

Background



What is a Public Private Partnership?

Private sector involvement in providing municipal services and infrastructure is not a new or ground-breaking concept; today's economic situation has just brought the concept more to the forefront. Solid waste hauling contracts, long-term leasing of office space, and private operation/maintenance of water and wastewater treatment plants are a few proven examples of how private firms have assisted municipalities in providing services through the years.

Public Private Partnerships recognize the fact that both the public and private sectors have certain advantages relative to the other in the performance of specific tasks. By allowing each sector to do what it does best, public services and infrastructure can be provided in the most economically efficient manner.

While increased private sector participation in providing services and infrastructure may lead to tangible benefits in certain circumstances, PPPs are not a panacea or the only option municipalities should consider in their efforts to provide quality services at the lowest possible cost.

Under no circumstances should PPPs be seen as a substitute for strong, accountable, and effective governance. Ensuring that the services are provided in a manner that is fair, affordable, safe, and environmentally friendly remains the exclusive responsibility of the municipality.

**Public
Private
Partnership
(PPP) :
Using
private
sector
expertise
and
resources
to address
public
sector
needs**

Anderson Consulting
Services

What constitutes a private partner?

Although the term PPP implies that partners in this process are for-profit companies, the definition of partnering is broad enough to encompass other organizations including:

- ❁ Other public sector institutions, e.g., federal or provincial governments, universities, municipalities, joint-service providers, school or health boards; or
- ❁ Not-for-profit organizations, e.g. community groups, service clubs, social service organizations, or recreation associations.

The route the municipality takes in entering into a partnership depends on the individual project. For example, if the municipality wants to enter into an agreement with a non-profit or another municipality, sole sourcing is the route they would take. If the municipality has decided to enter into partnership with the private sector, then other types of procurement should be used.

In most situations, the guiding principle should be to determine the type of organization which can provide the highest level of service at the best cost.

Reasons to consider PPPs

The state of the provincial economy, combined with new or increasing service responsibility and decreasing transfers from other levels of government, are the primary forces motivating municipalities in Nova Scotia to seek alternative means of providing services and infrastructure.

Furthermore, meeting environmental regulations in the areas of solid waste management, water quality, and wastewater treatment is forcing municipalities, especially in areas where infrastructure is old and in need of replacement, to seek other options. In many cases, the private sector is both willing and able to partner with the municipality in a win-win scenario.

The municipality can expect to achieve some or all of the following benefits from a PPP:

- ❁ **Construction Cost Savings:** Combining design and construction components under one private partner can result in savings through a 'phased in' or 'fast-track' construction schedule, faster procurement, lower interim financing, and a reduction in the risk of cost and time overruns.
- ❁ **Operational Savings:** In some cases, private partners

are able to reduce operating costs through operating multiple facilities, specialized technology, sharing specialized labour, more flexible compensation arrangements, bulk purchasing, and centralizing the administrative staff. These savings are often enhanced when the private partner is involved at the program or infrastructure design stage.

- ❁ **Faster Implementation:** By dealing with fewer service providers, combining the design and construction, reducing procurement time, and accelerating capital financing, required services and infrastructure may be introduced faster, and thus, cheaper.
- ❁ **Preserved or Improved Levels of Service:** Municipalities may gain access to expertise and facilities which, for various reasons, may not be available in-house. Economies of scale and the introduction of new technologies may open the way for the same or better service at a lower cost. Some private partners, such as firms operating water utilities, have operations throughout the world. This enables them to achieve economies of scale and access knowledge and technology not available to a single municipality.
- ❁ **Risk Sharing:** Under traditional practices, governments assume all risk associated with service delivery. PPPs allow the transfer of some of this risk to the private partner, such as that associated with liabilities, cost overruns, market fluctuation, ongoing maintenance, regulatory compliance, etc.
- ❁ **Financing Options:** Municipalities in Nova Scotia usually arrange long-term borrowing through the Nova Scotia Municipal Finance Corporation (MFC). While MFC generally has access to lower-cost funds than those available to the private sector, it only goes to the market twice a year and is restricted to a limited line of investment vehicles. The wide range of financing options (e.g. both debt and equity markets), use of tax instruments and the flexibility available to the private partner (i.e. the ability to periodically refinance debt or use financial innovation) may, in some cases, reduce the cost of capital for a particular project.
- ❁ **Avoidance of Capital Debt:** Municipalities in Nova Scotia are limited as to how much they may

incur in debt service charges as a percentage of revenues at any given time. While PPPs may be a means of financing capital projects 'off-balance sheet', it should be remembered that any capital costs to the private partner will be recovered in the service charge ultimately levied on the municipality or the end user.

