide infrastructure investment
- AFP used for schools, hospitals, highways, etc.



Our Audit Objective

To assess whether Infrastructure Ontario has effective systems and processes in place to ensure that:

- the decision to use Alternative Financing and Procurement (AFP) is suitably supported by a competent analysis of alternatives;
- all significant risks and issues are considered and appropriately addressed in the final agreement;
- public expenditures are incurred with due regard for economy



Types of AFPs in Ontario

Figure 3: Infrastructure Projects by Sector and AFP Model as of May 2014

Source of data: Infrastructure Ontario

Sector	DBFM	BF	DBF	BFM	DBFMO	Total
Health care	13	27	4	3	—	47
Justice	9	1	—	—	—	10
Transit*	3	—	2	—	1	6
Transportation	4	—	—	—	—	4
Pan Am Games	—	1	3	—	—	4
Education	—	—	3	—	—	3
Information technology	1	—	—	—	—	1
Total	30	29	12	3	1	75

* For two transit projects (Ottawa light rail transit and Waterloo light rail transit), Infrastructure Ontario is acting only as an adviser to the municipalities.



Facts

- Under AFP Model, project sponsors in the public sector establish the scope and purpose of the project
- Construction is financed and carried out by the private sector
- In some cases, the private sector is also responsible for the maintenance and/or operation of a project for 30 years after project completion
- The long-term liabilities and commitments relating to these projects are \$23.5B as at March 31, 2014
- As well, public debt has increased about \$5 billion as at March 31, 2014



Facts

- The key principle in using AFPs to deliver projects in Ontario is that VFM must be demonstrable using the AFP model
- A \$50 million threshold was used for Treasury Board AFP referral to IO
- Since its inception, IO has been involved in the delivery of 75 AFP infrastructure projects that were at various stages as of March 31, 2014



Status of AFPs at March 31, 2014 in Ontario

Figure 4: Status of AFP Projects as of May 2014

Source of data: Infrastructure Ontario

Sector	Construction Substantially Complete	Under Construction	Selection of AFP Contractor Under Way	Total
Health care	27	8	12	47
Justice	10	–	–	10
Transit*	–	2	4	6
Transportation	–	3	1	4
Pan Am Games	–	4	–	4
Education	–	1	2	3
Information technology	1	–	–	1
Total	38	18	19	75

* For two transit projects (Ottawa light rail transit and Waterloo light rail transit), Infrastructure Ontario is acting only as an adviser to the municipalities.



Main Findings

Part 1

- Was the decision to use AFP suitably supported by a competent analysis of alternatives?

- IO uses VFM assessments for proposed projects to confirm whether delivery would be more effective under AFP or traditional procurement
- We looked at 74 major infrastructure projects, completed or under way, that IO identified as more cost effective under AFPs
- Most were delivered on time and budget but, we questioned some calculations
- Specifically, the tangible costs, such as construction, financing and legal services, were estimated to be ~\$8B higher than if the projects were contracted out and managed by the public sector
- The majority—\$6.5B—relates to higher private-sector financing costs



Main Findings

- IO estimated the \$8B difference was more than offset by the risk of cost overruns if construction and, in some cases, maintenance was undertaken by the public sector
- IO estimated the risk of projects being late and over budget was ~5 times higher under the public sector
- No empirical data to support the key assumptions used to assign costs to specific risks
- Two quantified risks in the VFM assessments should not have been included and their combined cost over the 74 projects was almost \$6B
 - Asset residual risk is double-counted
 - Risk of delayed government approvals
- When two risks removed, 18 projects would have been assessed as \$350M less under public sector delivery than AFP



Main Findings

Figure 5: Combined Results of the Latest Value-for-money Assessments Conducted by Infrastructure Ontario
(\$ billion)

Source of data: Infrastructure Ontario

Component of Project Cost	Public-sector Comparator (PSC)	Alternative Financing and Procurement (AFP)	Difference ¹
Base costs	26.0	26.0	
Premium	–	1.9	
Competitive neutrality	0.8	–	
Subtotal	26.8	27.9	(1.1)
Financing costs	0.5	7.0	(6.5) ²
Ancillary costs	0.7	1.1	(0.4)
Subtotal	28.0	36.0	(8.0)
Retained risks	18.6	4.0	14.6
Overall Total	46.6	40.0	6.6

1. Numbers in parentheses show components where the cost of PSC is cheaper than the costs of AFP.
2. AFP financing costs are typically higher than public-sector financing costs, primarily because the provincial cost of borrowing included in the latest value-for-money assessments (VFMs) is lower than the private-sector cost. This difference in borrowing costs, extended over the long term of project agreements (where the AFP contractor may be responsible for maintaining and operating the facility) results in the AFP financing-cost component being \$6.5 billion higher.



Main Findings

Part 2

- Were all significant risks and issues considered and appropriately addressed in the final agreement?

- IO was not checking to ensure risks they assumed were to be borne by the private sector were in fact spelled out in the final AFP agreements
- We noted some inconsistencies between what was assumed in the assessments and the final agreements
 - Design risk transfer (e.g. hospital noted in our report)
 - Cost associated with permit approvals



Main Findings

Part 3

- Were public expenditures incurred with due regard for economy?

- In most cases, IO has delivered AFP projects on time and on budget. However, this model does come at a higher cost.
- A properly structured contract under public-sector procurement can manage risks considered mitigated or transferred under AFPs
- E.g., Cost overruns in public-sector procurement often occur due to incomplete project design, which can lead to change orders; unknown site conditions; work stoppages; and/or weather delays
- Just as AFP contractors make contingencies for factors that could result in cost overruns, public-sector contracts can be structured so that many of the risks are the responsibility of the contractor



Recommendations

- Gather empirical data on both AFP and non-AFP projects
- Revise VFM methodology to ensure risk valuations are justified
- Confirm that risks assumed to be transferred are actually transferred in the contracts
- Engage IO in traditional forms of procurement, where knowledge and skills are available in the public sector
- Confirm appropriateness of \$50M threshold
- Ensure proposed changes to VFM methodology are fully supported – logic and data



Recommendations

- Identify reasons for significant differences between actual contract values and IO's estimates of project cost
- Review and update the system of scoring bidders' submissions to ensure due consideration of both technical merits and price
- Ensure participants involved in evaluating submissions sign required conflict of interest declaration
- Develop formal process for managing intellectual property rights acquired in exchange for bid fees paid to unsuccessful bidders



Closing Thoughts on AFPs

- We did not conclude on the usefulness or viability of P3s. Our audit provided insight on the VFM assessment process.
- AFPs may result in use of consortiums, which may reduce the market for small industry contractors, and ability to select contractors and operators separately based on strengths.
- AFPs can be completed on time and on budget.
- Successful public sector delivery depends on effective contracting and project management.
- Advantage of AFPs is that governments don't pay until asset is built, and costs are reliably known at the outset.



Closing Thoughts on AFPs

- On the other hand, AFPs tend to have higher financing and ancillary costs.
- There is a role for both private and public sector delivery.
- Government needs to reassess those roles and the financing mix as its expertise continues to develop.
- **Ultimately, governments pay for either traditional public sector or AFP delivery.**



Questions?

Comments or information on audits can be sent to comments@auditor.on.ca.

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