

# A Better Way Understanding





# to Build

# Public-Private Partnerships



Photo: Courtesy of Docklands Light Railway Limited

## Part 1: Canada - U.K

*This is the first in a series of articles examining public-private partnerships (PPPs), how they are carried out in other countries and how Canadian companies can participate in them. The scale of the opportunity is vast; in the United Kingdom alone, PPPs have accounted for USD110 billion worth of contracts since 1990. They can be of great interest to Canadian firms with expertise in legal and financial services, architectural services, engineering design and consulting services, and construction and management services.*

**BY DENNIS AND SANDI JONES**

**M**odern governments have many responsibilities. One of the most important is to provide citizens with a wide variety of public services, such as education, healthcare and transportation, together with the infrastructure and facilities needed to deliver them.

In most developed countries, the public sector has tended to assume the responsibility for creating and operating this type of infrastructure. To procure it, the government specifies the detailed inputs required to build a facility, such as the materials to be used and the equipment to be installed, and a private contractor constructs it according to the specifications. When the contractor delivers the completed facility, the government pays for it in full and operates it from that time onward. Except for a brief warranty period, the private sector's responsibility for the facility ends as soon as the contractor is paid.

Since the early 1990s, however, a different procurement model for public infrastructure has been appearing in many countries. This is the public-private partnership (PPP), in which the public and private sectors collaborate to provide facilities and services under long-term agreements, typically for 25 to 30 years.

### The United Kingdom: A PPP sophisticate

In the United Kingdom, the most common form of PPP is the private finance initiative, or PFI. In a PFI project, a private-sector provider – usually a consortium of partners – contracts with a government agency to design, finance and build the desired facility. But the partnership does not end when the facility is finished; it continues for the lifetime of the PFI agreement, with the private partners operating the facility according to the standards and payments established by the public sector.

“We’ve been doing PFIs in the U.K. for many years,” says Stephen Chandler, Chairman and CEO of the Global Infrastructure Group (GIG), which specializes in international project financing and PPPs. “Our projects include hospitals, schools, highways and general public sector construction, and include not only the structures themselves but also the services that go along with them. We also provide pure services for existing facilities, such as the transit card project we did for the London underground.”

### Inputs and outputs

One of the most important differences between traditional procurement and the U.K.’s PFI model, says Chandler, is that the former specifies *inputs* (“use this kind of concrete for the foundations”), while the latter specifies *outputs* (“provide hospital facilities for a town of 50,000”). In a PFI, the government identifies the outputs it wants, in terms of services to the public, and the private sector decides on the inputs that can best deliver them. This frees the private partners to make the most effective use of their professional and technical expertise.

“In fact,” adds Stephen Harris, GIG’s President and COO, “I would say that our PFIs aren’t really about building things at all, but about delivering



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▲ One plus for P3s is that an entire project, from design to operation, can be covered under a single long-term contract that integrates the work of the private partners and the needs of the public partner.

services. In a PFI for schools, for example, we focus on educating children, not on putting up buildings. That is a fundamental difference between PFIs and traditional procurement.”

### Thinking harder

The PFI approach also forces both the public and private sectors to think more carefully about the costs and performance of a facility over its life cycle. “For a PFI,” says Harris, “you need a great deal of detail about how a building will provide the required services and how it will be operated and maintained for 25 or more years. That level of planning is far more work than putting out a procurement notice to have a building constructed as cheaply as possible. As a result, a facility procured under a PFI may be more expensive to build, but its total cost may actually be lower over the contract term because the contract accounts for the facility’s whole-life costing, not just for the cost of its initial construction.”

Another plus for PPPs is that an entire project, from design to operation, can be covered under a single long-term contract that integrates the work of the private partners and the needs of the public partner. Traditional procurement, in contrast, requires a string of separate contracts with multiple contractors, a fragmented approach that can increase the risk of delays and cost overruns.

### The Canadian PPP experience

In Canada, PPPs – or P3s, as they are called here – are long-term contracts wherein the public sector procures the design, construction, operation and/or maintenance of an asset, usually from a consortium of private firms, with the acquisition being privately financed over the economic life of the asset.

There have been two waves of P3s in Canada, the first of which ran from 1993 to about 2004. The current, second wave includes 55 projects, of which 19 have been substantially completed. All but two of the latter were delivered either early or on time, with the remainder less than two months late. Better yet,



Photo: © Tim Hall / Cultura / Alamy

▲ Canada’s approach to P3s follows the U.K. model closely, and Canadian infrastructure companies that have worked in domestic P3s will find the British PFI landscape familiar.



according to a January 2010 report from the Conference Board of Canada,<sup>1</sup> none of these projects saw any private-sector cost overruns that had to be made up by the public sector.

