Financing infrastructure through P3

By Skye Newnham, P.Eng, MBA, Major Capital Projects Advisory, Calgary

Public private partnerships (P3s) are becoming an increasingly popular option for infrastructure development at all levels of government in Canada. They represent an innovative, performance-based approach to provide high-quality, long-lasting public infrastructure. Completed P3 projects include hospitals, bridges, highways and new government buildings.

In a P3 model, the private sector assumes a higher level of risk than it would in a traditional design-build (DB) model by agreeing to some variation to finance, maintain and operate (FMO) the infrastructure for a multi-decade period at a fixed fee.

Traditional DB models require governments to have cash on hand, either through existing tax dollars or borrowing. With P3 projects, however, governments realize benefits by deferring the large, lump-sum payments required for major capital projects into smaller, performance-based, fixed payments spread out over several decades.

The structure of a P3 agreement allows governments and taxpayers to avoid the financial risks associated with variables outside their control, such as cost overruns, delays, deficiencies or latent defects. To manage the additional risks to the private partner, such as lengthy bidding processes, financing at variable rates and construction delays, the private partners often include a cost premium in their fees to ensure they realize a profit. Governments often retain risks associated with policy, regulation, demand changes and often geo-tech.

During the planning phase of a project, a value for money (VFM) analysis is conducted to compare the estimated costs of a P3 project with the traditional DB model. The VFM quantifies and supports the selection of the model with the lowest overall net present value cost and greatest cost savings to the public sector. It also allocates risk to the organization best able to manage and mitigate that risk.

For example, EY recently prepared a business case for a proposed $800m P3 transportation project by conducting a VFM analysis to assess the impacts of allocating risk between the traditional DB model and the design-build-finance-operate-maintain model (DBFOM). The VFM analysis included financial models for the traditional and P3 models, and built a risk registry based on the expertise of industry subject matter resources (SMRs) and leading practice methodologies from other Canadian and international jurisdictions.

The figure below demonstrates how the comparison between the two models can be made.
A risk register is created to capture all identifiable risks and then used to quantify each risk to estimate the likelihood and impact of the risk occurring. Risk allocation is dependent on many variables and will differ on each P3 project. The risks are summarized in a format similar to the one below.

Although there continues to be significant debate about the benefits of P3s, the economic reality of current governments requires innovative approaches to financing much-needed public infrastructure. P3 projects offer innovative financial models with options for service delivery, but the cost of transferring the risk to the private partner must be carefully considered. Tools, such as the VFM, can help ensure the most cost-effective public infrastructure delivery models are selected to safeguard taxpayer dollars.

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<th>No.</th>
<th>Description</th>
<th>Cost base</th>
<th>Probability of Impact</th>
<th>Change in Value</th>
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<th>Expected value</th>
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<td>Cost before risk ($M)</td>
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<td>100%</td>
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Effective communications: an integral part of a contract compliance review

By Jason Zannet, Major Capital Projects Advisory, Calgary

Effective communication during a contract compliance review between the auditor and each stakeholder — from the project sponsor to the contract owner and individual vendors — is of paramount importance. The challenge for many auditors during the initial planning phase is to identify the appropriate stakeholders, because there are often multiple individuals or groups who have an interest, such as supply chain, legal, corporate finance, business units and internal audit. Therefore, an effective communications strategy with an approved group of stakeholders is required and can significantly enhance the execution of a contract compliance review.

Planning phase

The communication strategy begins at audit approval when the project sponsor and contract owner engage the auditor to review the selected vendor. At this point, the gathering of relevant contract information, such as vendor, contract documents and cost data, begins. Once the required information and additional data from project staff are gathered, the auditor proceeds with the development of a preliminary review scope. This ultimately leads to a kick-off meeting with internal stakeholders, where all invested parties come together to confirm their understanding of the scope, identify potential areas of concern and finalize communications for the upcoming review to the vendor.

During the planning phase, the auditor typically engages the vendor to discuss the planned scope, information requests and priority contacts. At this time, the auditor can acquire a great deal of information simply by asking open-ended questions and listening carefully to the responses. The auditor may ask questions such as “How does this work?”, “How does the process begin?” or “What happens if...?”. The responses to these questions could lead to further analysis and information requests during the execution phase of the review.

Execution phase

Throughout the execution phase, frequent, clear and accurate communications between the auditor, contract owner and vendor are key. As potential issues arise, the auditor must have access to additional information to ensure that all risk areas, such as document samples, summary cost reports and process clarifications, are suitably explored. This may include additional information requests to the vendor as well as follow-up conversations to confirm the information being reviewed is applicable to the compliance review scope. With the receipt of additional information during this phase, it is important to ensure that a communications strategy provides consistent updates to all stakeholders. With fully informed stakeholders, the potential risks are better understood and managed – which then provides for a more successful review.
As the findings report is being drafted and discussed within the organization, the majority of communications are conducted internally. The auditor will review and discuss the report with the contract owner and internal stakeholders to confirm and obtain agreement on the findings. Effective communications during this phase give the internal stakeholders the chance to provide any additional information to either support or refute the reported findings. Finally, agreement is then obtained from the stakeholders on how to proceed regarding the communication of the findings to the vendor and who will lead the negotiations of the compliance review.

**Negotiation phase**

The negotiation phase begins with the presentation of the compliance review report and continues through to the collection of vendor responses and finally to settlement. Effective communications during this phase can help ensure that internal stakeholders are in agreement. With multiple stakeholders and agendas, a common direction during negotiation may prove difficult, but it’s essential. The contract owner may be more interested in the vendor relationship, whereas the business units may be interested in assurance. So an important communications exchange between these two parties is required to determine a common approach in negotiations.

**Closing phase**

While the auditor may not actively be involved in the negotiation phase, discussions regarding findings and supporting documentation are ongoing between the contract owner, auditor and vendor until the project is ultimately closed. During the closing phase, all communications should be documented to ensure any follow-up or upcoming compliance reviews will be given clear information as to how this review was concluded.

In summary, a successful compliance review relies on the execution of a strong communications plan. This plan keeps the appropriate stakeholders informed of ongoing progress, developments, impending issues and potential concerns. Ultimately, a proactive communications plan ensures everyone who requires information receives it, anyone who has information provides it, and information is conveyed as it is needed.

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