RECREATION P3s GONE WRONG:

LESSONS FOR HALIFAX REGIONAL MUNICIPALITY

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CUPE Research

INTRODUCTION

The Canadian Union of Public Employees represents close to 16,000 members in the province of Nova Scotia. Over 400 of these women and men are outside workers in the Halifax Regional Municipality who work in areas such as: snow and ice removal, parks and grounds, maintenance, sports fields, and other vital city services. CUPE is pleased to have the opportunity to contribute our expertise to this process. As the largest public sector union in Canada, we have undertaken substantial research and analysis about public infrastructure financing and alternatives to privatization.

Our position is clear: public private partnerships (P3s) are not equal partnerships when it comes to the public interest. Rather, they benefit private for-profit corporate partners at the expense of public services and communities. The conclusions of auditors general and other economists and policy analysts support this position globally.

While CUPE recognizes the need for an expanded and improved sports and recreation facility in the Halifax Regional Municipality, we do not believe that entering into a P3 arrangement is the best way to realize that objective. Relying on the private sector to design, construct, finance (in part), own, operate and manage a new facility, or facilities, in the downtown core requires compromising the public interest.

As we will demonstrate in this report, numerous P3 arenas have been abandoned by the private sector in Canada. The higher cost of borrowing by the private partner and the need to generate profits made the projects more expensive, explaining in part why they failed. The projects would have cost less and been more sustainable had they been publicly financed.

Physical activity is essential to human health and development. As communities grow, municipalities across Canada are seeing an increase in demand for recreation services such as community ice time at local hockey arenas.

Municipal governments have an opportunity to invest in publicly owned and operated facilities that build community assets and expand access to services. But competing costs and limited capital budgets are leading local governments to seek alternatives to public investment for capital projects like arenas and recreation facilities.

Private for-profit companies are eager to offer a convenient package that includes both financing and operation of new facilities through public private partnerships (P3s) or alternative service delivery (ASD), but at what cost? The profit-making incentive can influence the nature of a project so much that it may no longer address community needs, as was witnessed most recently in Edmonton, despite the higher cost of pursuing the project to the municipality and its taxpayers.

Experiences from communities such as Guelph, Ottawa, Moncton, Cranbrook, Port Alberni and elsewhere, provide important lessons for the Halifax Regional Municipality.

EXAMPLES OF RECREATION P3s GONE WRONG: LESSONS FOR HRM

Case Study #1: City of Edmonton

City of Edmonton staff are advising council to scrap plans for a P3 and keep a new recreation centre public. City staff made an official pro-public recommendation just this month, after word began leaking out that the P3 numbers didn't add up.

CUPE opposed the plan from the start, calling for the city to keep the much-needed rec centre in public hands. Other community groups, including Public Interest Alberta, also campaigned against the scheme.

In a press release announcing its recommendation that the facility would proceed as a "construction management" project, the city administration said it couldn't reach an acceptable deal with the private sector. Construction management is the way much of Canada's infrastructure has traditionally been built – with the private sector designing and building facilities that are publicly financed, operated and managed.

A city backgrounder highlights the pitfalls of building the Southwest Community Recreation Centre as a P3. A P3 gave the city no protection against rising costs and would have delayed construction until the fall of this year - at a cost of $2 million per month.

The P3 model was only viable if it included a rink with four ice pads, forcing the city to cut into the budget for recreation centre facilities. The city said it was "unwilling to compromise on those amenities."

While the city says it will continue to consider P3s for future projects, it's yet another example of the higher costs, delays and compromised services that come with this form of privatization.

Case Study #2: Guelph

The Guelph Sports and Entertainment Centre was built right into an 80,000 square foot downtown shopping mall. The City guaranteed a $9 million loan to a private company

(Nustadia Developments) to build an arena mall complex, and then invested another $10.5 million of public money.

It was early in the 35-year deal that the company realized they were in trouble. Revenue was lower than expected from ticket sales and concessions and the City had to bail the company out, after having already subsidized the project with almost $20 million of capital funding.

The Guelph facility, in competition with major centres, including nearby Kitchener, Brampton, Mississauga and Toronto, had difficulty booking major events. The arena was not able to pay for itself, much less the cost of servicing its debt.[1] Ticket sales and revenue from concessions were expected to finance the loans to build the facility and get it up and running.

