

## Chapter 2: The Decision to Partner

The goals of this chapter are:

- ❁ To outline the steps the municipality should take to identify potential PPP opportunities
- ❁ To assist the municipality in evaluating and prioritizing potential PPP opportunities
- ❁ To assist the municipality in selecting specific PPP projects for implementation

Each of the above responsibilities rests with a **municipal PPP Committee** described in *Chapter 1*. Once potential PPPs have been identified or approved for implementation, the PPP Committee will delegate responsibility for implementation to a **specific project team** (*Chapter 3*).

## Stages of The Partnership Building Process

1. Establish the  
Internal  
Framework

2. The  
Decision to  
Partner

3. Develop the  
Implementation  
Plan

4. Selecting a  
Preferred  
Partner

5. Negotiating the  
Contract

6. Working With  
the Partner

## 2.1 Identifying potential PPPs

The primary objective of this process is to uncover PPP opportunities existing within the municipality's current services and infrastructure. It involves a systematic review of all programs and facilities to determine whether additional feasibility analysis is required in each case.

The value of the exercise is that it prevents pursuing a partnership with little chance of success by identifying, at a preliminary stage, where public and private interests may collide or where the municipality's strengths outweigh those of the private sector.

There are four main stages to this process:

- ⊗ Establishing the evaluation criteria;
- ⊗ Identifying the full range of services;
- ⊗ Conducting a preliminary screen;
- ⊗ Applying various PPP structures to the remaining services.

These steps relate only to services currently being offered by the municipality or those included in municipal planning documents or capital budgets. New services, whether proposed by the private sector or the municipality will not be identified by this initial process. Such proposals must be evaluated by the PPP Committee as they arise.

### A. Establishing the evaluation criteria

Certain municipal services lend themselves more easily to partnering than others. The role of the PPP committee is to conduct a preliminary screening of the full range of existing and planned municipal services to determine which ones can be eliminated from more detailed analysis.

The evaluation criteria used will depend largely on the municipal PPP policy. Some questions a municipality may wish to ask when screening existing and planned services include:

- Can the municipality legally transfer responsibility for elements of this service to a private partner?
- Is a PPP for this service permitted under existing regulations?
- Is there a competitive market for the provision of this service? Will this competition continue through the life of the PPP?

- Could the service be marketed more effectively by a private partner?
- Can the output of this service be measured easily?
- Are there potential cost savings to the municipality through PPP?
- Is the municipality unable to provide the service due to limited financial capacity (capital and operating)?
- Does the service require expertise or a commitment of resources that is unavailable to the municipality?
- Is there political and public acceptance that a change in service provider would be beneficial? Has it been tested?
- Do existing employee agreements permit a PPP for this service?
- Will a PPP for this service have an acceptable impact on the operations of existing programs or other departments?
- Can required levels of specialized expertise be retained within the municipality at a reasonable cost?
- Can a PPP for this service be introduced under existing joint service delivery arrangements?
- Is the proposed service distinct and separate from the municipality's other services?
- Will user fees exclude certain segments of society from this service?
- Is the quality of service likely to improve as the result of a PPP?
- Can a PPP arrangement avoid significant service disruptions?
- Will a PPP provide protection of confidential data?
- Can government objectives be achieved equally as well or more effectively through a PPP?
- Can the service be provided more quickly through a PPP?
- Will a PPP for this service enhance the local economy?

These are simply examples and may not reflect the priorities contained in a municipality's PPP policy. They are not meant to be a substitute for a full feasibility analysis but rather are an initial screen to eliminate certain services from further consideration. For this reason, the evaluation criteria should be easy to administer and not require extensive research.

**B. Identifying the full range of services**

There are three types of services that can be identified as having potential for a PPP:

- Services currently being provided by the municipality;
- Services that the municipality sees a demand for or plans to provide in the future;
- Unsolicited proposals from the private sector.

**C. Conducting a preliminary screen**

There are numerous ways to identify the services that fall under each of these categories. Services the municipality is currently providing are relatively easy to identify. Financial statements, budget documents, departmental business plans, and existing contracts with private operators, concessionaires, and management companies will assist in identifying these.

Future or planned services can be identified through:

- capital budget documents
- capital improvement plans
- facility master plans
- municipal planning strategies
- business plans
- development plans
- public consultations

PPPs are often best suited to these types of services because they provide a way for governments to satisfy unmet and expensive demands. As a new service will be provided through the PPP, there is often less resistance from existing employees and current users.

Current, past, and future unsolicited proposals from the

private sector should also be considered a source of candidate PPPs. Proposals that were rejected in the past may gain new relevance when introduced under a strong commitment by the municipality to partnering. As stated earlier, future proposals must be evaluated by the PPP committee as they are received.

