



# Public Private Partnerships – The Essential Elements

2007 Municipal Officials Seminar

February 26, 2007

# Agenda

- Introduction to Public Private Partnerships
- Public Infrastructure Delivery Models and Mechanisms
- Procuring of P3s
- Deloitte's Infrastructure Advisory Model
- Municipal Considerations

# Introduction to Public Private Partnerships



# Broad Definition of Public Private Partnerships

***“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.”***

Source: Canadian Council of Public Private Partnerships

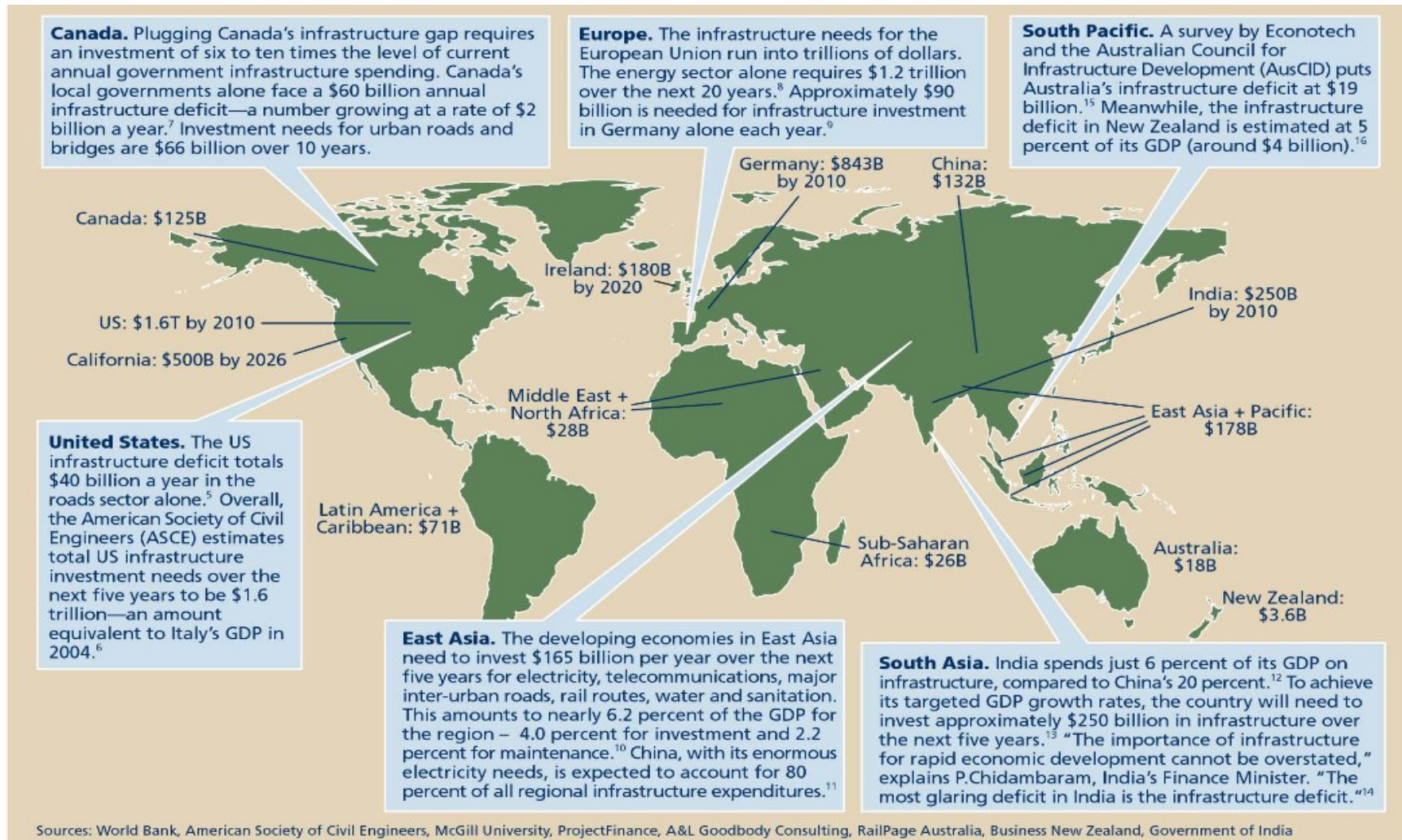
- There are some jurisdictions who choose to call their approach to alternative financing a form of partnership yet do not choose to use the PPP moniker
  - UK government refers to Private Finance Initiative as a form of PPP
  - The Government of Ontario chooses to use the phrase Alternative Financing and Procurement as a form of partnership with the private sector that defines and assigns risks, resources and rewards