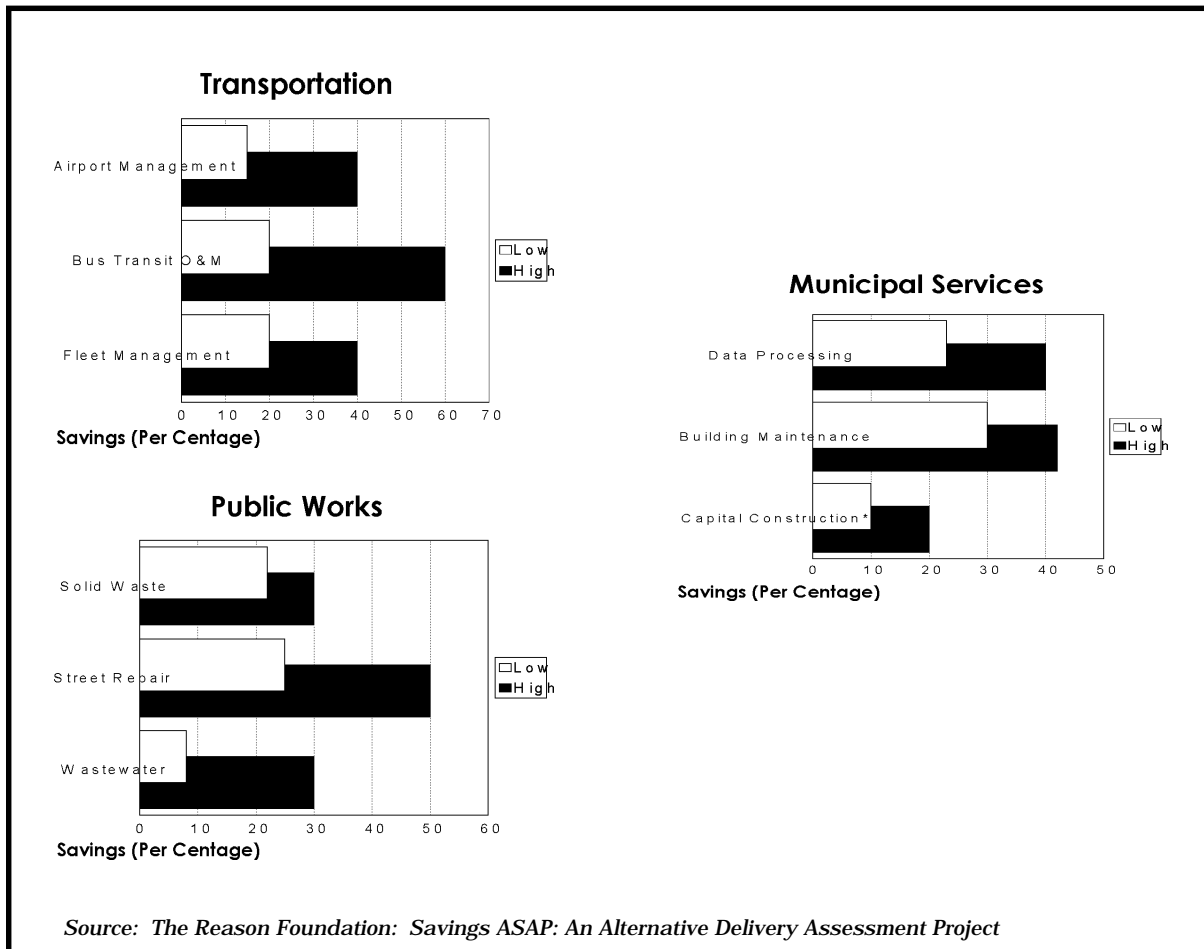
- ❁ **Enhanced Public Management:** In allowing a greater role for the private sector in the provision of municipal services and infrastructure, municipal managers are able to spend more time planning and monitoring results as opposed to managing the resources required to provide a service.
- ❁ **Greater Performance Measurement:** Exposing municipal services to competition and conducting detailed evaluations of the costs and benefits associated with alternative service delivery, allow additional opportunities to benchmark municipal programs against market standards.
- ❁ **Increased Public Sector Revenues:** PPPs may provide municipalities with new sources of revenue in the form of property taxes, lease or franchise payments, or profit sharing agreements.
- ❁ **Enhanced Economic Development:** PPPs create opportunities to market municipal services to other jurisdictions, attract private investment from outside the province where permitted, provide expanded lines of business to local entrepreneurs, enhance the quality and expertise of the local labour force, create a new business climate in the region as well as a new rapport between government and the commercial sector, and create exportable technologies for local industry.
- ❁ **Innovative Solutions:** Competition encourages potential private partners to search for creative ways to deliver a particular service more efficiently than their competitors or the municipality itself. Innovation may be particularly important when a municipality is looking to provide a new service or infrastructure, to solve a problem where there is no immediately apparent solution, or if the cost of the traditional approach may be not be affordable.
- ❁ **Realize the Value of Under-Utilized Assets:** Creative development projects combined with intensified marketing initiatives by a private partner may succeed in increasing the use of a particular asset or service to reflect its potential value.

