P3

Overview of Public-Private Partnerships

Yukon
Economic Development

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FOR MORE P3 INFORMATION
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INTRODUCTION

Within the last 15 years, public-private partnerships have emerged as a viable method for governments to acquire and maintain assets. The public sector has faced increasing demands for new infrastructure, while operating in an environment of shrinking budgets.

Traditional procurement[1] — government purchasing and operating capital assets and infrastructure with taxpayers' money — is not always the only, or most efficient, option available. Consequently, governments are developing innovative practices to facilitate the design, construction, operation, maintenance, and financing of new capital assets.

Public-private partnerships are utilized in larger jurisdictions throughout Canada and the rest of the world. Public-Private Partnership (P3) initiatives have proven to be successful at creating greater value for taxpayers' money and allowing governments to do 'more with less'.

The Yukon government is currently exploring new methods of procuring public infrastructure and capital assets.

The purpose of this document is to provide an overview of public-private partnerships and discuss possible benefits and drawbacks of P3 procurement.

[1] Procurement — to acquire, obtain or get possession of a capital asset or infrastructure.

P3s DEFINED

Government can partner with outside organizations in variety of ways. The diagram on the following page outlines four types of partnership arrangements. For the purpose of this paper only the first type of partnership, *substantive partnerships*, has the characteristics required to meet the definition of a P3.

The Canadian Council for Public-Private Partnerships defines P3s as:

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.

Risk sharing and the innovation, competition and efficiency brought by the private partners are the key features that work toward making P3s viable and beneficial.

GOVERNMENT PARTNERSHIPS

TYPES OF PARTNERSHIPS	CHARACTERISTICS	ATTRIBUTES
SUBSTANTIVE PARTNERSHIPS	1. Bring together public and private sector partners. 2. Partners work together toward shared goals or objectives. 3. Each partner contributes time, money, expertise, and/or other resources. 4. Decision-making and management responsibilities are shared among partners. 5. Partnerships **share risks and rewards**. 6. Taxpayers receive **greater value for money**.	**Types of risk** • Design and construction risks • Commissioning and operating risks respecting availability, operating costs, performance, and maintenance costs. • Risks resulting from obsolescence or changes in technology • Regulatory risks, including changes in taxation • Financing risks • Risks related to governance and sustainable political support **Value for money** • P3s can deliver the same level of service for a lower cost or an enhanced level of service for the same cost, or service delivered sooner.
COMMUNITY DEVELOPMENT PARTNERSHIPS	1. Bring together public and private sector partners. 2. Partners work together toward shared goals or objectives. 3. Each partner contributes time, money, expertise, and/or other resources. 4. Decision-making and management responsibilities are shared among partners.	
CONTRIBUTORY PARTNERSHIPS	1. Bring together public and private sector partners. 2. Partners work together toward shared goals or objective. 3. Each partner contributes time, money, expertise, and/or other resources.	
CONSULTATIVE ARRANGEMENTS	1. Bring together public and private sector partners. 2. Partners work together toward shared goals or objectives.	

CHARACTERISTICS OF A P3

A P3 project typically involves the construction of new assets. P3 agreements are often long-term and define an on-going business relationship between the partners.

Unlike privatization, government involvement is maintained to oversee the public's interest for quality, safety and certainty. Performance is measured and can be legally enforced through provisions of the P3 contract.

P3s include the following characteristics:

- Public and private partners are brought together within a clearly defined contractual agreement;
- Partners work together to develop incentives so the private partner shares similar goals and objectives;
- Partners contribute expertise, financing, and other resources for utmost efficiencies;
- Private partners assume limited decision-making and management responsibilities while the government sets project objectives;
- Public and private partners will share risks and rewards. Each partner assumes risks that they are best able to manage; and,
- Taxpayers receive greater value for money than with traditional procurement because of the introduction of competition, life-cycle costing, risk transfer and innovation.

P3s ARE DIFFERENT

Public-private partnerships are significantly different than traditional procurement or privatization. The public and private sectors have differing objectives, accountabilities and operating practices.

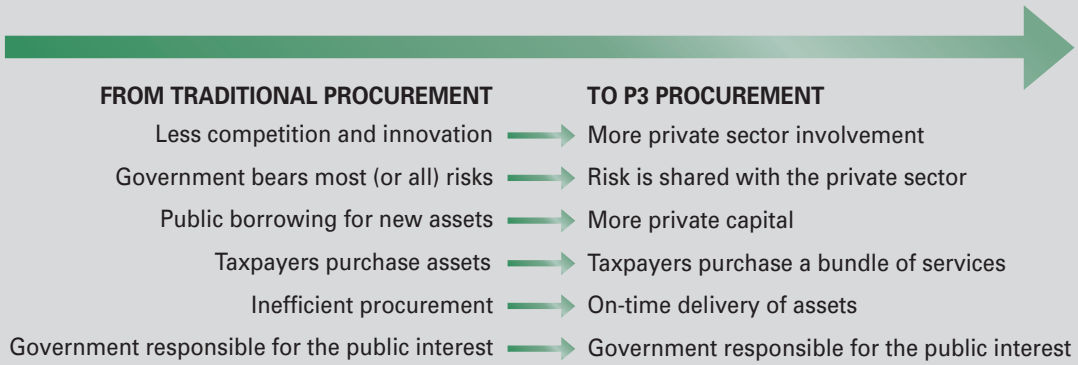
In a P3, the government role changes from directing and managing assets to overseeing and maintaining quality service outcomes.