This is critical to note: It was not the private partner who had to absorb the costs but the municipality, who were now left to cover both the public and private sector's debt.[2] In the summer of 2001, the City began to pay Nustadia's $750,000 mortgage payments and would continue to pay them for four years. The city has also been paying all federal and corporate taxes associated with the project. All of the risk has been borne by the Municipality of Guelph.

Case Study #3: Moncton

The City of Moncton has also had problems with a P3 recreation facility. The project known as the "Moncton Fourplex" was criticized by residents for being expensive and unnecessary.

Slated to open in 2002, the City would pay $1.4 million per year over 20 years for a $15 million facility. That is almost 50% more than the actual cost in debt payment alone, a far greater cost than if the city had simply undertaken the project on its own through public financing. The City also lost on the benefits that would have come to the municipality as a result of being the sole recipient of user fees, concessions, advertising revenue, and so on. The City will continue to pay $150,000 a year to the private company owner to run the facility.

[1] Metroland Papers, Wednesday October 22, 2003: byline: Martin Derbyshire
[2] Metroland Papers (Guelph), p.1, "A tale of two public private partnerships".

CITIES DECIDE AGAINST P3: Projects kept (or brought back) in house

Case Study #1: Cranbrook

The City of Cranbrook, B.C. attempted to use a P3 to keep the debt incurred from building a 4,250-seat arena off of its books. But the project has faced many problems from the start. At first, the private partner had trouble securing financing and construction was late starting. The company met with Council in October 2001 and complained that its costs were in excess of what they had anticipated and their revenues had shortfalls. It was determined that the company was responsible for the first $140,000 shortfall and the city would be responsible for the rest.

The City's borrowing power was reduced substantially as a result of the long-term lease.[3] In the year 2000, ownership of the private partner changed hands when an American company bought out the original firm and a new subsidiary was created. The project proved much more expensive than was expected and when the project failed the City suddenly found itself with the highest debt level in the province of BC.

The tax increase to residents of Cranbrook alone for this project was 7%.[4] Meanwhile, fees had gone up considerably from what was charged at the city-owned rinks, up to over $100/hour for ice rental time, discouraging community use of the facility.

"Five years after the project first began, having struggled through legal disputes, cost overruns and construction delays, the P3 project has officially failed. The private company has left town after paying the City $1.7 million to take the mess off of its hands. The facility has been brought in house and it is now up to the City to find a way to make it work."[5]

Case Study #2: Nelson

In the year 2000, the City of Nelson was looking to develop a recreation complex. It was to be about the same size as Cranbrook's, at a projected cost of about $19 million. They received proposals from three different private sector companies but decided against taking the P3 route. Instead they borrowed the money from the Municipal

[3] Cranbrook Daily Townsman, June 27, 2001, "Cranbrook's borrowing power decreases."
[4] Cranbrook Daily Townsman, May 15, 2001, "Cranbrook taxes to go up almost 11%."
[5] The Daily Townsman (Cranbrook): August 3rd, 2004, "1999 rears its head: Our failed public private adventure," page 4, Barry Cloutier; August 4th, 2004, "Questions remain concerning Rex Plex employees, Kootenay Ice," page 1, Mark Hunter.

Finance Authority. "We thought we might as well take the risk and lower (borrowing) costs," the Mayor stated.[6]

Case Study #3: Port Alberni

The community of Port Alberni also rejected a P3 arena deal. In depth analysis of the financial part of the deal led the city to conclude that the P3 would benefit the private partner more than it would the City or its residents. They decided that the community would be better off using traditional public procurement to develop the needed facility.[7]

PROBLEMS WITH P3s IN GENERAL

The evidence indicating that P3 recreation facilities are a bad deal for municipalities and communities is clear. But all P3s, by their very definition, are bad deals for the public sector. They lower the standard of living for workers and communities, eliminate decent jobs, reduce quality of services, cost more and are an irresponsible use of public funds, benefiting for-profit companies at public expense.

More Debt, Less Value for Money

Expensive borrowing rates for private companies and the need to make a substantial profit both jack up the costs of any project developed using a P3 model. P3s are promoted as a way to keep debt off the public books and eliminate debt, but while P3s may hide debt, they never reduce it – just the opposite.

Public debt, however, costs less to repay and allows the City to retain public ownership and control of the asset. The obsession with avoiding government debt is misguided. There is good debt and bad debt. P3s incur bad debt for the public partner.