✿ **Enhanced Facility Maintenance:** Municipalities are often reluctant or unable to dedicate appropriate funds for the ongoing maintenance of facilities despite the long-term savings that may be achieved in doing so. Depending upon the structure of the partnership, private partners are motivated to protect the value of their assets, extend their life, and invest in equipment and machinery that lead to increased efficiency.

✿ **True Costing and True Value:** The price of municipal services, in the form of user charges or the general tax rate, seldom reflects the full cost of the service (e.g. depreciation, risk capture, overhead). The PPP process helps determine the true cost to the municipality.

✿ **Arms-Length Independence:** PPPs may facilitate the efficient and needs-based delivery of certain services by removing political influences from day-to-day operations.

Demonstrated Range of Savings



Which components of service provision have the potential for increased private sector participation?

No matter which category of PPP the municipality is interested in entering into, these factors are common:

- ❁ **The decision to provide a service:** Includes the municipality's statutory responsibility to provide certain services, as well as its role in identifying public needs, feasibility analysis, and the development of implementation plans.
- ❁ **Management and regulation:** Includes the monitoring and evaluation of services to ensure compliance with stated and regulatory performance standards, accountability, transparency, accessibility, and compliance.
- ❁ **Project design:** Includes the translation of objectives and performance standards into detailed specifications.
- ❁ **Procurement and construction:** Includes the purchase, lease, or construction of all fixed assets detailed in the design stage. Often the design and construction components of service delivery are combined.
- ❁ **Finance:** Includes the provision of interim and long-term financing, either debt or equity, for working capital and capital investment.
- ❁ **Ownership:** Includes the legal title of fixed assets including equipment, intellectual property, software, technology, land, rolling stock, and/or buildings.
- ❁ **Operations:** Includes delivery of the service and day-to-day decision-making authority related to it.
- ❁ **Maintenance:** Includes preventive maintenance, repair, and refurbishment of any required fixed assets including equipment, rolling stock and/or buildings.
- ❁ **Sales and Marketing:** Includes ensuring that an asset or service is utilized at an appropriate level.
- ❁ **Public Information:** Communicating information about the PPP to the constituents of the municipality.

Depending upon the circumstances and the service in question, both the public and private sectors possess inherent advantages in performing each of these tasks. With the exception of the decision to partner, service management and regulation, municipalities may wish to consider increased private sector participation in each of the above responsibilities on a project by project basis.

The **decision to provide a service** and the **management and regulation** of all public services should ultimately

remain the responsibility of the municipality under any partnership structure.

What are the various forms a PPP can take?

PPPs exist in many forms, with varying degrees of responsibility shifted from the public to the private partner. The following forms of PPP may be considered by municipalities in Nova Scotia:

- **Privatization/Build-Own-Operate (B-O-O):** Ownership and responsibility for a particular asset or service is transferred from the municipality to the private partner or is built by the private partner in cooperation with the municipality. This form of PPP usually involves private sector financing of the project.
- **Build-Own-Operate-Transfer (B-O-O-T):** The private partner designs and builds a required public service facility and operates it for the municipality for a specified period after which ownership reverts to the government. This may

Various Forms of Public Private Partnering

	Design	Procurement & Construction	Financing	Ownership	Operations	Maintenance	Marketing
Privatization /Build-Own-Operate (BOO)	Private or Public	Private or Public	Private	Private	Private	Private	Private
Build - Own Operate-Transfer (BOOT)	Private	Private	Private	Private then Public	Private	Private	Private
Build-Transfer-Operate	Private	Private	Private	Public	Private or Public	Private or Public	Private or Public
Lease/ Purchase	Private	Private	Private then Public	Private or Public	Private or Public	Private or Public	Private or Public
Turnkey	Private	Private	Public	Public	Private	Private or Public	Private or Public
Developer Financing	Public	Public	Private	Public	Public	Public	Public
Operations & Maintenance	Public	Public	Public	Public	Private	Private or Public	Private or Public

or may not include private financing.