D. Which services could be provided by a PPP?

Once the full range of existing and future municipal services has been identified, the task of the PPP committee is to apply its evaluation criteria to each one. This process answers the question “which existing and future services could be delivered as a PPP?” This is not a commitment by the PPP committee to initiate PPPs for these services, it is simply a means of eliminating services that do not meet these criteria from further analysis.

The PPP committee should develop a rating system where the full range of services can be labelled according to suitability for further PPP consideration. Potential categories include:

■ **Not Suitable for Further Consideration:** Services that might fall under this category include:

- those which legally cannot be transferred to the private sector;
- those for which no competitive market exists, and
- those that deal with confidential or sensitive information, e.g. governance, police, fire and social services. (However, there may be components or support services that can be provided through a PPP.)

■ **Not Suitable for Further Consideration at This Time:** Services that might fall under this category include:

- those where the output cannot be measured easily;
- those where there is political or public resistance to partnering;
- situations where user fees are fully leveraged or unacceptable, or
- instances where partnering is not permitted under existing collective agreements.

In each of these cases, there are steps the municipality can take to prepare the service for PPP in the future.

■ **Suitable for Further Consideration at this time:** These are services for which there are no immediate and

obvious obstacles to PPP, so they could be delivered through a PPP. These services will form the basic menu of PPP opportunities currently available to the municipality. The challenge to the PPP committee is to assess whether or not these services **should** be delivered through a PPP.

E. Menu of partnering opportunities

By applying the full range of partnering structures permitted under the PPP Policy to those services found to be suitable for further consideration, the PPP committee is provided with a complete listing of partnering opportunities.

Table 2.1 illustrates what a municipality’s menu of options might look like. More than one PPP structure may apply to each of the services identified.

The menu not only identifies those services that merit further consideration for PPP; it also lists the types of PPP structures that are deemed applicable or acceptable to each.

For example, although 11 services were found to be suitable for further consideration in Table 2.1, there are actually 25 different PPP options available.

**Table 2.1: Menu of Privatization Options**

Privatization/ B-O-O	B-O-O-T	B-T-O	Lease Purchase	Turnkey	Developer Financing	Operations & Maintenance
Electric Utility						
Airport						Airport
		Water Treatment Plant		Water Treatment Plant		Water Treatment Plant
	Police Station		Police Station			
			Street Lights		Street Lights	
Transit Service						Transit Service
	Stadium	Stadium		Stadium		Stadium
		New Landfill		New Landfill		
Fleet Management System						Fleet Management System
			Bridge			
						Data Processing

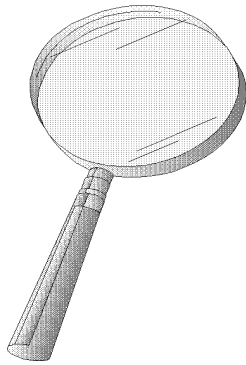
Generally, each municipality should establish its own policy on dealing with unsolicited proposals. The preferable approach, in virtually all cases, is to employ a competitive process when initiating a PPP.

There may be a rare occasion when a unique proposal is submitted that upon evaluation, cannot be put to the test of the competitive marketplace. However, in the majority of instances, a number of suppliers will be able to compete to provide the service, program, or infrastructure being proposed.

The policy must be in place to protect issues of intellectual property or unique technology, for the protection of the organization submitting the unsolicited proposal.

Therefore the preferred response to an unsolicited proposal is to follow the municipality's PPP policy, subject it to a thorough evaluation, and if it is viable, invite competition to provide the product or service.

## 2.2. Selecting specific PPP opportunities for implementation



The menu of PPP opportunities identifies those services that are suitable for further consideration at this time. Once the menu has been compiled, the PPP committee then decides which ones will proceed to the implementation stage. As implementation requires a great deal of time and resources, it is essential that each opportunity be thoroughly analysed before a commitment is made.

In some cases, all opportunities identified in the menu will proceed to implementation. In others, only one or two will proceed. There are three distinct stages of this analysis and each one may allow the PPP committee to further narrow its list of PPP opportunities. They are:

- ◆ Analysing legal, regulatory, and institutional constraints;
- ◆ Conducting preliminary cost-benefit analysis, and
- ◆ Determining general marketability of each opportunity.

### A. Analysing legal, regulatory, and institutional constraints

A preliminary analysis of legislative and regulatory constraints will have been conducted at the opportunity identification stage. Before a particular opportunity for implementation is approved, the service must be examined in detail to ensure that there are no legislative or regulatory barriers to PPP. If this step is ignored, significant investment in time and money can be spent developing a partnership only to find that it

cannot proceed in the current environment.