### Familiar landscapes

Britain's long experience with PFIs and the assistance of British PFI specialists contributed substantially to the early development of Canadian P3s. As a result, Canada's approach to P3s follows the U.K. model quite closely, and Canadian infrastructure companies that have worked in domestic P3s will find much that is familiar in the British PFI landscape.

Similarly, the benefits and drawbacks of PPPs apply in both countries. On the negative side, some costs can be higher than with conventional procurement. Private partners who assume risk expect to be compensated for it, for example, and private financing is more expensive than public financing. In addition, P3 agreements are more expensive to develop than conventional contracts because of their complexity and their long durations involve highly sophisticated and detailed planning.

On the positive side, the benefits of a well-structured P3 can be cost savings over the asset's life cycle, on-time delivery, innovation and potential quality improvements, as well as the allocation of particular types of risks to the partner best equipped to handle them. For the

<sup>1</sup> Mario Iacobacci, *Dispelling the Myths: A Pan-Canadian Assessment of Public-Private Partnerships for Infrastructure Investments*. Conference Board of Canada, January 2010.



Photo: © Larry Fisher/Masterfile

▲ Between 1998 and 2008 more than 75 P3 contracts, worth \$28.4 billion, were signed at the provincial and municipal levels in Canada; such as the Confederation Bridge linking P.E.I. to the mainland.

public partner, suitable risk allocation can be a major benefit over the course of a 25 year-contract. "With conventional procurement," says Harris, "the contractor is responsible for construction faults for only five or six years. But in a PFI-procured building, if the roof leaks after 20 years, the contractor has to pay to fix it, not the government."

### Structuring and financing PFIs in Britain

"There is no single way of structuring and financing PFIs in this country," says Chandler. "They can range from a one-to-one relationship between a government agency and a private

company, to a relationship between an agency and a consortium of companies, to a special-purpose vehicle that delivers services. This provides a great deal of flexibility, but the key is always to concentrate on the results you want to deliver – when things go wrong, it is usually because both government and the private sector have lost sight of what they're trying to accomplish. As for the financing side, the capital can come from several sources. PFIs typically use private financing, but there can be public financing too, or even a mix of government money, private debt, equity investments, bank loans, sovereign wealth funds and so on."

## PFIs in the United Kingdom

Since 1990, 900 PFI contracts worth USD110 billion have been signed in the United Kingdom, and 700 projects are now operational. Health and education together account for 504 of the contracted projects. The following are three representative PFIs:



- ▶ The Birmingham New Hospitals Project will modernize acute hospitals and mental health services, and includes a new 1,231-bed hospital and a new Clinical Sciences Centre.
- ▶ The South Lanarkshire education project involves the design, new build and renovation of 18 schools.
- ▶ The Lancashire waste project involves 15 local authorities and is intended to reduce the amount of waste going to landfill by 75 per cent.

Currently, two of the major PFI opportunity sectors are schools and solid waste management, and there is considerable activity in other areas as well.



### Getting the contract right

Structuring a PFI contract to safeguard the interests of all parties, including the public interest, is one of most important factors in the success of a project. “If you don’t get the contract right,” says Harris, “you are going to have major problems in the future because you’re tied to such long commitments. Contracts should be written by lawyers experienced in international PPPs, with the advisory costs wound into the contract. It’s a mistake to try do it cheaply, for example by using in-house counsel instead of PPP experts.”

In 2000, to help the public sector develop better PFIs, the British government set up Partnerships UK (PUK) as a permanent source of expertise that would assist with complex PFIs and help support individual infrastructure projects.

“PFIs bring together contractors, facility managers, equity investors and banks,” says Edward Farquharson, PUK’s Project Director, “and they are generally structured on a limited-recourse basis. At PUK, though, we don’t dictate how a project should be structured or financed. Once we have established very clear output specifications, we leave it to the private sector to find the best financing and structuring solutions.”

### Risk sharing and ownership

“One fundamental point about our PFIs,” says Chandler, “is that we structure them in ways that assign risks to the partners best able to manage them. This varies from contract to contract. In a railway service agreement, for example, you may find 50 pages of detail defining who assumes what risks, and which risks are shared. Risk allocation is very complex and there is no single formula for it. But the public sector can never shift all the risks of a PFI to the private sector; some of it must inevitably remain with the government.”