- **Build-Transfer-Operate (B-T-O):** Same as above except ownership of the facility reverts to the municipality prior to commencing operations.
- **Lease/Purchase:** The private partner designs, finances, and builds a facility to meet public needs and leases it to the municipality for a specified period, after which ownership vests in the municipality.
- **Turnkey:** The municipality provides the financing for the project, but engages the private partner to design, construct, and operate it for a specified period of time.
- **Developer Financing:** The private partner assists in financing a project in return for development concessions.
- **Operations and Maintenance:** The municipality contracts with the private partner to operate and maintain a particular facility or service.

The following table illustrates which partner has responsibility for each service component under the various partnership structures discussed above.

While there are potential benefits to partnering with the private sector to provide municipal services and infrastructure, these must be weighed against the potential risks. It is impor

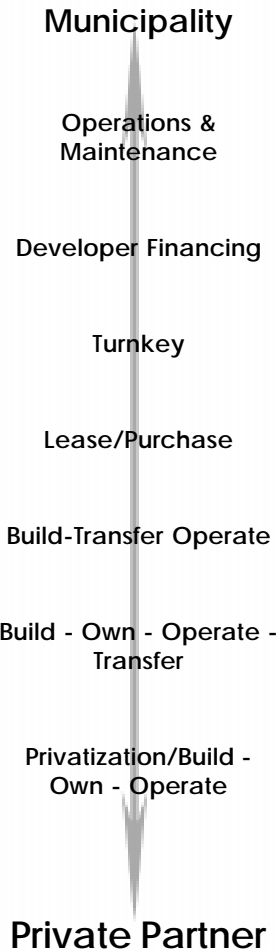
While there are potential benefits to partnering with the private sector in providing municipal services and infrastructure, these must be weighed against potential risks. It is important to remember that assumption of risk is the foundation of all business. While PPPs may be beneficial in transferring some risk to the private partner, complete risk avoidance usually comes at a very high price. The challenge is to negotiate a partnership where the risks of doing business are more than offset by the resulting benefits.

What are some of the risks involved in public private partnering?

Some of the risks that municipalities may face when embarking upon PPPs are included in the following section. Many of these risks can be offset or eliminated entirely by adhering to best practices during the partnership building and contract negotiation stages.

- ❁ **Loss of Control:** PPPs may result in the transfer of some control to the private partner in determining the types of services offered, service levels, timing, and pricing, depending on the nature of the contract that is negotiated and the

Risk Transfer In PPPs



resources the private partner invests in the project.

❁ **Confused Lines of Accountability:** Under a PPP, the service provider (i.e. private partner) may not be directly accountable to the public as is the case when municipalities provide services directly. Increased public resources may be required to ensure that the private partner is fulfilling contractual service requirements.

❁ **Increased Cost to the User:** As many municipalities do not account for recoverable costs through user fees for the full range of costs associated with service delivery (e.g. depreciation, risk, overhead) when setting tax rates or service fees, partnerships may result in a higher price to the end user or the municipality.

Depending upon the degree of flexibility worked into the contract, monitoring and conflict resolution costs may also outweigh any benefits that might have otherwise accrued from the sharing of risks and rewards. Municipalities should be cautious in evaluating programs that may require user fees, to ensure that these fees are not so high that they exclude certain segments of society.

❁ **Loss of Municipal Jobs:** Municipal employees may face job losses or significant changes in their job descriptions. This may lead to morale problems with remaining staff, work stoppages, or, in some limited cases, legal challenges.

❁ **Service Interruption:** Work stoppages, bankruptcy or other business-related problems faced by the private partner could lead to service interruptions, so the municipality must have a backup plan in place.

❁ **Limited Competition:** Where municipalities are seeking to increase private partner participation in services that have been provided by the public partner, there may be a limited number of firms with the experience or expertise to compete for the contract. In such cases, a public monopoly may simply be replaced with a private monopoly that nullifies many of the advantages of a partnership.