Auditors General of Ontario, Nova Scotia and New Brunswick, and the National Audit Office in the U.K. have expressed concern about claims that P3s are cheaper than public ownership. They question P3 accounting practices and the extent to which they obscure and hide real public liabilities.

P3 funding should really be counted as municipal debt because the municipality (or public partner) is ultimately responsible if private sector loans are not repaid by the

[6] Nelson Daily News, December 11, 2001
[7] Canadian Centre for Policy Alternatives, "Public Private Partnerships: The True Costs of P3s", 2003 http://www.policyalternatives.ca/bc/bottom-line-p3.pdf.

private sector. Off-book funding is in effect a charade that disguises the financial liabilities of the municipality while increasing the risk to the public entity.

"The International Monetary Fund recently issued a report warning against "off-book borrowing" for PPPs. The IMF's managing director stated that P3 debts should be counted as public borrowing, and that "governments had 'no business' hiding private finance projects away from their balance sheets."[8]

REDUCED ACCESS

Equal access to sports and recreation facilities is essential for an equitable society where everyone has a fair chance, regardless of their social class, race, gender, or ability.[9] And governments' role is to ensure that all children have the opportunity to realize their full potential and fully participate in community life.

Studies show that active children achieve higher grades, and are less likely to smoke and to abuse drugs and alcohol. Access to community recreation programs has been linked to reduced crime rates.[10]

To promote access, municipalities typically subsidize the cost of ice time in public recreation facilities, whereas the private profit motive drives operators to charge the highest price the market will bear.

While the motivation to pursue a P3 may be increased recreation capacity, the private sector profit-focus may actually reduce access.

Fewer Good Jobs

P3s almost always mean lower wages for workers. Profits, after all, have to come from somewhere. P3's undermine the public sector's role in service delivery and usually mean transferring public sector jobs to private companies whose staff is less likely to be unionized, and receive low wages with few if any benefits.

[8] "Brown warned: don't hide £100bn, Dan Atkinson, Mail on Sunday, 25 April 2004, http://www.thisismoney.com/20040425/nm77403.html"

[9] Parliamentary Report, www.parl.gc.ca/InfoComDoc/36/1/CHER/Studies/Reports (28/04/2005)
[10] Canadian Council for Social Development, Insight report, Spring 2001

With privatization, the gap between rich and poor widens and average incomes and spending power in communities goes down. Corporate profits come at the expense of local businesses and strong communities.

Is this kind of community that residents of HRM are seeking?

Conflicts of interest, Lack of transparency

Auditors and auditors general are consistently raising concerns about P3s in Canada. There is tremendous potential to mismanage public funds. In recent reports, even organizations such as the World Bank and, more locally, the CD Howe Institute that support the principle of P3s, cannot point to any outright successes in terms of public benefit.

When P3 contracts are secret, as they consistently have been because of standards practices regarding corporate confidentiality, the public and their elected representatives have little if any opportunity, to influence how services are delivered and how tax dollars are spent and invested. Governments' financial transactions, on the other hand, are required to be transparent. Public policies and procedures that require public consultation and approval are seen as obstacles to P3s.

Increased Risk, Reduced Accountability

Substantive risk is not actually transferred to the private sector in P3 arrangements. This is because there is no way to account for the risk that the private sector may fail. Agreements assume that the private sector will continue to operate, while the public sector generally has no choice but to assume many risks in order to continue to deliver services.

Never is everything covered in any deal, and many aspects are unclear. Who is ultimately responsible when a group of companies forms a consortium to make a bid? What happens if one or more of these companies changes ownership?

Private operators have walked away from P3 arena deals in many Canadian cities when profit margins collapsed, leaving the city to pick up the cost of providing these services and of financing the more expensive debt incurred at private sector borrowing rates. In this way, by virtue of its role in the community, the public partner essentially guarantees the loan, whether stated in the deal or not.

Hidden costs

Long and costly negotiations, lawyers, accountants and other consultants, management fees, developing and evaluating RFPs, drafting and negotiating and renegotiating complex agreements, are all expenses incurred on the City side that can really add up.

Even once the P3 is up and running, the public partner has legal, supervisory, and insurance and risk costs. Legal and forensic advice and audits on par with private sector's high paid lawyers and consultants, termination payments, monitoring and ongoing negotiation, are all costs rarely factored in to the costing of a P3 deal.

