



# *Alternatives North*

March 31, 2015

J. Michael Miltenberger  
Minister of Finance  
Government of the Northwest Territories  
PO Box 1320  
Yellowknife, NT  
X1A 2L9

Dear Minister Miltenberger:

## Introduction

Based on our review of evidence, Alternatives North is skeptical about the benefits of public private partnerships. However, we acknowledge the GNWT apparent commitment to using this method of financing. More specifically, the Government of the Northwest Territories has determined that the renewal of the Stanton Territorial Health Authority hospital will be done using an alternative financing and procurement system, a public private partnership. Our concerns on this method of financing are well reported in a recent audit in Ontario that we will present. We maintain our concern that the public is serviced by achieving top notch facilities as cost effectively as possible. Alternatives North encourages the Government of the Northwest Territories to rigorously apply the relevant best practices for P3 projects identified by the OAG when proceeding with the renovation of the territorial hospital.

This letter presents some best practices, potential problem areas to avoid and asks questions for clarification.

## Auditor General of Ontario review

The Auditor General of Ontario (AGO) recently reviewed 74 projects that the Ontario government's development arm, Infrastructure Ontario, had carried out using alternative financing and procurement (AFP) or public private partnerships (P3 projects) as they are commonly known. Forty seven of the projects were in health care. The AGO found that tangible costs (like those for construction, engineering and legal services) were actually considerably lower with publicly financed projects - by a total of \$8 billion, in fact.

## Flawed Analysis

Cost differences that led to choosing an AFP approach resulted from the assignment of high-valued risk that a project would not finish on time or on budget if it was delivered by the public sector. *Despite the*

*absence of empirical data*, the risk value if publicly delivered was calculated as \$18.6 billion but only \$4 billion if privately delivered. The audit concluded that a

“properly structured contract under public-sector procurement may also be able to manage risks considered to have been mitigated or transferred under AFPs. Cost overruns in public-sector procurements can in many cases be due to incomplete project design that leads to late changes to the project specifications, unknown site conditions or delays caused by weather and work stoppages.”

The AGO audit established some best practices for the use of alternative financing and procurement.

#### Risk Valuation and Value For Money

The first recommendation of the Auditor General report was that the Government of Ontario should

“gather data on actual cost experience from recent public-sector infrastructure procurements and alternative financing and procurements (AFPs) and revise its Value For Money assessment methodology to ensure that the valuation of risks assumed to be retained under both the AFP and public-sector delivery models are well justified.”

The Stanton renovation website noted “An in-depth business case analysis looked at a variety of models and provided evidence that a P3 procurement model would provide significantly more value-for-money compared to a traditional procurement and delivery process.

#### **Questions related to this recommendation and statement:**

- **Did the GNWT do a review of its methodology for the valuation of risks for P3 projects in the NWT prior to its determination to go forward using a public private partnership?**
- **What percentage of costs difference between public and private delivery were related to tangible costs like construction, engineering and legal costs?**
- **What percentage of any difference was attributable to risk factor allocation for project not completing on time and on budget?**

The second AGO recommendation stated: “To ensure that value-for money assessments in producing large scale infrastructure projects are valid and objective, Infrastructure Ontario should confirm:

- That all risks assumed to be transferred to the AFP contractor are supported by relevant provisions of the project agreement;
- That the cost assigned to retained risks in the public sector comparator are not accounted for elsewhere;

The Stanton renovation website indicated that: “The Private Partner assumes the upfront costs and risks of the project while ownership of the facility remains with GNWT.”

The GNWT P3 Management Framework states the proposal should not be outside of:

“the price range determined by the Public Sector Comparator (PSC) approved by Financial Management Board and the Agreement, and the risk profile does not differ materially from that approved by Financial Management Board” and

“Changes in project scope that result in the deletion or addition of capital work that changes the Public Sector Comparator initial capital cost by +/- 15% need to be reassessed for value for money (Section 2.3) and resubmitted for approval.”

Some of the GNWT criteria for determining if a project should become a P3 include:

- On-time/on-budget delivery and protection against scope creep is important.
- The nature of the assets and services are capable of being costed on a whole of life, long term basis.
- Risk allocation can be clearly determined.
- Competitive private sector financing can be obtained, and the cost of private sector financing will be offset by delivery and/or user savings.

Two of the criteria against choosing a P3 approach are:

- High levels of systems integration make risk allocation difficult
- There are substantial regulatory or legal restrictions on the provision of the service.

In its asset class suitability section, the Framework places health facilities as 5 of 9 for having lower suitability and facility upgrades as the least suitable.