Specific statutes and regulations requiring examination will vary with the service being considered for PPP. For example, environmental and health concerns will apply chiefly to water, solid waste, and wastewater projects, while transportation and education barriers may dominate a partnership for student busing.

In general, potential constraints to PPP should be examined using existing legislative, regulatory, taxation, and local public policy frameworks. A determination should be made concerning the ease of mitigating these obstacles.

**B. Legislative framework**

Municipalities are governed by Municipal Act, the Towns Act, and the statutes governing the province's three Regional Municipalities. Although efforts are currently under way to review these statutes to provide greater flexibility to municipalities with respect to PPPs, significant barriers currently exist. For example, while a municipality can, through bylaws, govern the use of public or private sewer systems, it can only mandate residents to connect to a publicly-owned system. This is clearly an obstacle to a privately-owned and operated wastewater system.

Other statutes applying generally to municipal PPP structures include the Municipal Affairs Act, Assessment Act, the Halifax Regional Municipality Act, the Cape Breto Regional Municipality Act, the Planning Act, and the Public Utilities Act.

**C. Regulatory framework**

Both federal and provincial agencies impose standard guidelines governing many municipal services such as water and wastewater. While there is no reason to believe that these guidelines would differ in any way under a PPP, the relationship between a regulatory agency and a municipal government may be quite different than one between the regulatory agency and a private partner.

Traditionally, the relationship between a municipality and a provincial regulatory agency has been characterized by shared financial risk. Since the financial participation of the province may eventually disappear under a PPP scenario, so too will the willingness of regulatory agencies to assume risk in its approval and policy functions. As a result, a private partner may be required to obtain discretionary approvals that typically are waived for municipalities. While these approvals

may be relaxed as trust and a private sector track record are established, they will certainly exist in the short-term. These approvals may create barriers or increase the cost of partnering.

D. Taxation framework

Obstacles and issues related to property tax can be found in the Assessment Act. Municipalities are currently not permitted to grant property tax concessions to the private sector, but this is under review. Therefore, under any scenario where a private partner owns the property involving a particular service, it will be subject to property and business occupancy tax. This is an increased cost of partnering that does not apply under public ownership unless the partnership is structured to mitigate the situation.

The same applies generally to federal and provincial income and corporate taxes, and the Harmonized Sales Tax. Both provincial and federal tax authorities deal with special requests for exemptions or concessions on a case-by-case basis. Similarly, municipalities should investigate tax-related obstacles on a project-by-project basis. As these issues are complex and subject to ongoing change, the PPP Committee may wish to seek outside assistance for this part of the analysis.

E. Local public policy framework

Despite the growing acceptance of public/private partnerships as a legitimate means of providing municipal services, a great deal of mistrust and misunderstanding continues to exist. While education and communication may go a long way to reduce resistance, in some cases, there may be insurmountable obstacles to PPP.

Each of these areas is complex, requiring significant resources, and expertise to examine in detail. By doing so, however, the municipality will avoid initiating a partnership that is ultimately destined to fail.

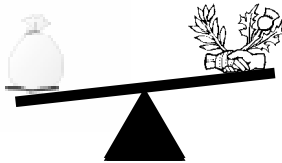
A second reason to examine the legislative, regulatory, taxation, and public policy constraints early in the process is that it allows the time required to implement necessary changes. For example, the Department of Housing and Municipal Affairs is currently examining legislative changes to facilitate PPPs at the municipal level in Nova Scotia. If the municipality is aware that these changes are planned, the proposed PPP may simply be delayed as opposed to discounted entirely.

## 2.3 Conduct preliminary cost-benefit analysis

Ideally, the municipality will enter into a PPP to achieve one or more of the benefits outlined in the introduction to this document. In many cases, such benefits can be achieved only by incurring new costs. If the benefits of partnering outweigh the costs, a sound business case likely exists.

The purpose of the preliminary cost-benefit analysis is twofold:

- ❁ To establish the **benchmark** cost of providing the service in-house.
- ❁ To determine whether the potential benefits of partnering outweigh the costs.



**Benchmark costs** are the current financial costs, either capital or operating, of providing a particular service in-house. A clear understanding of these costs is an essential prerequisite to measuring the potential benefits of partnering. Benchmark costs include the following:

- ◆ The full direct costs of providing the service including salaries and wages, benefits, office space and equipment, capital equipment, rolling stock, debt servicing etc.;
- ◆ Indirect costs, such as corporate overhead, that can be defined as incremental to the service and that will disappear following a PPP;
- ◆ The one-time costs associated with entering into a partnership such as severance packages, contract administration, performance monitoring, exiting the service, and
- ◆ The cost of capital financing including interim and long-term financing, and the associated fees.
- ◆ Benchmark costs may be fully developed to provide a shadow bid.