# Canadian Federal Infrastructure Strategy

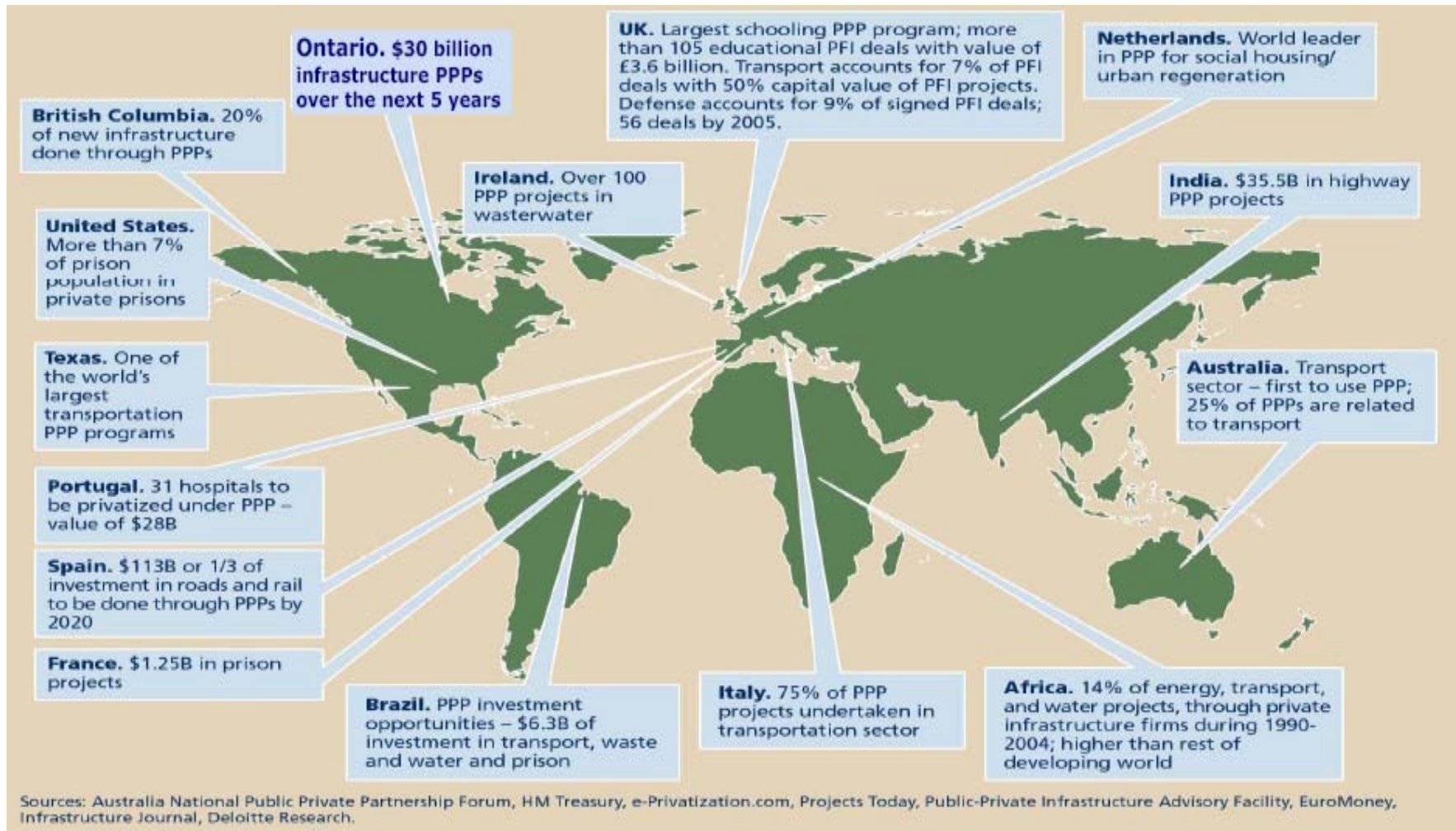
**“A Core challenge is to ensure that federal spending has maximum impact. This can be achieved by taking advantage of innovative financing sources through public-private partnerships (P3s). Greater use of P3 will also provide opportunities for Canadian pension funds and other investors to participate in infrastructure projects here in Canada rather than being forced to look abroad, as is often the case now. ”**

Source: Canada’s New Government – Advantage Canada, Building a strong Economy for Canadians, November. 2006

# The Global Infrastructure Gap



# Sector Highlights from Around the World



# Delivery Models and Mechanisms



# Putting PPPs in Context

While there is no universal definition for traditional delivery or public-private partnerships, the following provide characteristics that are found in these two types of delivery models:

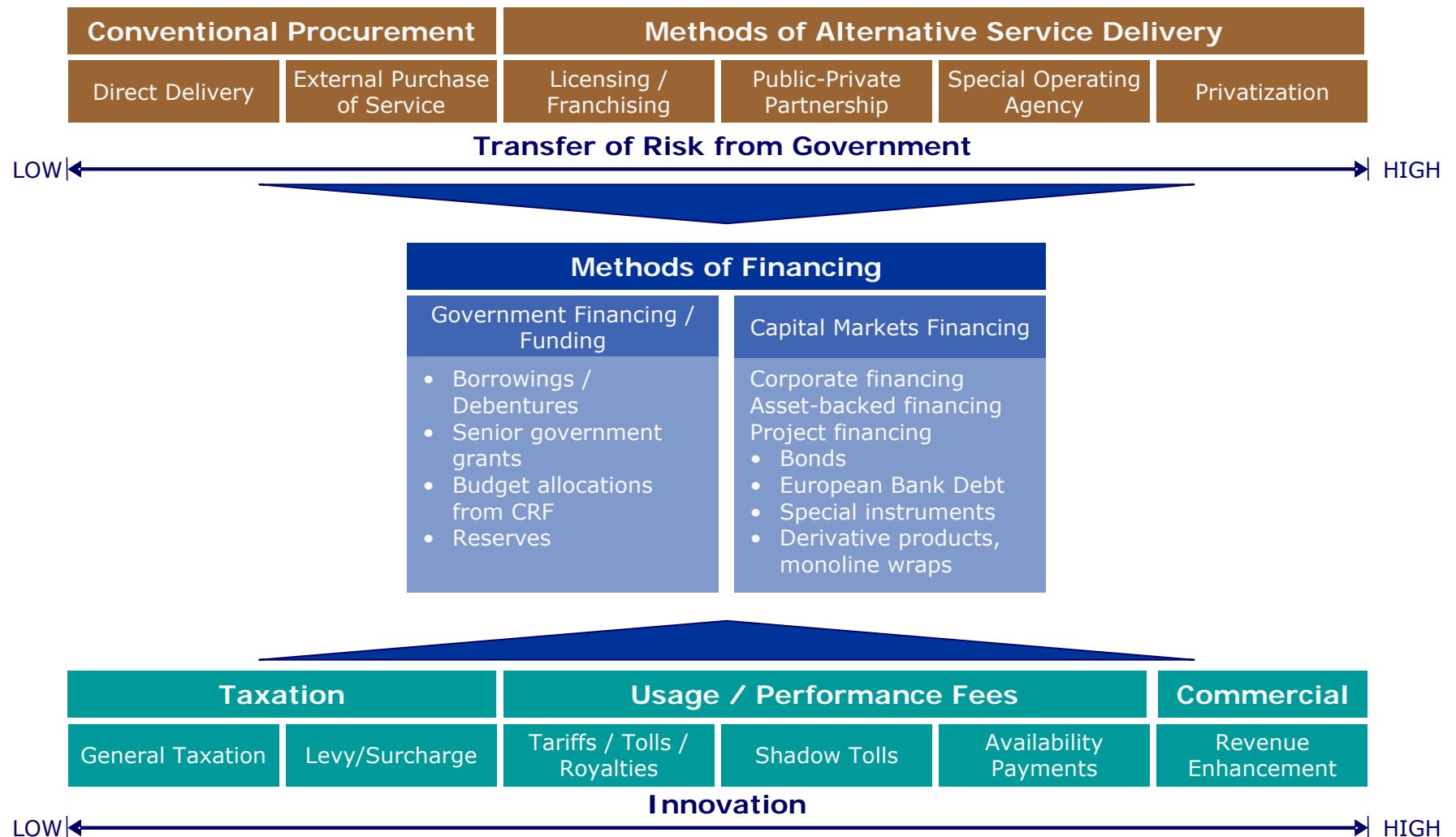
## TRADITIONAL

- The public sector procures **assets**, not services, from the private sector
- Assets are input-specified; the public sector specifies its requirements in **input terms** as part of the procurement
- Components of delivery are **separated** (design, bid, build, operate) resulting in a less efficient service provision
- Asset **paid for at completion**. Hold-backs and extended warranties cover only very short period of assets useful life
- **Risks typically remain with the public sector**. Private sector not incentivised to provide long-term quality asset