In most U.K. PFIs, the risks of designing, building, operating and maintaining an asset stay with the private sector. Other risks may either reside with

the government or be shared; with social infrastructure, for example, demand risk is generally retained by the public sector, whereas in some transport projects, it might be allocated to the private party. Decisions about risk allocation are driven by factors such as value for money and the financial capacity of the various PFI partners.

### Who owns what?

The actual ownership of a British PFI facility may sometimes seem murky to outsiders, but in reality it is quite clearly defined – it belongs to the government. “Typically,” says Farquharson, “the asset, or the land on which it is built, or both, is owned by the public sector throughout the term of the PFI contract. During this time it is leased or licensed to the private operator, but at the end of the contract it reverts to public ownership.”

This isn’t the case everywhere, however. “In some countries,” Chandler points out, “it’s believed that PPP means transferring the entire ownership of a facility to the private sector. But in the U.K., we always keep ownership with the government, even if the contract is as long as 40 years. In a way, the private sector is simply taking care of the asset for

## P3s in Canada

Between 1998 and 2008, more than 75 P3 contracts – worth a total of \$28.4 billion – were signed at the provincial and municipal levels, and several federal and provincial organizations are now working with the private sector to carry out P3 projects. Among these organizations are:



#### › PPP Canada

A federal Crown corporation established to encourage the development of Canada’s P3 market [www.p3canada.ca](http://www.p3canada.ca)

#### › Infrastructure Canada

Provides information and criteria on the Canada Strategic Infrastructure Fund and the Infrastructure Canada Program [www.infrastructure.gc.ca](http://www.infrastructure.gc.ca)

#### › Infrastructure Ontario

A Crown corporation of the Ontario government dedicated to the renewal of Ontario’s infrastructure [www.infrastructureontario.ca](http://www.infrastructureontario.ca)

#### › Public-Private Partnerships Quebec

Advises the provincial government on P3s; becoming part of Infrastructure Quebec in 2010 [www.ppp.gouv.qc.ca](http://www.ppp.gouv.qc.ca)

#### › Partnerships British Columbia

Promotes and supports P3 opportunities in the province [www.partnershipsbc.ca](http://www.partnershipsbc.ca)

#### › Alberta Treasury Board

Invests in public infrastructure via P3s [www.treasuryboard.gov.ab.ca/AlternativeCapitalFinancing.cfm](http://www.treasuryboard.gov.ab.ca/AlternativeCapitalFinancing.cfm)

our public sector, in return for payment. But ultimately, the government always owns and controls the facility.”

The situation with Canadian second-wave P3s is similar: ownership either remains with the public sector or is transferred back to the public sector at the end of the contract term, and the public sector retains full control of the operation and outcomes of the project during the life of the contract.

➤ **Standard PFI contracts**  
In the U.K., **standardized contracts** are used across the entire PFI spectrum. Among other things, they provide an **overview of PFI risk allocation**, and anyone who is interested in PFI projects in the U.K. should review them. PDFs are available at [www.hm-treasury.gov.uk/ppp\\_standardised\\_contracts.htm](http://www.hm-treasury.gov.uk/ppp_standardised_contracts.htm).

### The view from the work site

EllisDon, one of Canada’s leading infrastructure construction companies, first became involved with domestic P3s in 2000. “At the time,” says Stephen Gash, the firm’s Vice-President of Public Infrastructure Development, “there was a discussion going on about P3 procurement for hospitals. Because we’re the largest builder of hospitals in Canada, we decided to position ourselves to take advantage of P3s, so we went to the U.K. to see what was happening there. We ended up partnering with the British firm Carillion on two prototype P3 projects in Canada, the William Osler Health Centre in Brampton and the Royal Ottawa Hospital. That entrenched us solidly in the Canadian P3 market, and since then it has become a major business for us.”

EllisDon’s P3 group works with a range of advisers, consultants and partners, many of whom are experts in the specialist disciplines of Britain’s PFI sector. Fortunately, the company had already laid the groundwork for a move into U.K. P3s because of its long experience with non-P3 construction abroad, including work on London’s Canary Wharf Project. Given this background, plus its solid performance in domestic P3s and its network of PFI experts both in Canada and the U.K., EllisDon is now considering some niche opportunities in Britain’s PFI market.