❁ **Decreased Service Quality and Efficiency:** In its efforts to ensure an acceptable rate of return on investment, private partners may be motivated to reduce costs at the expense of service quality, preventative maintenance, or even public safety. In the case of 'cost plus' contracts, where the private partner is guaranteed a minimum return, there may be little or no motivation to reduce costs or improve efficiency.

❁ **Limited Control Over Public Policy:** Municipal policy objectives such as equal opportunity employment, standard levels of service or guaranteed minimum wage levels may be difficult to realize under a PPP.

❁ **Long-term Commitments:** In circumstances where the private partner is expected to contribute large amounts of capital to a specific project, the required term of the contract may need to be quite long so as to allow a reasonable amortization period.

Longer contracts increase the risk of legal disputes, service interruptions and the gradual elimination of any in-house expertise in the service area over its duration.

❁ **Perception of Bias in the Selection Process:** Not only must a municipality's procurement process be fair, open, accountable, and objective, it must also be perceived as being so. Competitive procurement for municipal services or infrastructure may expose the municipality to charges of favouritism or exclusion. This is especially true when innovative service delivery solutions are required and the lowest cost bid may not necessarily be the one selected or when a sole source service provider is engaged without competition.

❁ **Transfer of Assets:** The transfer of highly visible assets may be perceived negatively by the public or may not be permitted under provincial legislation. Where ownership of a particular asset is to be transferred to the municipality following the conclusion of a partnership, the private partner may not be motivated to conduct ongoing or preventative maintenance towards the end of the contract.

❁ **Confidential Information:** A PPP may require access to privileged information or confidential data by the private partner. In the absence of sufficient controls and penalties, the potential for the abuse of this information exists.

When considering the potential benefits and risks of PPPs, municipalities should strive to achieve the balance between the two that results in the best service at the lowest possible cost with an acceptable level of risk. Complete risk transfer, like complete risk assumption, is seldom a cost effective solution.



PITFALLS

What are some of the common fallacies concerning public private partnerships?

Although private partner participation in the provision of municipal services and infrastructure is not a new concept, the absence of widespread experience with the process has fuelled a number of common misconceptions including:

- **The prime benefit of PPPs is debt avoidance:** While private partner financing does avoid 'on-book' capital debt, the municipality is ultimately responsible for repaying the money it borrowed through service charges levied by the private partner.

Although there are often advantages to private partner financing, complete avoidance of capital debt should only, in certain circumstances, be the primary reason for a PPP. The true benefits of partnering result from increased efficiency and innovation made possible through the introduction of competition.

- **Municipalities can always finance a project more cost effectively than the private partner:** In fact, there are occasions when the private partner can finance a project more cost effectively than the Municipal Finance Corporation. This is largely due to MFC's practice of going to market only twice a year and the limited lines of investment vehicles open to it under current legislation. Furthermore, the private partner has access to equity capital and is able to refinance existing debt when interest rates drop. These options are not presently available to the MFC. Therefore, life cycle costs of capital must be considered.

Also, the private partner may deploy certain tax advantages or investment incentives. Thus, while debt avoidance should never be used as an argument in favour of PPPs, the appearance of lower cost financing at MFC should likewise not be used as an argument against it.

- **PPPs are used primarily for infrastructure projects:** While partnerships for infrastructure tend to be the most visible, those involving the provision of services are just as common. The *1996 Inventory of Municipal Public/Private Partnerships* published by the Canada/Nova Scotia COOPERATION Agreement to Promote Private Sector Participation in Municipal Infrastructure found that roughly half of all Canadian municipal PPPs were for service delivery.
- **The municipality loses control over services under PPPs:** The municipality **should not and does not have to give up** its role as service manager or regulator, even under a private partner ownership arrangement. In fact, a formal contract may provide municipalities with more control than they enjoy under 'in-house' service provision.

- **Existing employees always lose under PPP:** In fact, many partnerships identified in the *Inventory of Municipal Public/Private Partnerships* required that the private partner hire existing staff at similar wages and benefits. In fact, Nova Scotia's labour laws usually guarantee the succession of labour contracts. When staff reductions are required, they often take place through attrition or relocation elsewhere in the private or municipal organization. The private partner may also be able to increase the marketability of its employees through cross training and exposure to a variety of operations, responsibilities, and technology transfer.
- **The private partner's requirement for profit will increase the cost of service:** While the private partner does require a profit, it is usually able to earn this profit at existing or lower costs. This may be achieved through increased productivity, bulk purchasing, innovations in technology or management, use of centralized administrative staff, or increased revenue through expanded and improved services. In some cases, users may even be willing to pay more for the range and quality of services provided by the private partner.