## PUBLIC-PRIVATE PARTNERSHIPS

- The public sector procures **services**, not assets, from the private sector
- The public sector requirements are defined in **output terms** as part of the procurement providing opportunity for innovation and risk transfer
- Components of delivery are often **bundled** (design, build, finance, operation and maintenance) resulting in integrated, efficient service delivery
- **Payments made over life of asset** and linked with operational performance. Revenue earned through a mix of direct revenues, availability payments and/or performance payments
- Significant levels of **risk transfer** to the private sector over life of contract. Risks are allocated to the party that is best able to manage them

# Delivery Models and Mechanisms



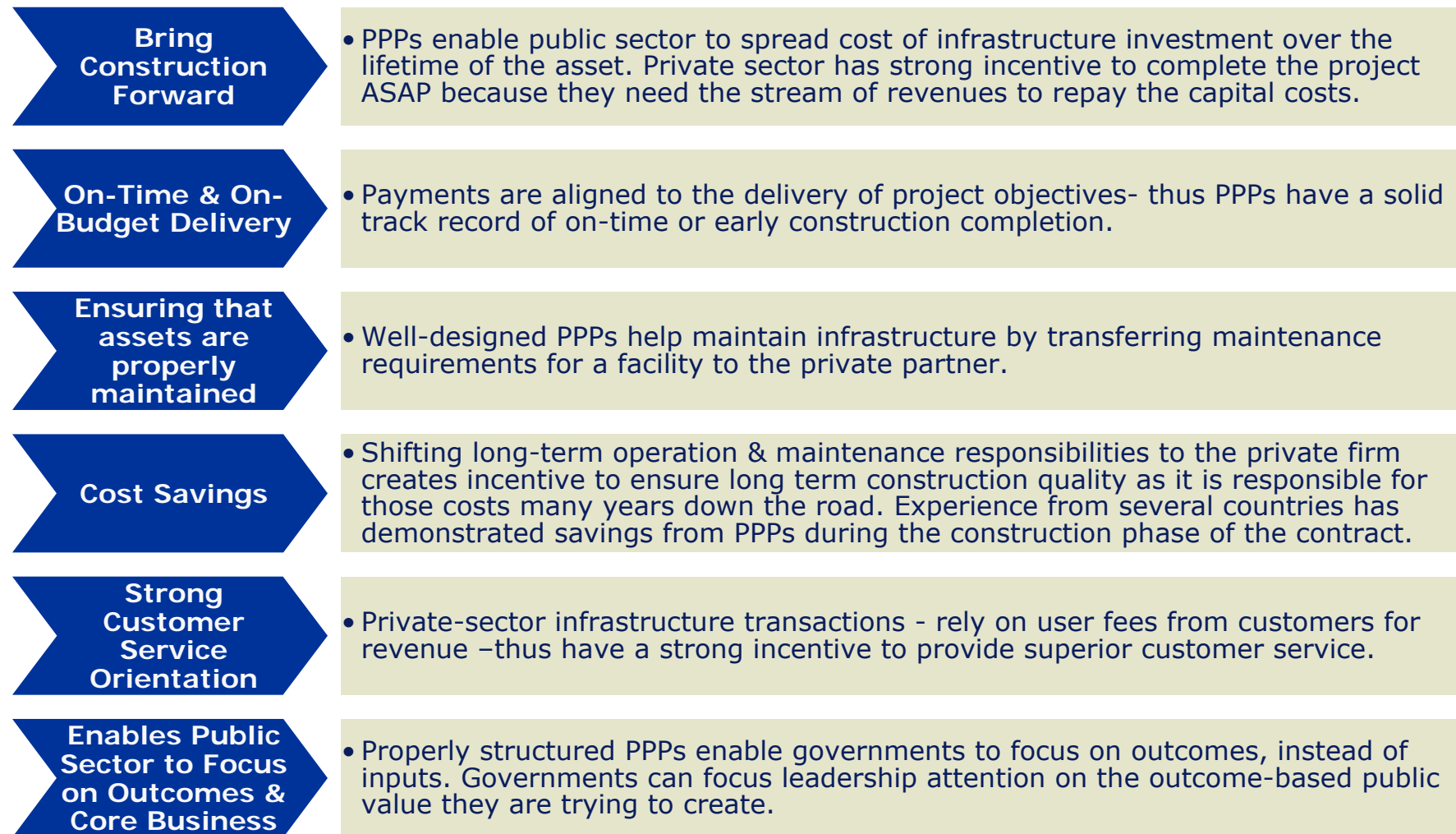
# Key Characteristics of PPPs

Element of Consideration	Characteristics
Risk Transfer	<ul style="list-style-type: none"> <li>• The cost of capital for the public sector is lower because project risks are not considered in government cost of borrowing. Government cost of borrowing is based on taxing power without consideration of the project risks</li> <li>• However, risks can be allocated to the party (public or private) best able to manage them</li> <li>• The ability to transfer risk is a key determinant as to whether a project should qualify for a PPP</li> </ul>
Strategic Advice	<ul style="list-style-type: none"> <li>• Strategic advice may be required for business case development, economic analysis, project program management, financing structures and other related items</li> </ul>
Deal Structuring	<ul style="list-style-type: none"> <li>• The selection of the appropriate type of partnership is a function of what type of risk should be transferred. This determines what the deal terms ought to be.</li> <li>• Also, if there is a potential revenue stream (e.g., tolls), then the deal terms need to be altered to take this into account. There may also be opportunities for gain sharing of ancillary revenues.</li> </ul>
Legislation	<ul style="list-style-type: none"> <li>• If new legislation is required, try to get it in place prior to any project. Otherwise, the legislative activities may present execution risk for the project</li> <li>• If there is legislative risk, bidders may price this into the project</li> </ul>
Communications	<ul style="list-style-type: none"> <li>• Effective communications should be planned early and be ready to be executed</li> <li>• The communications plan must present in clear rationale the benefit to the public. This must be done in conjunction with a risk / issues management to quickly diffuse potential "hot" issues</li> <li>• It may be advantageous to pre-announce the entire nature of the projects for some jurisdictions</li> </ul>
Auditing	<ul style="list-style-type: none"> <li>• Some jurisdictions have preferred to bring their Auditor in to early stage PPP discussions</li> <li>• This allows for a decision or indication in advance that the project team is proceeding correctly</li> <li>• This decision has its risks and is entirely dependent on the jurisdiction and its internal and external relationships with the legislative auditor</li> </ul>

