

**Municipalities  
and the problems with  
Public-Private Partnerships (P3s)**

**A primer for elected officials  
and concerned citizens**

**July 2009**



## **Building Community Infrastructure**

Ontario's towns and cities are working to build strong and vibrant communities. To meet increasing demands, many are hoping to fix aging infrastructure or build new facilities such as arenas, sports and entertainment complexes, public transit systems and community and recreation centres.

Traditionally, local governments have publicly financed the building of community infrastructure and operated them as public services. Municipalities use tax revenue and/or borrow money at the lowest possible rates to finance the project. They use a public procurement process to hire a company to design the building, another for its construction, and then staff the facilities with public employees.

Some communities have experimented with private funding because it initially looked like a good deal. Private for-profit companies are eager to offer a convenient package that includes both financing and operation of new facilities through public-private partnerships (P3) or alternative service delivery (ASD). In the end, such endeavors have been hugely expensive.

### **What is a P3?**

Public-private partnerships (P3s) are quite different from public procurement. Under the typical P3:

- The private sector puts together a for-profit consortium to provide some or all of the private financing, design, construction, operation, maintenance, and even ownership, for these facilities.
- The most common models of P3s are: Design-Build-Operate (DBO) or Design-Build-Operate-Finance (DBOF) projects, but neither of these is a good deal for municipalities.
- The private consortium lends some, or all, of the funds for the public project. Once it is built, the private operator hires private employees to maintain and operate the structure.
- The local government leases back the facility, providing regular payments over the life of the contract, usually for a term of 25-40 years.
- The local government uses the private operator for provision of operating services, finances and key decision-making about issues such as cost.

### **When Public goes Private: Key Issues**

The private sector has promoted P3s as an answer to many challenges faced by municipalities. The evidence suggests otherwise:

- Do P3s cost less? No. Evidence from across Canada and the United Kingdom shows they cost more and deliver less in terms of service and accessibility to the public.

- Are P3s more efficient? No. Municipalities have paid a high price for ‘on-time delivery.’ Years are lost and costs are higher because of a very lengthy, complex procurement process.
- Are P3s the way to solve the problems of ageing municipal infrastructure? No. In fact, they don’t address maintenance or reconstruction of existing infrastructure. And they generally cost a municipality more than or at best the same as annual repayments on a municipal loan.
- Are P3s an answer for ‘off-book borrowing?’ No. Everyone from the International Monetary Fund (IMF) to the Auditor General of Ontario state that P3 debts should be counted as government debt.

This document is meant to provide you with information about the financing of public infrastructure, the costs of P3s and related issues of transparency, accountability and public access to facilities.

## **A Solution in Search of a Problem**

*“P3s have been a solution in search of a problem. The problem P3s are supposed to solve has changed frequently. Each rationale... has been disproven or fallen into disrepute.”*

“Value for Money? Cautionary lessons about P3s from British Columbia,”  
Canadian Centre for Policy Alternatives, June 2006

## **The Problems with P3s**

While commercial interests have heavily promoted P3s, many private projects in Ontario, Canada and other countries, like the United Kingdom, have gone awry. Municipalities have been forced to bail out for-profit operators or facilities and assume large debts when the operator has walked away. A summary of P3 experiences in Ottawa, Niagara Falls, Windsor, London, Guelph and Oshawa can be found on pages 9 and 10.

## **P3s Cost More**

Here are some of the reasons that P3s cost more:

- Private financing costs are higher simply because municipalities can borrow money more cheaply than any private sector investor or investment group can borrow money.
- For-profit operators must make a profit. They typically add on a 10 to 12 per cent profit margin once a P3 enters the operational stage.
- With DBO or DBFO functions bundled into multi-year contracts, P3 procurement processes are much more expensive than traditional public procurement.

- Lawyers, accountants, detailed proposals, drafting, negotiating and renegotiating agreements are costs that the public partner must incur in the complex P3 procurement process.
- The municipality loses revenue from ticket sales, concessions and space rental that would have been received had the facility been publicly owned and operated.