Furthermore, prior to implementing a P3 option, a detailed business case is prepared to analyze the project's life-cycle costs.

Life-cycle costs include the capital costs of building and constructing an asset, ongoing operations and maintenance, major upgrades and rehabilitation over time, and decommissioning or disposing the asset at the end of its useful life.

Undertaking a life-cycle cost analysis presents a more accurate picture of project costs than what occurs with traditional procurement. This can result in significant cost-savings to government and taxpayers over time.

There are several aspects that shift between traditional procurement and P3 procurement, as illustrated by the following chart.



P3s ADD VALUE

P3 procurement can add value to a project by allocating appropriate risk between partners, coupled with private sector innovation, competition and efficiency. These elements combine to create greater value for taxpayer and government money.

APPROPRIATE ALLOCATION OF RISK

The P3 assessment process identifies the risks associated with each project. Assigning risk appropriately between partners is intended to minimize costs, improve performance and provide greater financial certainty to the public sector. The appropriate assignment of risk varies from one project to another. A typical P3 situation is shown in the chart to the right.

Public

- Legislative changes
- Changes to project scope
- Land acquisition
- Governance
- Sustainable political support

Shared

- Inflation
- Taxation
- Permitting
- Catastrophic events

Private

- Design
- Construction costs
- Operation and maintenance costs
- Operating performance
- Technological obsolescence
- Financing
- Commissioning

INNOVATION, COMPETITION, EFFICIENCY

Governments are often criticized for entering into P3s due to a perception that costs will be higher because of the private sector's profit requirements and financing costs.

However, involving the private sector in the design, construction, operations and financing of projects[2] can bring a range of benefits.

The private sector prefers to operate in a fair and competitive business environment. P3 procurement involves offering the private sector an enhanced role in the project. New and innovative solutions considering life-cycle costs, rather than just design and construction costs, can generate greater value for public money.

In P3 procurement, the private sector has more latitude to innovate rather than being bound to a tight set of specifications as in traditional procurement.

Competition in the post-construction stages of a project can also result in lower costs to government.

The private sector is focused on providing the public partner the best product at the best price possible. The private partner is also interested in securing an adequate return on investment. To do this, private businesses must operate efficiently to avoid duplication, waste, cost overruns and project delays.

These efficiencies are benefits that can be passed onto the public partner through lower costs and more 'on-time', 'on-budget' project delivery.

[2] For a description of P3 business models, refer to page 9.

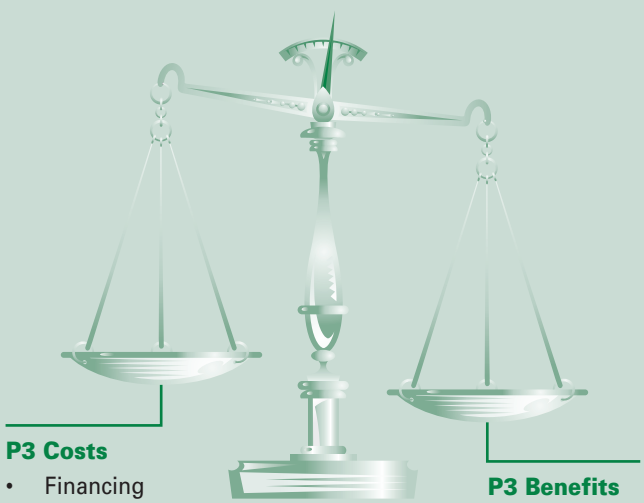
VALUE FOR MONEY

The principle goal of P3 procurement is to generate value for money. Value for money is often achieved by strategically allocating appropriate risk between partners. Value for money is also attained by enhancing private sector innovation, competition and efficiencies in procurement practices and from thorough up-front analysis of the project, including consideration of life-cycle costs.

Value for money is assessed in part by comparing applicants' bids against a public-sector comparator (PSC). The PSC is an estimate of the life-cycle costs that government would incur over the life of the asset through traditional procurement. The PSC incorporates an estimate of the project's life-cycle costs compared to the payment costs over the life of a P3. A value for money analysis looks at other factors as well, such as knowledge transfer, service quality and risk reduction.

Value for money is achieved if P3 costs are less than PSC costs over the life of the project or if service quality is enhanced.

The diagram below illustrates the costs and benefits of P3 procurement versus traditional procurement.



P3 Costs

- Financing
- Profit
- Bid/transactional costs

P3 Benefits

- Risk transfer
- Competition
- Innovation
- Asset maintenance and rehabilitation pre-defined prior to construction

P3 CONSIDERATIONS FOR THE PUBLIC PARTNER

Public-private partnerships, as a government procurement tool, may be able to deliver benefits to taxpayers. Establishing a P3 is a relatively complex process and government needs to consider a number of factors.