Questions related to this recommendation and statement:

- How will the project agreement ensure effective transfer of risks to the AFP contractor?
- Where will the costs assigned to retained risks be recorded?
- What level of systems integration requirement was determined for the Stanton renovations?
- What regulatory and legal restrictions will the contractor be required to meet?
- How will the Stanton renovations overcome the barriers identified in the asset class suitability section?

#### Value Added Innovation

Infrastructure Ontario had determined that when it compared the public and private sector costs, it would consider that the private sector would bring value-added innovations that the public sector would not. The A-G's third recommendation challenged any assumption that innovation would pay off for the public partner, stating that the Government:

“should ensure that all proposed changes to its Value For Money assessment methodology, including its plan to increase the base cost on the public-sector comparator side by up to 13.3% to reflect value-added innovations that the private sector may be bringing to projects, can be and are fully supported and can sustain scrutiny”.

**Question related to this recommendation:**

- What value-added innovations criteria will be utilised during the process to evaluate proposals for the territorial hospital?
- Are any claimed benefits fully supported and able to sustain scrutiny?

### Preliminary Cost Assessment Is Needed

The AGO reported that “Having a good estimate of project costs before going to tender, in order to better evaluate the reasonableness of future bids, is especially important when the market may be dominated by only a few large players.” The recommendation that flowed from this statement read:

“In order to have a good estimate of project costs before seeking Treasury Board approval, as well as to better evaluate the reasonableness of future bids, Infrastructure Ontario should identify the reasons for the significant differences between actual contract values and its estimates of project cost, especially for projects that have long-term financing, maintenance and life-cycle costs. Infrastructure Ontario should accordingly review and update its processes for arriving at these estimates.”

The Stanton renovation website states:

“The GNWT uses a four level construction cost estimating system that has been the standard in numerous jurisdictions for many years. This system is based on the fact that only very rough estimates can be forecast at the early stages of a project, and that the cost estimates need to be refined as planning proceeds to become as accurate as possible. The best information available is used at each stage in a project.”

The Framework states:

“As part of the feasibility analysis, a P3 financial model(s) should be developed to estimate the potential costs and to identify areas where expected benefits could occur. This shadow bid is developed by modelling the project as if it were delivered as P3 procurement. A comparison between the PSC and shadow bid can identify areas where expected value for money could occur, and would be the basis for determining whether to proceed with a P3 delivery model.”

**Questions related to this recommendation and statement:**

- **Does the GNWT have a detailed budget estimate or shadow bid to determine if the proponent’s proposals are reasonable and do reflect an actual lower cost?**
- **Will the GNWT release estimated budgets costs (shadow bid) once the proponent is chosen?**
- **Will the GNWT identify and make public long-term financing, maintenance and life-cycle costs of the project?**

### Money Isn’t Everything

The AGO audit looked at the scoring process and determined Infrastructure Ontario placed more weight on a low bid than on technical merit. It recommended that:

“Infrastructure Ontario should review and update its system of scoring bidders’ submissions to ensure that due consideration is afforded to both the technical merits of the submissions and to price.”

**Question: How will the scoring system for comparing proposals ensure a balance between the technical merits of given proposals against projected financial costs and savings they promise?**

### Transparency and Accountability

The Framework lists what documents should be made public and states:

“The GNWT is committed to open, transparent and accountable procurement. The aim is to disclose as much as possible in the public interest without impacting the government’s ability to generate value for money for taxpayers. While the goal of transparency in P3’s is important, openness must not harm the competitive process, the government’s negotiating position and must not discourage bidders.”

**Question: Will the GNWT release its business case and final agreement once the private partner has been selected?**

### Amount of Holdbacks

The audit reported that the average time to resolve minor deficiencies was 13 months and that the amount of payment withheld till completion could influence the resolution of minor deficiencies.

The AGO recommended that:

“Infrastructure Ontario should review the amount of the payments that it holds back at substantial completion of the projects it delivers to help ensure that minor deficiencies are corrected on a timely basis.

**Question: What percentage holdback will be retained to ensure minor deficiencies are resolved?**

### Cost of Borrowing

Finally the audit reported that overall costs of the AFP projects for financing, maintenance and operation for projects included liabilities, commitments, as well as the costs for borrowing money to make the payments to contractors when the various projects reached substantial completion. It was noted the borrowing costs were not clearly identified.

The GNWTP3 Framework states:

The interest portion of payments is a voted, budgetary debt servicing expense under the Operations and Maintenance Vote.

**Question:**

- **What is estimated cost of borrowing money to pay the contractors?**
- **Will this cost be included in overall cost accounting of project?**
- **Where will the cost of borrowing be recorded?**
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Thank you for taking the time to answer our questions about a significant proposal for our territory’s future.

Best wishes,



Craig Yeo  
For Alternatives North