In contrast, public debt is more cost-effective. Governments (of all levels) can access the lowest borrowing rates because they typically have the best credit rating. Public debt allows municipalities to retain public ownership and control of assets, and ensures a process where elected officials can advance community concerns transparently and openly.

## Higher Fees, Less Access

Commercial operators need to make a profit; profit is basically their sole reason for existence. Unfortunately, that requirement supersedes the needs of residents and groups to have access to facilities:

- Municipalities typically subsidize the cost of the utilization of public facilities to promote access, whereas the private profit motive drives operators to charge the highest price the market will bear.
- Elected officials can no longer be held responsible for day-to-day operations, making the management of services less transparent and less responsive to community needs.
- Because for-profit operators are only interested in building new facilities rather than repairing existing infrastructure, P3s allow public funds to be directed away from community priorities, but it also means that operational maintenance will be less of a priority for them over time.

### A Perspective from FCM

*“The problem of municipal infrastructure financing has nothing to do with the availability of funds or the cost of borrowing. The issue stems mainly from the level of municipal revenue, which is often insufficient to maintain and increase investment in the maintenance, rehabilitation and reconstruction of existing infrastructure. In fact, the funds paid out each year to a P3 partner are more or less the same amount as the annual repayments on a municipal loan taken out for a traditional project.”*

“P3s and Municipalities: Beyond Principles, a Brief Overview of Practices,”  
Commissioned for the Federation of Canadian Municipalities (FCM)

## **Loss of Democracy, Control, and Transparency**

“Healthy democracy depends on full information for citizens, full participation by citizens, independent advice and judgment from public servants, accountability to [government] and accountability to electors...Public-private partnerships are undermining all of that.”

“How Public-Private Partnerships are Bad for Democracy”  
Canadian Union of Public Employees, November 2004

P3s are a commercial relationship that fundamentally change the values and processes of democratic governments. In effect, the normal checks and balances of democratic systems are being subverted by the imperatives of investor certainty, commercial confidentiality, proprietary control of information and long-term contractual agreements.

- Ownership, operation and control of the project are most often given over to the for-profit operator. Elected officials and residents no longer have a say in how the facility is run, what user fees are charged or how accessible the facility must be to residents and groups.
- Lengthy contract terms of 25-40 years erode aspects of democratic decision-making such as accountability and transparency, and bind future governments for decades.
- The need of for-profit operators to protect details of the procurement process from competitors often takes precedent over providing key information to elected decision-makers and the public.
- The complexity and cost of bidding actually reduces competition from potential partners.

These issues make P3s inherently secretive, unaccountable and often very risky. Just ask the Hamilton City Councillor who was required to pay \$10,000 for freedom of information requests to find out how much his city paid in capital costs to the P3 running the city’s water and waste water services. Or “Translink”, Vancouver’s regional transportation authority, which was charged with making the decision for the Richmond/ Airport/ Vancouver rapid transit P3, but could not get the financial feasibility study and business case analysis for the proposed project because it contained “competitive” (and therefore confidential) information.

## **Economic and Job Losses**

Public services are a vital part of every community’s economic health. Good paying public sector jobs are a significant contributor to the municipal tax base. These unionized jobs provide workers with the wages, benefits and pensions to ensure them, and their families, the ability to live with dignity and security. Especially in this financial climate, when private sector job losses

are spiraling out of control, public sector employment is a bulwark that provides communities with the economic security of local workers who live, work and contribute to the local economy. P3s and privatized services tend to provide much less in terms of local economic benefits—often, P3 contracts are awarded to transnational corporations who take the profits generated out of the local community.