## Key Characteristics for PPPs (continued)

Element of Consideration	Characteristics
Procurement Process	<ul style="list-style-type: none"> <li>• Some governments benefit from demonstrating a transparent and equitable procurement process for a preferred bidder, as this helps to relax detractors and demonstrate to the public that there has been a cost effective process</li> </ul>
Contractual Structuring	<ul style="list-style-type: none"> <li>• The draft contract should go out with the RFPs to the bidders, as this will prevent drawn out negotiations with bidders once the top candidate is chosen</li> </ul>
Bid Review	<ul style="list-style-type: none"> <li>• Financial modeling will be required to analyze various bids and deal terms</li> <li>• Advice on structured financings will also be required</li> </ul>
Procurement Management	<ul style="list-style-type: none"> <li>• This includes advisory assistance on the procurement process, which provides and assurance of transparency and equity among the bidders,</li> <li>• Provides process monitoring whereby a fairness monitor may be used</li> <li>• Also provides a procurement process manager helping to organize legal, financial and other technical advisors</li> </ul>
Relationship Management	<ul style="list-style-type: none"> <li>• There should be steps in the contract for the proponent to undertake should alternative dispute resolution processes not prove successful</li> <li>• A concession type of contract is a long-term relationship that the proponent enters into with a contractor / consortium so an effective relationship and the managing of that relationship is critical</li> <li>• Each relationship is different, an outsourcing arrangement is different from a P3 or other form of alternative financing</li> <li>• Moreover, the construction period and the financing period are the smallest time increments of a multi-year concession contract, so a great deal of attention should be paid to the operations (post construction) part of the agreement</li> </ul>

# Benefits of PPPs



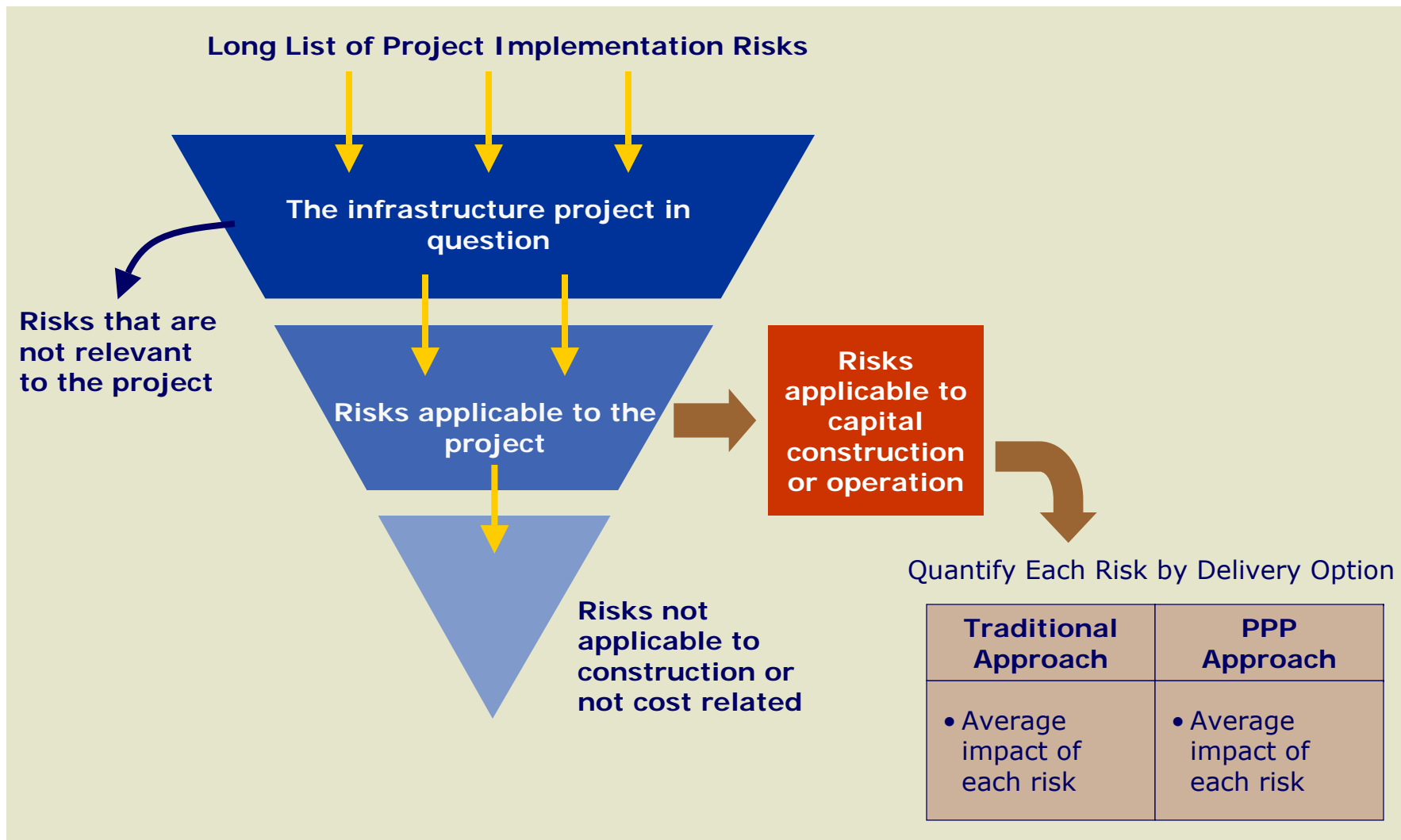
# Procuring of P3s



# Three types of efficiencies associated with PPP projects

Type	Definition	Examples
Resource Allocation Efficiencies	<ul style="list-style-type: none"> <li>• Efficiencies are gained from the private sector's ability to allocate resources more effectively</li> </ul>	<ul style="list-style-type: none"> <li>• The private sector's motivation is on the completion of the project to a set of performance standards. Conversely, the public sector will have competing interests for operating resources, which may reduce the performance of the project over its lifecycle</li> </ul>
Production Efficiencies	<ul style="list-style-type: none"> <li>• Resources for a specific application can also be used more effectively</li> <li>• The ability to be more productive is developed during the private sector organization's years of practice delivering similar projects</li> </ul>	<ul style="list-style-type: none"> <li>• The construction and operation of infrastructure may be completed in less time and / or lower overall cost by using market tested techniques and incentives for innovation</li> </ul>
Economic and Social Efficiencies	<ul style="list-style-type: none"> <li>• Access to capital allows more projects to be funded on a fixed capital budget</li> <li>• Social benefits of infrastructure accrue faster as infrastructure is built sooner</li> </ul>	<ul style="list-style-type: none"> <li>• More efficient movement of goods and people</li> <li>• Improved quality of life resulting from increased access to infrastructure</li> </ul>