No Guarantees

In a P3 arrangement, the parent company of the private partner may change throughout the life of the agreement. This can make facilities and services unpredictable, create volatile relationships and will likely result in significant costs in the form of legal fees and contract renegotiations.

Public ownership ensures that there is a process where elected officials can advance community concerns. A complex contract between a private sector partner, residents and the municipality will not provide nearly the same accountability. HRM's current RFP essentially outlines the terms of a gift to the private sector, a gift that has the potential to drain the City's finances down the road, while the privates continue to profit.

Commercial confidentiality has been used to justify denying public access to information and even to deny elected officials access to financial and other information. This means that **"partnering" with the private sector compromises democratic accountability and transparency.** There are no guarantees that the city will have a say in important future decisions, placing the residents of HRM at risk of being the victims of corporate foul play.

PUBLIC FINANCING ALTERNATIVES

Governments have options. Firstly, the cheapest way to finance any project is through public borrowing, because municipalities typically have the best credit rating around and thus have access to the lowest borrowing rates. Secondly, many new, tried and true mechanisms exist to leverage public funds for infrastructure.

Tax-exempt bonds allow municipalities to borrow funds at lower rates of interest than they would pay on regular bonds.

Crown corporations, like the Canadian Mortgage and Housing Corporation, wholly owned by the federal government, can issue bonds and have significant borrowing power. With sufficient pressure from municipalities, the federal government could create an infrastructure corporation, structured as a wholly owned crown corporation similar to CMHC.

Municipal financing authorities exist in most provinces, which allow municipalities to benefit from **pooling of debt**. These can be expanded.

Dedicated infrastructure funds, subsidies from senior levels of government, and innovative solutions like Public Interest Companies (PICs), are all viable options.

Lewis Auerbach, who formerly served as Director in the Audit Operations Branch of the Auditor General of Canada, has addressed governments' options in this way:

"Governments can decide not to make funds available, or to make them available for some kinds of projects and not for others. In other words, the constraints that lead to the choices are self-imposed. It (P3) is a choice especially difficult to comprehend when it leads to higher, rather than lower cost to taxpayers".[11]

Having the benefit of research documenting other experiences with P3s, we hope that HRM will make the right decision and use the municipality's good credit rating and low interest rates to invest in a public facility that will give back to the community. The benefits of having the ability to make choices and adapt to change in the long run, rather than being stuck in a 35-year deal, cannot be overstated.

[11] Auerbach, Lewis. Issues Raised by Public Private Partnerships in Ontario's Hospital Sector, 2002

CONCLUSION

The City of Newmarket's Director of Parks, Recreation and Culture issued a report in 2003, documenting research findings and recommendations regarding public private partnerships for their community. The document's conclusions parallel and support CUPE's recommendations to HRM.

- Many private facilities were turned back to municipalities after a few years.
- There is little to no advantage to having a private firm finance, construct and operate the facility.
- Private companies would not have the willingness or ability to design/build/own/operate a facility without a subsidy from the municipality;
- Risk associated with many factors including initial costs, possible overruns and competition with other facilities would need to be heavily subsidized by the municipality.

Keep in mind, these are the conclusions from a municipal director.

QUESTIONS FOR MUNICIPALITIES CONSIDERING P3 RECREATION FACILITIES:

- Will the municipality do a proper comparative analysis of public versus private financing, considering all associated costs from conception to completion over the life of the contract?
- Should the project fail to provide adequate return for the private proponent, is the municipality prepared to pick up the tab of the full project at the higher cost incurred by private sector borrowing?
- Can the municipality guarantee that the project will deliver appropriate and sustainable services in exchange for public investment or is the city prepared to subsidize corporate profits through tax dollars with little return for the community?
- Can the municipality ensure that all negotiations and contracts will be available for public scrutiny? If not, is the municipality willing to compromise its own commitments to transparency and democratic accountability in order to "partner" with the private sector?

P3s result in increased public costs, hide public debt, reduce accountability, and allow public funds to be directed away from community priorities.

P3s mean compromises on quality and contribute to increased social inequality by reducing access to City services.

Public debt is more cost-effective and allows municipalities to retain public ownership and control of assets.

Public ownership ensures that there is a process where elected officials can advance community concerns.

For more information on the dangers of privatization and public alternatives please visit: www.cupe.ca/www/privatization

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