- Good paying public sector jobs are lost to for-profit operators who mostly employ non-union, low-waged workers who may not even live or work in the local community in order to maximize profits: local procurement or community-sustaining wages are not priorities for P3s.
- Reliance on P3s displaces small and medium size businesses in favour of province-wide, nation-wide, or even transnational corporate operators. These changes do not build capacity in local communities; indeed, in some cases, P3s actually reduce the capacity of the local community and local governments to operate and manage public services themselves.
- P3s can bias spending towards new projects that cost more to operate, rather than addressing repairs and maintenance of existing infrastructure.
- P3 projects provide municipalities little, if any, flexibility to deal with changing circumstances and adjust to new realities, such as climate or demographic change, that require attention for the benefit of the broader public.

## **A High Price for On-Time Delivery**

P3s are touted for their “on-time” and “on budget” promises. But, according to a study by the Canadian Centre for Policy Alternatives (CCPA), in actuality:

- P3 agreements are so complex that there are often significant delays before projects are even started.
- Private contractors will provide contractual guarantees, but for a price. That can result in inflated bids by developers who anticipate contract penalties in advance.
- For example, the U.K. Association of Chartered Accountants found that public health bodies were paying a premium of 30 per cent on construction costs to ensure P3 hospitals were completed on time and on budget.

## **P3 Debt is Public Debt**

- The Auditors General of Ontario, Nova Scotia and New Brunswick, and the United Kingdom's National Audit Office have all expressed concerns about claims that P3s are cheaper than public ownership, with serious questions about P3 accounting processes and how they obscure and hide real public liabilities.
- The International Monetary Fund (IMF) has warned against "off-book borrowing" for P3s, stating that P3 debts should be counted as public borrowing and not be hidden away from their balance sheets.
- Standard & Poor's credit-rating agency now counts P3 debt as government debt. Source: Value for Money? Cautionary lessons about P3s from British Columbia," Canadian Centre for Policy Alternatives (CCPA) 2006

## **The Theory of Risk Transfer is Debatable**

For-profit operators charge for what they call "risk transfer," likely at a premium. Risks can include a change in law, contractor default, cost overruns, design or warranty latent defects, dispute risks, health and safety or environmental issues, and site conditions.

It is debatable whether there is a meaningful transfer of risk, particularly when the operator is a consortium put together for the project, since such entities can declare bankruptcy and walk away from projects if they are deemed not profitable or not profitable enough. If a project goes awry, as has happened in Guelph, Hamilton and Ottawa, the private operator can walk away or go bankrupt, leaving governments to step in and cover all costs. There is also little risk to P3 projects because:

- After construction is completed, private operators have a multi-decade client (the municipal government) who will not go bankrupt. That's an extremely low-risk investment that enables the private operator to refinance at much lower rates.
- P3 consortia in the United Kingdom have actually advertised that their projects contain little inherent risk and have issued bonds with a triple A rating, which indicates low risk.
- Where else can a for-profit operator secure a municipality as a 30-year client than with a P3?

## **Lower Costs of Conventional Public Procurement**

“What is striking... is that in all cases risk transfer almost equals the amount required to bridge the gap between the public sector and the [P3]. This suggests that the function of risk transfer is to disguise the true costs of [P3s] and to close the difference between private finance and the much lower costs of conventional public procurement and private finance.”

Pollock, A., Shaoul, J. and Vickers, N. “Private Finance and ‘Value for Money’ in NHS Hospitals: A Policy in Search of a Rationale?” *British Medical Journal (BMJ)*. Vol. 324, p. 1208, May 2002

## **Flawed Value for Money (VFM) Reports**

For-profit contractors have relied on Value For Money (VFM) reports to provide the business analysis for proceeding with a P3 or not. The problem is that the process is so subjective that it can be manipulated by vested interests, according to the Canadian Centre for Policy Alternatives (CCPA).