# The risk framework is a method of comparing a traditionally delivered project to a PPP approach



## There are many types of risk that need to be allocated to realize efficiencies

	Definition
<b>Design / Technical Risk</b>	<ul style="list-style-type: none"> <li>• The risk of failures related to engineering or design.</li> </ul>
<b>Land Assembly Risk</b>	<ul style="list-style-type: none"> <li>• The risk that acquiring land will delay the overall project schedule.</li> </ul>
<b>Environmental Approval Risk</b>	<ul style="list-style-type: none"> <li>• The risk that securing environmental approvals will delay the overall project schedule.</li> </ul>
<b>Construction Risk</b>	<ul style="list-style-type: none"> <li>• The risk that cost escalation will occur due to faulty construction or delays.</li> </ul>
<b>Operating Risk</b>	<ul style="list-style-type: none"> <li>• The risk that the costs of keeping the assets in good condition (e.g., maintenance costs) vary from budget.</li> <li>• The risk that the operating costs of the budget vary from the budget.</li> </ul>
<b>Demand Risk</b>	<ul style="list-style-type: none"> <li>• Deficient revenue resulting from lower than projected demand or lower required price points.</li> </ul>
<b>Financial Risk</b>	<ul style="list-style-type: none"> <li>• Costs related to inadequate financial hedging and / or debt management.</li> <li>• The risk that inflation will be greater than budgeted.</li> <li>• The risk that the residual value of the asset at the end of the term will be lower than budgeted.</li> </ul>
<b>Environmental Risk</b>	<ul style="list-style-type: none"> <li>• Costs related to unforeseen environmental lawsuits or mitigation costs to avoid potential lawsuits.</li> </ul>
<b>Regulatory Risk</b>	<ul style="list-style-type: none"> <li>• Costs related to delays in project approvals, changed in policy or law, etc.</li> </ul>

## Ideally, risk would be borne by the party Best able to manage that risk

	Ideal Party to Retain Risk	Reasoning
Design / Technical Risk	<ul style="list-style-type: none"> <li>• Private sector</li> </ul>	<ul style="list-style-type: none"> <li>• This is a core skill of the private sector proponents.</li> </ul>
Land Assembly Risk	<ul style="list-style-type: none"> <li>• Public sector</li> </ul>	<ul style="list-style-type: none"> <li>• The private sector may be unable to secure some land</li> </ul>
Environmental Approval Risk	<ul style="list-style-type: none"> <li>• Public sector</li> </ul>	<ul style="list-style-type: none"> <li>• Environmental approvals are public sector approvals</li> </ul>
Construction Risk	<ul style="list-style-type: none"> <li>• Private sector</li> </ul>	<ul style="list-style-type: none"> <li>• This is a core skill of the private sector proponents.</li> </ul>
Operating Risk	<ul style="list-style-type: none"> <li>• Private sector</li> </ul>	<ul style="list-style-type: none"> <li>• This is a core skill of the private sector proponents.</li> </ul>
Demand Risk	<ul style="list-style-type: none"> <li>• Mostly public sector</li> </ul>	<ul style="list-style-type: none"> <li>• The private sector does not control the factors that control demand risk</li> </ul>
Financial Risk	<ul style="list-style-type: none"> <li>• Mostly private sector</li> </ul>	<ul style="list-style-type: none"> <li>• The private sector's financiers will fully account for the risks inherent in the project</li> </ul>
Environmental Risk	<ul style="list-style-type: none"> <li>• Private sector</li> </ul>	<ul style="list-style-type: none"> <li>• This is a core skill of the private sector proponents.</li> </ul>
Regulatory Risk	<ul style="list-style-type: none"> <li>• Public sector</li> </ul>	<ul style="list-style-type: none"> <li>• The private sector does not have any control over these elements</li> </ul>

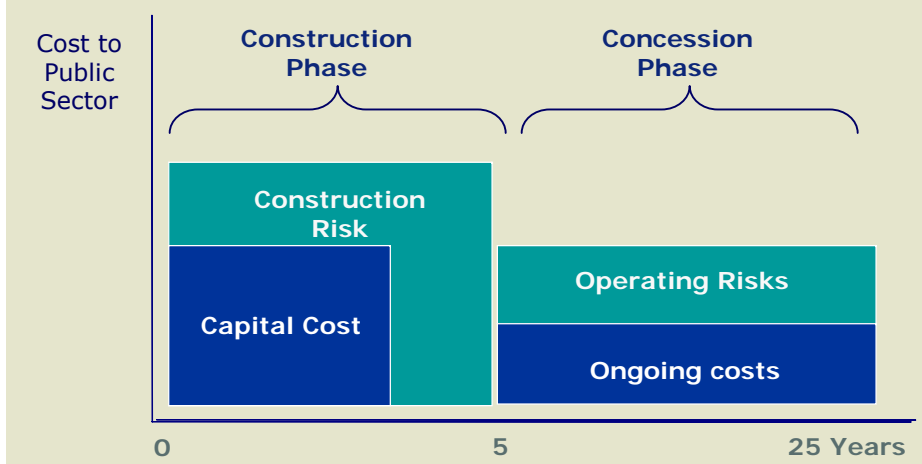
**It is important to remember that each project is different. Different parties will have different appetites for risk. This will affect who ultimately bears the risk in the project agreement.**

# Sample Project Controls

Item	Traditional Construction	PPP
Governance	<ul style="list-style-type: none"> <li>• Poor oversight and reporting procedures often leading to significant increases in scope without appropriate due-diligence checks and balances</li> </ul>	<ul style="list-style-type: none"> <li>• Controls through a SPV structure provide for added independence and oversight to control the scope of the project</li> </ul>
Construction Financing	<ul style="list-style-type: none"> <li>• Financing by public sponsor who provides ultimate "backstop"</li> <li>• Usually monthly or periodic draws</li> </ul>	<ul style="list-style-type: none"> <li>• Private partner provides equity and debt funding leading to additional approval requirements to increase borrowing limits and / or scope changes</li> <li>• No 'backstop' by public sponsor</li> </ul>
Design	<ul style="list-style-type: none"> <li>• Sponsor developed design</li> </ul>	<ul style="list-style-type: none"> <li>• Contractor is required to assume design risk</li> </ul>
Construction	<ul style="list-style-type: none"> <li>• Contractor is responsible for all construction related activities</li> </ul>	<ul style="list-style-type: none"> <li>• No change</li> </ul>
Operation / Maintenance	<ul style="list-style-type: none"> <li>• Sponsor assumes all operation risk, including maintenance, life cycle expenses and revenue / demand risk</li> </ul>	<ul style="list-style-type: none"> <li>• Private partner assumes all operational risks including maintenance and life cycle expenses and, and may accept some demand / revenue risk</li> </ul>