- Government maintains its role as a public service provider through the terms of a P3 contract. P3s represent an opportunity to achieve a public sector purpose through a private sector vehicle.
- The costs associated with establishing a P3 agreement ('transactional costs') are higher than traditional procurement costs. P3s require more preparation, planning, oversight and co-ordination than traditional forms of procurement.
- Government can achieve its public interest objectives by preparing a contractual agreement that includes the appropriate incentives and security provisions.
- Given the long-term nature of P3 agreements, the public sector partner needs to make a very long-term commitment to working with a private partner.
- P3s require higher levels of ongoing communication compared to traditional procurement methods.
- Expectations need to be aligned with actual P3 benefits. P3s are **not** remedies for cash-strapped governments and are **not** always the best procurement option.

P3 CONSIDERATIONS FOR THE PRIVATE PARTNER

Public-private partnerships are a relatively new challenge for the private sector and the government. There are number of considerations for businesses entering into this type of business arrangement.

- Private sector needs the opportunity to provide innovative and cost-effective solutions.
- When bidding for a P3 project, the private sector is required to show value for money in comparison to traditional procurement costs.
- An advantage of P3s comes through building new alliances with experienced companies and developing new markets.
- Government is accountable to the general public – operating within principles of fairness and transparency throughout the life of a P3 agreement. Private sector accountabilities lie with shareholders. The private partner must recognize the public sector's requirement to disclose information. There needs to be a balance between the need to be transparent and the desire to protect proprietary information.
- The private sector will also incur higher up-front transaction costs. Firms with P3 experience often develop strategies to minimize these up-front costs.

MAIN ADVANTAGES

- Reduce the public sector's exposure to commercial risk, by sharing risks and rewards.
- Utilize private sector's efficiency, knowledge and innovation.
- Grow business capacity and enhance competitiveness amongst Yukon businesses.
- Create opportunities to achieve 'greater value for money' – providing either the same service for a lower cost, more service for a comparable cost, or service delivered sooner.
- Provide a source of long-term capital for the public sector and put private sector money, rather than public money, at risk.
- Ensure optimal maintenance of assets over time which can save long-term costs, reducing maintenance and rehabilitation expenses.

NEXT STEPS

The Yukon government is considering using P3s as a procurement option. A body of knowledge and experience is being built through involvement with P3 practitioners and through pilot projects in the territory. This will lead to a cumulative sense of best P3 practices that will be used to build a Yukon-relevant framework to guide the government's assessment of when and how to use P3s. This framework will provide guiding principles and outline procedures to ensure fair, transparent and consistent processes. Government will continue to build on its body of best procurement practices to achieve Yukon benefits.

P3 BUSINESS MODELS

There are a variety of P3 models and are used extensively. Typically, P3 partners share risks and rewards of infrastructure development. The Canadian Council for Public-Private Partnerships has developed a combination of the following functions: Design, Build, Finance, Operate, Maintain, Own, Transfer, Lease, Develop, and Buy.

Design-Build-Finance-Operate: A design-build contract (the construction of an infrastructure) is followed-up by an operation and maintenance contract. The assets can remain publicly-owned throughout the life cycle or the private sector can retain some or all of the assets. Financing is provided through a private entity, usually a financial services company, who funds the project directly or uses various mechanisms such as a long-term lease or bond-issue.

Design-Build: The private sector designs and builds an infrastructure to meet public sector performance specifications, often for a fixed price so risk of cost overruns is transferred to the private sector.

Build-Lease-Operate-Transfer: The private sector designs, finances and constructs a new asset or facility on public land under a long-term lease and operates the facility during the term of the lease. The private owner transfers the new facility to the public sector at the end of the lease term.

Build-Own-Operate: The private sector finances, builds, owns and operates a facility or service into the future. The public constraints are stated in the original agreement and modified through ongoing regulatory authority.

Build-Own-Operate-Transfer: A private entity receives a franchise to finance, design, build and operate a facility (and to charge user fees) for a specified period, after which ownership is transferred back to the public sector.

Buy-Build-Operate: Transfer of a public asset to a private or quasi-public entity, including a contract that the assets are to be upgraded and operated for a specified period of time. Public control is exercised through the contract at the time of transfer.

Lease-Develop-Operate: A private or non-profit operator, under long-term lease, expands and operates an existing public facility. The expanded facility remains publicly owned and is transferred back to the public sector at the end of the lease term.

Finance Only: A private entity, usually a financial services company, funds a project directly or uses various mechanisms such as a long-term lease or bond issue.

Operation & Maintenance Contract: A private operator, under contract, operates a publicly owned asset for a specified term. The private assets are the service and management expertise of the company.

Service Contract: Similar to an operation and maintenance contract, except that all tangible and intangible assets remain privately-owned. Only the service is purchased by the public sector.

Operation License: A private operator receives a license or rights to operate a public service, usually for a specified term. Information technology projects often use this model.