VFM audits are a specialized analysis that compares predicted costs of a P3 project to traditional public procurement. Here are the problems with VFMs as they are now done:

- VFMs use a controversial “discount rate” to calculate the current value of future payments for P3s, taking into account factors like inflation, interest rates, etc. The higher the discount rate is, the lower the present value of future expenditures.
- The discount rates have been found to greatly understate the current value of future P3 contract payments, so much so that the United Kingdom Treasury now requires that VFM comparisons use a standardized discount rate in a consistent and transparent manner—one that is much lower than those used previously.
- Stunningly, these VFMs do not discount public sector capital costs. They treat these costs as a lump sum despite the fact that governments borrow money over the long term.
- Economist Hugh Mackenzie’s very recently released report, “Bad Before, Worse Now: The Financial Crisis and the Skyrocketing Costs of Public Private Partnerships (P3s),” documents how the financial crisis has made P3s an even more expensive and risky way to build public goods like hospitals, roads and schools.

## Options for Public Financing

While P3s are more about creating new business opportunities for investors than finding capital for new infrastructure, remember that local governments have other options for public financing.

Public borrowing is the cheapest way to finance any project because municipalities typically have the best credit rating and thus access to the lowest borrowing rates. New and tried-and-true mechanisms exist to leverage public funds for infrastructure that are simple and easy.

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

Dedicated infrastructure funds, subsidies from the Federal and Provincial levels of government, especially now that there are public commitments to infrastructure spending as part of Federal and Provincial stimulus packages, and innovative solutions like Public Interest Companies (PICs) and Public-Public Partnerships (PuPs) are all viable options.

## Conclusion: Quebec backs away from P3s

Ontario Municipalities should also consider what is happening in other regions in Canada. Anti-P3 momentum has been building across Quebec for months, across all sectors. Health minister Yves Bolduc recently said he was reconsidering the privatization of Montreal's CHUM megahospital. In a reversal of his government's previous single-minded promotion of privatization, Bolduc said that "P3s were not a religion" for his party. Treasury board president Monique Gagnon-Tremblay has stated publicly she doesn't see P3s as a cure-all for the province's infrastructure needs. And transport minister Julie Boulet has signaled clearly that the reconstruction of Montreal's Turcot interchange will likely go ahead as a public project, ending P3 plans. In May, the province's municipal affairs minister blocked a P3 arena project in Gatineau.

## References

1. Stuart Murray, "Value for Money? Cautionary lessons about P3s from British Columbia", Canadian Centre for Policy Alternatives, June 2006.
2. Pierre J. Hamel, "P3s and Municipalities: Beyond Principles, a Brief Overview of Practices", Commissioned for the Federation of Canadian Municipalities (FCM).
3. "How Public-Private Partnerships are Bad for Democracy", Canadian Union of Public Employees, November 2004.
4. Pollock, A., Shaoul, J. and Vickers, N. "Private Finance and 'Value for Money' in NHS Hospitals: A Policy in Search of a Rationale?" British Medical Journal (BMJ). Vol. 324, p. 1208, May 2002.
5. Hugh Mackenzie & Associates, "Bad Before, Worse Now: The Financial Crisis and the Skyrocketing Costs of Public Private Partnerships (P3s)," June 2009.

**For more information on P3s see  
[www.cupe.ca/privatization](http://www.cupe.ca/privatization)**

## **Ontario Municipal Experiences with P3s**

### **Brampton Hospital P3**

In Brampton, a P3 hospital that was built under Mike Harris' orders was supposed to have a capital cost of \$350 million. This ballooned to \$650 million by the time the building was finished. However, to keep costs from ballooning further, one of the three clinical care buildings was cut, the number of ORs was cut, and the total number of beds planned for the community was reduced from 720 to 479 (with a new promise to open 608 beds by 2012).

### **Guelph- City takes back ownership**

In 1998, the city of Guelph negotiated a deal with a private firm to build and operate a 5,000 seat arena in the downtown core. Guelph put up \$10.5 million and guaranteed a loan of \$9 million taken out by the private operator. Opened in 2000, the centre consistently lost money until in 2005, the private operator walked away, leaving roughly a \$20 million debt to the city. The city has paid more than \$4 million for loan payments, and spends more than \$100,000 a year to subsidize community rink users who otherwise would not be able to afford the cost of renting ice time.