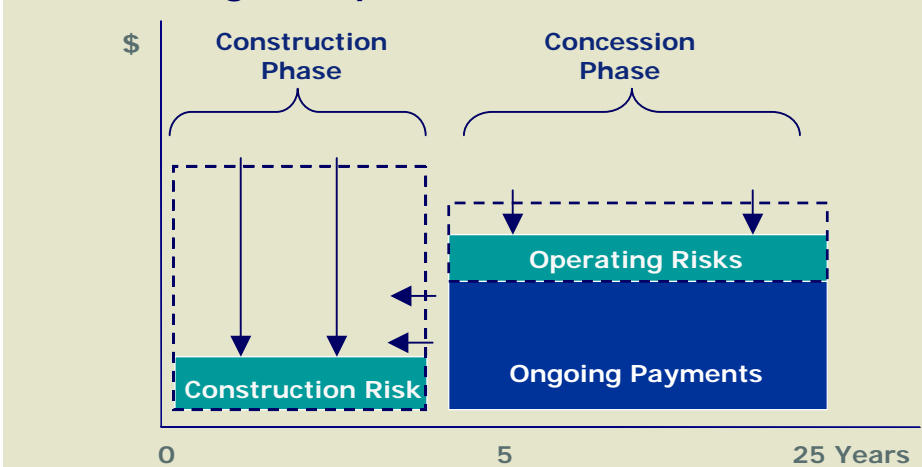
# Cost and Risk Profiles for the Public Sector under each scenario

## Traditional Funding Example



- Public sector pays for services / assets as they are provided.
- Full costs of construction are paid in advance of operational commencement.
- Due to limited risk transfer, most cost overruns also become liabilities for the public sector.

## PPP Funding Example



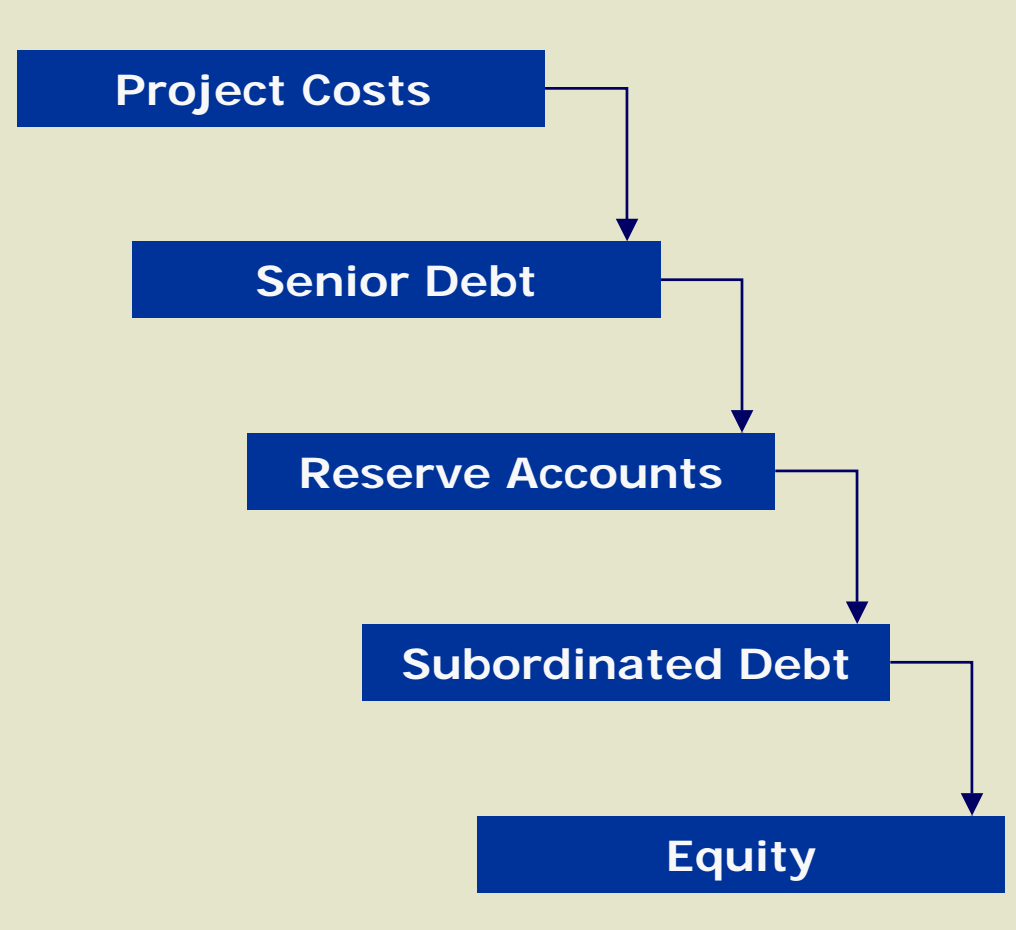
- The construction phase is shortened
- Construction risk is mostly assumed by the private sector partner
- Operating risk is mostly assumed by the private sector partner
- Ongoing payment reflect amortized capital costs and ongoing costs
- Savings in capital costs and ongoing costs versus higher cost of capital, profit imperative and taxes