A second advantage of determining benchmark costs is that it provides insight into the municipality's current approach to providing the service. The benchmarking exercise may assist managers in finding ways to increase efficiency without resorting to a PPP. This is one reason why benchmarks should be calculated prior to the implementation phase.

The allocation of costs must be carried out in a manner which would create a level playing field for external service providers when compared to in-house costs.

It is recommended, where possible, that municipalities considering alternate service delivery options first prepare

activity-based accounting for the services to be assessed for partnering or managed competition. Only these overhead costs which would not 'go away' for either in-house or external service provision should be excluded in the level playing field costing of this service.

If the benchmark costs fail to dissuade the PPP committee from considering the service for partnering, the next step is to conduct a preliminary cost-benefit analysis. Although some benefits and most costs can be expressed in financial terms, many cannot.

The 'softer' elements of the service must be identified and considered where possible. Examples include:

- Loss of control or accountability;
- The change and upheaval associated with partnering;
- The loss of in-house expertise, and
- Risk transfer as a benefit or a liability.

The benchmarking exercise will have already identified many of the costs associated with providing the service in-house. However, there are some costs that are commonly overlooked including:

- ◆ Overhead costs resulting from the use of the municipality's equipment, office space, and staff by the private partner.
- ◆ The one-time costs of establishing the partnership including the request for proposals, evaluation of submissions and contract negotiation. Consultants may be required for this process.
- ◆ The costs associated with monitoring the contract, liaising with the private partner, and maintaining in-house expertise.

It should be remembered throughout this exercise that the goal is to determine whether or not the service should proceed to the implementation stage. It is not meant to provide a definitive statement on the desirability of negotiating a PPP. Due to the time and resources required for conducting the analysis and the intangible nature of some of the costs and benefits, the depth and due diligence will vary with the scope (budget, public profile, employee impact etc.) of the service being examined.

By this stage, the PPP committee should have a fairly good idea of which projects will proceed to the implementation

## 2.4 Assess private sector interest

stage. The final hurdle involves an examination of the general marketability of each project. Marketability, in this sense, refers both to the ability and level of interest among private vendors to provide the service as well as to the conditions of the market for the service (i.e. demand, price, long-term outlook, scale of the project). Not to be forgotten, is an approach to employees, with a suggestion that they too might form a private company to bid on the PPP. This may be defined as 'managed competition'.

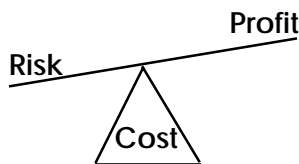
However, if employee ownership is an option:

- ◆ The employees should have no additional access to internal information- they should have the same access that the private sector proponents have, to ensure a fair bidding process, and
- ◆ The employees' proposal must calculate costs the same way that a private sector proponent would - including such things as overhead, depreciation of facilities and equipment, salaries, benefits, etc.

The objective of any private sector firm is to invest its resources (time and money) in a way that allows it to earn a reasonable rate of return on that investment. The magnitude of the required return is a function of the risk that the investor must assume. If the risk to the private firm is too high, it may require a level of compensation (either in the form of increased user fees or guarantees) that offsets the intended benefits of the partnership. If the municipality is unwilling or unable to provide this compensation, there may be little or no interest from the private sector in providing the service.

The municipality may wish to gauge private sector interest prior to investing the time and resources required to implement a partnership opportunity. Private sector interest can be measured in a number of ways including:

- ◆ Various financial analysis specific to the service including simple cash flow analysis to determine the net cash flow required by a private partner, projected to user fees or tax rates;
- ◆ Overlay of a capitalization rate on net operating income/ against asset valuation;
- ◆ Issuing a Request for Expressions of Interest - this document would detail the broad objectives of the desired partnership and the risks the municipality is willing to share;
- ◆ Seeking advice from other municipalities that have part-



nered similar activities (see the *Inventory of Canadian Municipal PPPs* published by the Canada/Nova Scotia COOPERATION Agreement), and

- ◆ Seeking advice from consultants.

If the private sector does not show sufficient interest in providing a particular service, the municipality may either change the scope of the project (i.e. reallocate risks or increase compensation) or eliminate it from further consideration for PPP. Services where there is an adequate level of private sector interest (i.e., two or more interested, qualified proponents) will proceed to the implementation stage described in the next chapter.