### Parallels and practicalities

Gash sees a considerable advantage for EllisDon in the fact that the Canadian and the British models are so much alike – in fact, the contract forms the company used in its first P3 projects were almost identical to the PFI forms used in the U.K., although they were customized for Canadian requirements. That said, there are a few divergences. The usual North American practice is to guarantee contract performance through sureties, whereas the U.K. requires direct contractual undertakings from each subcontractor and a level of contractor equity that demonstrates shareholder

commitment to the project. Another difference is that British PFIs may also include a full suite of services, including so-called “soft services.” A hospital, for example, could be supplied with patient food services, housekeeping and waste management, while a prison project could involve the provision of complete custodial services. Such services are typically not part of the Canadian P3 model.

Practically speaking, how should a Canadian infrastructure company go about finding PFI opportunities in Britain? “It’s a question of using your networks and contacts to identify suitable projects,” says Gash, “and then looking at what teams you might be able to join and to which you might add value. The flow of PFI projects has slowed in the U.K., however, partly because they have worked through much of their infrastructure backlog. As a result, several big European companies are shifting focus away from the U.K. and now see Canada as one of the world’s most promising P3 markets. That’s a development that can offer major procurement opportunities. Another possibility is to build a contact network in the U.K. so you can partner with British companies to go into a third-country P3 market.



Photo: Courtesy of EllisDon

▲ As the largest builder of hospitals in Canada, EllisDon decided to take advantage of P3s and went to the U.K. to see what was happening there.



## EDC and PFIs

EDC has been involved with P3s since 1997, and has worked with the various kinds of P3 models used in the U.K., Ecuador, Hungary, Mexico, the UAE, the Dominican Republic and the Bahamas. In the U.K., EDC was co-underwriter, co-arranger or arranger for three PFI projects that outsourced various Ministry of Defence training programs.

### PFI opportunities in the U.K.

There are several sources of information that companies can use to learn about PFI expertise in the United Kingdom. A good place to start is the UK Trade & Investment (UKTI) office of the British Consulate-General in Toronto. UKTI is involved in several initiatives aimed at exploring partnership opportunities for British PFI players and Canadian firms, and can provide PFI expertise through its networks in the United Kingdom. UKTI can also arrange introductions with U.K. contacts for Canadian companies that are seeking potential partners to pursue PPP projects in Canada or in joint partnerships in third markets.

The *Official Journal of the European Union* lists all the major tenders on offer in the EU, including PPPs. These listings provide instructions and information

about tendering, bid specifications, prequalification, eligibility and other essentials. Other online journals, such as *Project Finance Magazine* and *PPP Magazine*, and the web site of Partnerships UK, are additional useful sources. There are also various organizations, such as the International Project Finance Association, that offer assistance on a subscription basis.

### Partnering and preparation

As for becoming a partner in a PFI, it is essential to understand the prequalification, bidding and selection processes that apply to a particular project. But the hardest part for a Canadian company may be to identify a suitable set of partners with whom to work, and to make sure that its capabilities make it an attractive candidate for a consortium. In

addition, U.K. firms are very sophisticated about PFIs, and will be highly effective competitors for projects that Canadian firms might bid on.

Even before reaching that stage, though, a Canadian infrastructure firm should examine its operations and see where it can provide more value for less money, while keeping quality high. It also needs a strong financial position, both to attract partners and to manage the unexpected, and must be capable of working with letters of guarantee, rather than sureties, for bonding purposes. ■

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Photo: Courtesy of Partnerships British Columbia

## The road ahead

The shift toward P3s in public infrastructure procurement is an important development worldwide. Canada is becoming a strong P3 market and Canadian businesses should be positioning themselves to take advantage of future opportunities. Doing so is all the more important since foreign companies are already winning P3 contracts in this country, and Canada's infrastructure firms must learn to compete with them or risk being marginalized within Canada's own borders. This means that Canadian businesses in the P3 arena need to collaborate with other domestic companies, not only in the domestic P3 market, but also in markets abroad.

But there are good reasons to be optimistic about the future. "Canadian companies would have a big advantage in our PFI market," says GIG's Harris. "Your PPP expertise has matured in the last few years and you have a very good reputation in the field, so Canadian firms with P3 experience should certainly consider exporting their skills. People would be pleased to see you in the U.K., and I think you could do very well here indeed."

*In the next instalment of this series, we'll look at PPPs in Spain and the opportunities they can offer to Canadian businesses.*