# Project Finance = PPP

## Project Finance

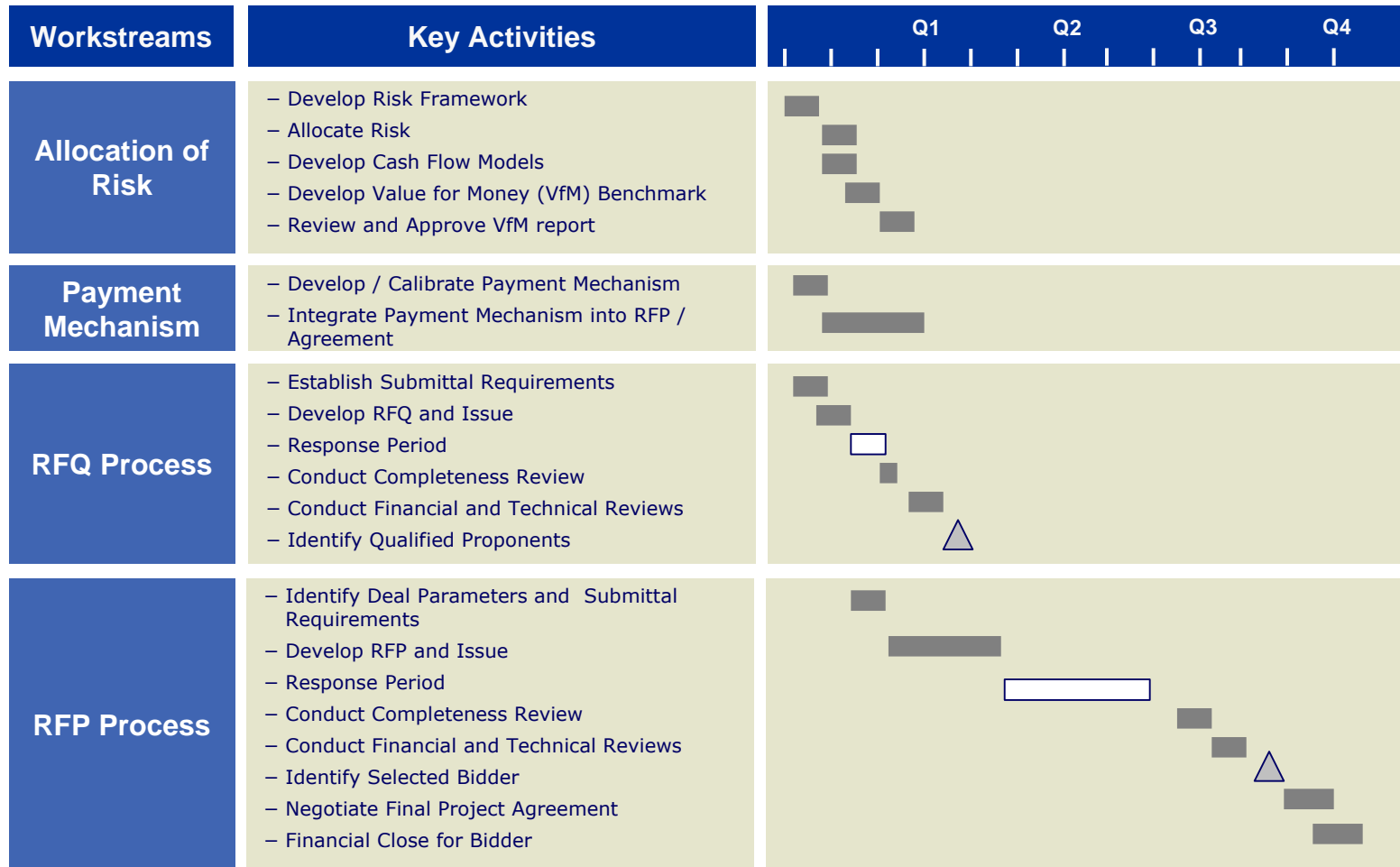
- Project financing is used typically in long term projects
- Procurement of an asset or “service”
- Finance is limited recourse
- Security of future cash flows of the project rather than any direct security over assets
- Cost a factor of project risk and contractual framework
- Long term – typically 20-30 years or longer