It is also important to note that municipalities rarely account for all costs when pricing a particular service. When items such as depreciation, overhead, financing, and risk are included in the municipality's costs a more accurate comparison can be made.

- **Service quality will decline under a PPP:** If the partnership is structured so that private partner is subject to competition, the quality of service will likely be maintained and may even be enhanced in an effort to keep the contract and draw new customers. Also, the private partner is more likely to engage in expenditures for ongoing and preventative maintenance, improved efficiency or additional staff throughout the life of the contract. Finally, performance standards can be stipulated in the contract with penalties for failure to comply.
- **Partnering is a municipality's only reaction to dwindling resources:** While the combination of increasing service demands and dwindling public resources has placed greater attention on alternate service delivery, it is important to note that partnerships are gaining popularity in the private sector as an efficient way of doing business. Services, whether public or private, are often best delivered by specialists, rather than by 'in-house' employees with few of the incentives inherent in a focused, single purpose opera-

tion.

- **PPP is the same as privatization:** The table on page 7 illustrates that privatization is one among many forms of PPP options available to municipalities. It involves the transfer of virtually all components of service delivery responsibility to a private partner. In many cases full privatization is neither desirable or permitted under legislation and public private partnering comes in many forms apart from privatization

Steps that should be followed in building a PPP

The exact process to be followed when assessing the feasibility of and negotiating a PPP will vary according to the type of service or infrastructure in question, the partners involved, and the preferred partnership structure. Each service or infrastructure project should be evaluated separately on its merits as a potential PPP.

However, there are a series of common steps in the partnership building process which will ensure that a fair and open process is used to assess the feasibility of a partnership; select the most appropriate private partner, and negotiate a favourable service contract for all parties involved. These steps are introduced in the figure below.

Stages of the Partnership Building Process

1. Establish Internal Framework
2. The Decision to Partner
3. Implementation Plan
3. Implementation Plan
4. Selecting a Preferred Partner
5. Negotiating the Contract
6. Working With the Partner

The steps are detailed and complex processes that vary from partnership to partnership. The following chapters will address each of these six steps individually, outlining the different options available to municipalities and the conditions under which they best apply.

Guiding Principles for Public Private Partnering

1. Exercise Critical Judgement

- ❁ Evaluate each PPP opportunity on its own merits - don't undertake it if it's not going to be feasible.
- ❁ Negotiate the best deal for the taxpayers of the municipality.
- ❁ Ensure that quality service is being provided to the residents of the municipality throughout the life of the PPP.
- ❁ Remember that PPPs require a shift in organizational thinking from directing or (rowing) operations to managing (or steering).

2. Commitment Must Be Demonstrated (Not Just Stated)

- ❁ If a municipality decides to undertake a PPP, make sure there's a strong commitment on behalf of council and senior staff. Don't waste the resources that both the municipality and the private partner are required to invest in the process.
- ❁ A strong commitment is essential - pulling out half way through a project sends messages that the municipality isn't committed to partnering.
- ❁ PPPs are like marriages - both partners must be content that they can build a long-term commitment before entering into the arrangement.
- ❁ Recognize that conditions change over the long-term length of a PPP, and be prepared to make changes when appropriate.

3. Communicate, Communicate, Communicate

- ❁ Communication is important throughout every stage of the PPP process. Communications must be two-way and include employees, council, the public, and the partners.

4. Maintain a Focus on Process and Outcomes

- ❁ The goal of a PPP is to achieve synergy between the municipality and the private partner. In a successful PPP, the whole is more than the sum of the two partners.
- ❁ The structure of the procurement process will determine the PPP's success or failure.
- ❁ Recognize that the request for proposal documents are the backbone of the contract.
- ❁ Managing PPP contracts effectively means that the municipality must acquire new sets of skills. It's role now is to steer not row.
- ❁ Don't stifle the creativity of the private partner.
- ❁ Results are more important than inputs.

5. Be Fair

- ❁ Selecting a partner must be fair, transparent, and open.
- ❁ Flexibility is the key to a successful contract negotiating process.
- ❁ Ensure that the PPP involves arrangements for fair treatment of employees and a smooth, seamless transfer from the municipality to the private partner.
- ❁ Solve problems using conflict resolution techniques - do everything possible to stay out of court.