### **Oshawa- loses revenue-generating concessions**

The city of Oshawa initially agreed to a P3 arena, but eventually realized it was a bad deal when the proposed financial details were revealed. While the city public financed the arena and runs it, the revenue-generating concession business at the arena continues to be run by the private operator, thereby depriving the city of a much-needed revenue source.

### **Ottawa- bailing out arenas**

The Bell Sensplex P3 arena was supposed to "allow Ottawa residents to incur little or no debt" according to then-Mayor Bob Chiarelli. The arena opened late and is now getting bailed out to the tune of \$1.2 million per year. As well, the city took responsibility for the private operator's \$25.6 million debt to build the arena, waived property taxes and development charges and agreed to buy 2,400 hours of ice time from the operator. The city also took over another P3 ice rink, the Ray Friel centre, from a private operator in 2006, which saddled the city with an additional \$12 million debt.

### **The Hamilton-Wentworth Water and Wastewater Treatment P3**

In 1994, the City Hamilton-Wentworth signed a contract with Philips Utilities Management Corporation (PUMC) that led to ten years of misery for local residents. In that period, PUMC slashed its workforce by half, 180 million litres of raw sewage spilled into the harbor and raw sewage also flooded into hundreds of private homes and business premises. The company refused to take responsibility so the city had to take on the cleanup efforts. After another failed attempt in 2004 to put the project out for tender to private corporations, Hamilton has finally brought the project back in-house. Since 2005, the in-house public operation has performed significantly better than in the decade when it was under private control. In 2006, the city's

Public Works department reported to Council that public delivery had saved the city at least \$1.2 million; each year of public operation since then has brought Hamilton-Wentworth further savings and better quality services.

### **Niagara Falls- rejecting costly P3 proposal**

In December of 2006, the city of Niagara Falls rejected a proposal from a private operator in favour of a smaller twin-pad arena for about \$18 million. The P3 proposal for a much larger arena would have cost \$46 million, which the operator wanted to split with the city in addition to having the city guarantee \$1.8 million in yearly revenue.

St. Catharines also voted down a similar pitch from the same operator.

### **Windsor- P3 arena voted down**

In October 2006 after consulting with city staff, Windsor city council voted to reject an unsolicited proposal for a P3 arena and recreation centre in favour of a publicly owned and operated facility. The P3 deal would have forced the city to waive \$1.8 million a year in property taxes.

### **London- subsidizing private profits**

In 2002, private companies partnered with the City of London to build and operate the John Labatt Centre, a 9,100-seat sports and entertainment venue. In 2005, the centre generated \$12.3 million in gross revenue, with the private operators pocketing more than \$1 million. In contrast, the city of London got \$150,000 as its share of profits, but had to pay \$4.2 million to bankers for the cost of borrowing millions to build the centre. Local taxes rose 6.6 per cent in 2006.

### **The Picton Waste Water Treatment Plant**

This example is very recent. On March 25 of this year, Prince Edward County Council had to reject P3 bids from two private companies – Epcor and Corix – because of “high capital costs” and “proposed operating costs far exceeding the known operating costs for the Prince Edward County operation.” The minutes from that Council meeting reveal that direct public operation of the plant would be half the cost of the private projections. So Council rejected these P3 bids and now has to pay the private companies \$75,000 each for preparing the bids! CUPE had recommended that Picton should not consider a P3 project as soon as the idea was broached; after expensive tendering, their own engineering consultant told them going the P3 route would just delay the project for another year. But lobbyists hired by private firms kept pushing – and Prince Edward County Council spent time and resources investigating the possibility only to find that private companies couldn’t build the Picton Waste Water Treatment Plant for less than it would cost to finance a public operation, and that once built, P3 operation would cost twice as much.