## Typical Cash flow Cascade

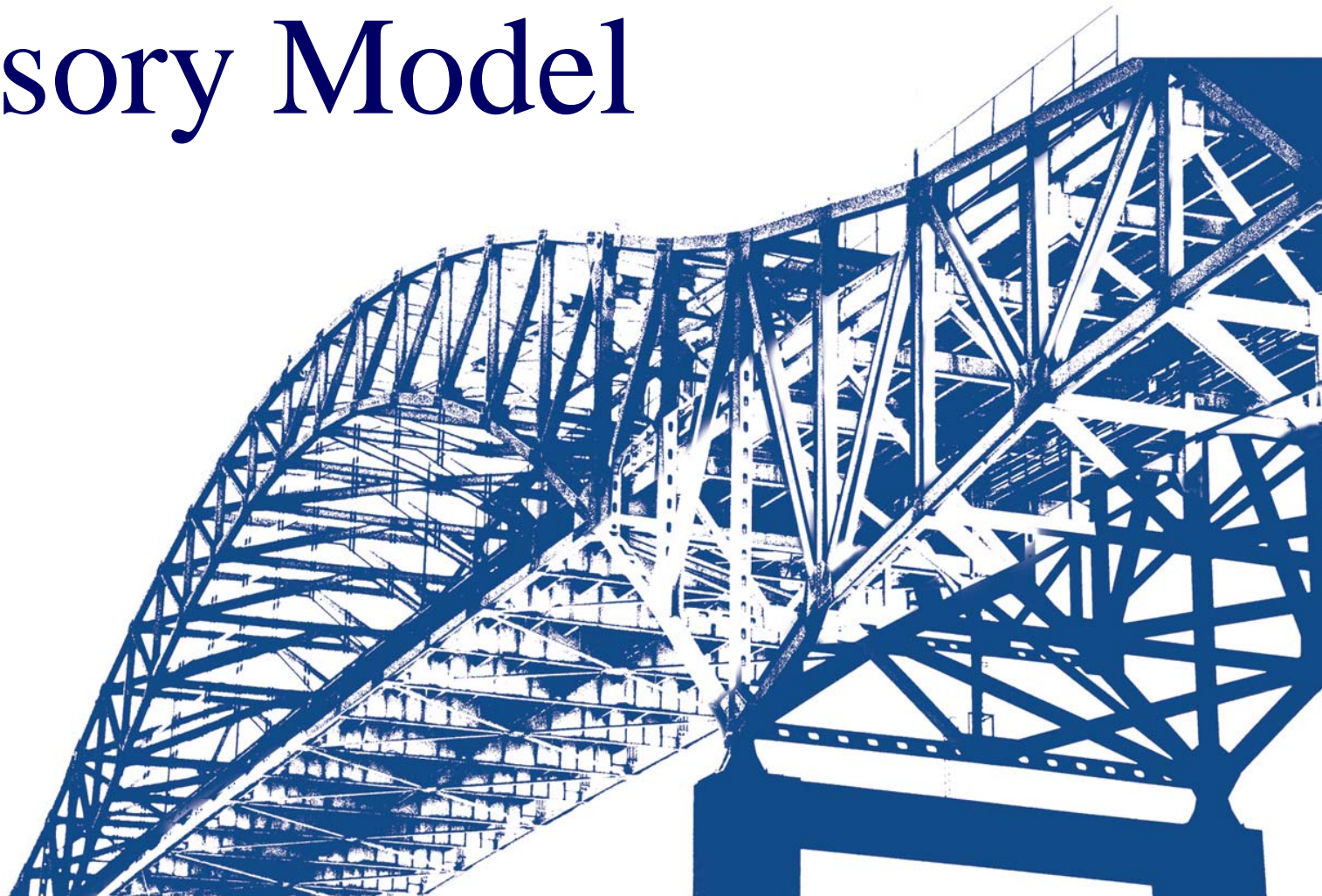


# Typical Project Steps

- The full procurement process can take approximately 9-12 months



# Deloitte's Infrastructure Advisory Model



# Infrastructure Advisory & Project Finance

- Deloitte's IA&PF group provides services predominantly to governments seeking to deliver public infrastructure and related services in a manner that provides greater value for money for rate payers / taxpayers
- We provide services in all three phases of an infrastructure project:
  - **Planning Phase** – defining a project, selecting an appropriate delivery model, developing a business case and all other preparatory work to ensure a successful project
  - **Transaction Phase** – designing, managing and leading competitive processes to engage the market and reach financial close with the winning proposition (the one that ensures performance, effectively transfers risk and sustainable infrastructure service provision)
  - **Concession Phase** – working with our clients to ensure that the long term relationship with their “service providers” are well managed and to ensure performance commitments are met

# Deloitte's Infrastructure Advisory team will leverage a One Deloitte model

	PLANNING PHASE	TRANSACTION PHASE	CONCESSION PHASE
Activities for Infrastructure Delivery	<ol style="list-style-type: none"> <li>1. Condition of infrastructure fiscal situation</li> <li>2. Legislation / regulation</li> <li>3. Leadership: political, public service and project management</li> <li>4. Planning: environmental assessments and project opportunities</li> <li>5. Business Case Development</li> <li>6. Communications: internal and external</li> <li>7. Implementation Plan</li> </ol>	<ol style="list-style-type: none"> <li>1. Transaction process</li> <li>2. Request for Qualification</li> <li>3. Market sounding</li> <li>4. Risk Transfer and Value for Money</li> <li>5. Payment mechanisms &amp; establish Performance Standards</li> <li>6. Draft Request for Proposal and legal contract</li> <li>7. Finalize Request for Proposal and legal contract</li> <li>8. Bidder selection and negotiations</li> <li>9. Financial close</li> </ol>	<ol style="list-style-type: none"> <li>1. Transition to constructor (e.g., design / build)</li> <li>2. Construction</li> <li>3. Facility operation and maintenance (contract and relationship management)</li> <li>4. Asset hand back</li> </ol>
Deloitte's Value Proposition to Government Sponsor	<p><b>Strategic Advisor</b></p> <ul style="list-style-type: none"> <li>• Financing assessment / fiscal needs assessment</li> <li>• Capital plan development and budgeting</li> <li>• Legislative / regulatory review</li> <li>• Risk management profile / framework</li> <li>• Project management function</li> <li>• Change management and business transformation preparation</li> </ul>	<p><b>Transaction Advisor</b></p> <ul style="list-style-type: none"> <li>• Transaction process advisory</li> <li>• Risk transfer identification and quantification</li> <li>• Development of Value for Money benchmark / assessment</li> <li>• Revenue source advisory</li> <li>• Financial modeling</li> <li>• Structured project finance advisory</li> <li>• Bidder negotiation services</li> </ul>	<p><b>Trusted Advisor</b></p> <ul style="list-style-type: none"> <li>• Construction advisory</li> <li>• Payment verification services</li> <li>• Contract management and relationship management advice</li> <li>• Change management and business process redesign</li> <li>• Business transformation</li> <li>• Human resource skill shifts and HCAS advisory</li> <li>• Ongoing project oversight and monitoring</li> </ul>
Critical Success Factors for Municipalities	<ul style="list-style-type: none"> <li>• Identify and remove legislative and regulatory hurdles</li> <li>• Assemble small knowledgeable and multidisciplinary team</li> <li>• Secure political and project champions</li> <li>• Ensure project fits within overall capital investment strategy</li> <li>• Assess current needs of the market re: deal scope and structure</li> <li>• Ensure all stakeholder groups are consulted for input to project definition</li> <li>• Determine project viability and sustainability</li> </ul>	<ul style="list-style-type: none"> <li>• Interact with bidders to understand their perspective</li> <li>• Fair, transparent and open procurement process</li> <li>• Respect bidders' time requirements for due diligence</li> <li>• Maximize opportunities for innovation</li> <li>• Optimize risk allocation for each individual bidder – esp. where there is different risk appetites</li> <li>• Ensure deal structure has flexibility to accommodate changes over the concession period</li> <li>• Keep strong communications lines open with all stakeholders</li> </ul>	<ul style="list-style-type: none"> <li>• Knowledge transfer from procurement phase to operational phase</li> <li>• Appropriately resource contract management function</li> <li>• Develop contract manual</li> <li>• Revise contract as necessary and needed (esp. in facilities management)</li> <li>• Open and regular communication between service provider and government sponsor</li> <li>• Independent engineer to confirm completion and/or milestones achieved</li> </ul>

# What sectors do we work in?

## Transportation Infrastructure

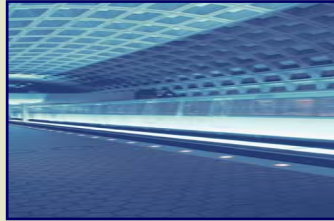
Airports



Roads



Rail



Ports



Ferries



## Social Infrastructure

Corrections



Education



Public Buildings



Healthcare



## Utility Infrastructure

Waste Facilities



Power



Water & Waste water



# Our Approach to Infrastructure Advisory is Unique

- **One size does not fit all** – PPP are not the only solution available to project sponsors to deliver their critical infrastructure projects – We provide independent and objective advice on the best delivery model for the project
- **We look beyond the transaction** – Many professional services firms or bankers will undertake an effective transaction – BUT effective preparation in advance of a transaction and attention to the concession period after the transaction are even more important than “getting the deal done”
- **We understand the “public purpose” of infrastructure** – Our infrastructure team is comprised predominantly of finance and transaction specialists, engineers, accountants and former civil servants and professionals that have devoted their entire careers to serving Federal, Provincial and Municipal government clients
- **We truly bring leading global knowledge to our clients** – Infrastructure Advisory is supported by a globally community of practice of over 300 professionals that regularly shares best practices and lessons learned around the globe – the practice is currently working on a major study on the role of innovative partnerships

# Deloitte.

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