## 2.5 Initiate implementation Process

The final task of the PPP committee in the 'decision to partner' stage is to prioritize and schedule those projects which have been selected for implementation and give individual project teams the responsibility to carry out the task.

The preferred process for prioritizing services which have withstood the above analysis depends upon several variables, including, most importantly, the level of resources the municipality can commit. Therefore, an assessment must be made in order to assess the level of effort required to engage in the PPP process. After that has been concluded, some municipalities may wish to implement each opportunity immediately while others will initiate only a small number of projects per year.

The following are factors the PPP Committee may wish to consider when prioritizing services for implementation:

- ⊗ Which projects have the greatest potential for financial benefit?
- ⊗ Which projects have the greatest possibility of early success?
- ⊗ Which projects will demand the most staff resources?
- ⊗ Which unmet service demands are most pressing?
- ⊗ Which services have the most likelihood of generating competition?
- ⊗ Which projects can be undertaken simultaneously?

Once the list of PPP opportunities has been prioritized, the Committee must schedule each project for implementation. Depending upon the number of services identified for PPP, the

schedule may have to span more than a single year. As new PPP opportunities arise, they too must be integrated into the schedule.

**Case Study 2.1:**

**The City of Charlotte, N.C.**

**The City of Charlotte, N.C. has developed an extensive service review program where each and every municipal service is subjected to competition on a regular basis. Both the private sector and the City may submit bids to provide the service. The program began in 1995 and, to date, 45 services have been involved. Of these, the City (in house) itself has won 16 competitions.**

**Twenty-nine services are up for competition in 1997 including fleet management, waste water flow management, sewer cleaning, payroll processing, animal control, school crossing guards and street cleaning.**

**The City uses a five-year rolling schedule where new services are identified for competition each year. The five-year waiting period between identification and competition provides managers with adequate time to make efficiency-enhancing changes to their respective operations and prepare them for competition.**

When the PPP implementation schedule has been established, responsibility for those projects first on the list must be transferred to a separate project implementation committee. This committee will be responsible for guiding the PPP process from the partner selection stage to contract negotiation and monitoring. The PPP project team is described in the *Chapter 3*.

From this point forward, the role of the PPP Committee is reduced to providing periodic advice to individual project teams as well as evaluating new partnership proposals for implementation and responding to sole source applications. The remainder of this guidebook deals exclusively with the implementation of specific PPP projects.

## BEST PRACTICES

- ◆ Analyse the municipality's infrastructure, programs, and services to determine the potential for PPPs, including
  - future opportunities for PPPs
  - benefits and risks
  - barriers
  - cost-benefit analysis
  - benchmark costs
- ◆ Ensure there is adequate interest from the private sector before continuing with the PPP process.
- ◆ Prioritize projects that have been identified as potential PPPs and set up an implementation schedule rather than initiating all projects at once and assigning project teams to each potential PPP.
- ◆ Use outside experts to assist the project team when required.
- ◆ When comparing public and private alternatives, either as a feasibility analysis or a detailed evaluation of actual proposals, evaluate the proposed costs of future private operations against the cost of future public operations.
- ◆ Risk must be shared between the public and private parties. Generally speaking, the more risk the private sector bears, the more compensation it will demand.
- ◆ Once the analysis is complete, the municipality should decide if it can effectively negotiate the allocation of risk in a contract. Depending on the situation, the municipality may assign risks to the private partner.
- ◆ Responsibility for compliance within the full range of federal/provincial regulations must be clear in the PPP.

- ◆ Impacts on existing employees must be fully considered when comparing the costs of public and private operating alternatives.
- ◆ Assess the contract's impact on existing union contracts or labour agreements and union negotiations in the future.
- ◆ Make sure fees charged by the private operator do not exclude residents from using the facility or service.
- ◆ The public must be fully and completely satisfied that procurement rules and regulations are in the public's interest, and not susceptible to manipulation.
- ◆ The municipality must develop and publish its PPP procurement policy so residents understand that the municipality is using this means of procurement because:
  - the need is identified but the means to achieve it are unknown;
  - creative solutions are expected to be a key element of the procurement process;
  - the municipality expects the private sector to assume a variety of risks not ordinarily accepted by the public sector;
  - factors other than prices will be important to satisfy the needs of the municipality - complexity of the project, experience and credentials of the private partner, and the financing arrangements, and
  - the private sector is expected to provide some investment capital in the project.
- ◆ Municipal workers should be able to submit bids in any out sourcing program, in recognition that the underlying reasons for PPPs are competition and cost-effectiveness.