

Public Interest Partnerships Framework for Development

Introduction

A true partnership is the result of two or more partners coming together to each invest in a venture where each partner shares in the risks and rewards of that venture's outcome. Through a partnership agreement, the partners state how much each will invest, what risks each partner assumes/shares, how the rewards will be divided, how long the partnership will last and what happens when the partnership ends.

Successful partnerships will be ones where the risks and rewards are commensurate with the extent of the investment that the partner has made in the venture. In a partnership, there is usually an element of uncertainty as to what risks will come to pass or how much reward will ultimately be realized. Partners come together either because they could not carry out the venture on their own or because they perceive that the venture would be enhanced if they collaborate. Appendix 1 illustrates a number of existing public interest partnerships (PIPs) between the City and various external organizations.

Purpose

The purpose of this framework is to provide guidance to those that are contemplating a partnership with a third party for a project or program that combines public and commercial interests (other than straightforward service contracts and commercial leases). The framework is divided into four phases:

- Project Development and Consultation
- Procurement Process
- Approval and Communication
- Operation

By following this framework, public interest consensus can be reached and a successful partnership can be developed.

Project Development and Consultation

There has been much written on the pros and cons of private sector involvement in the delivery of public services and public infrastructure, making it difficult to separate fact from fiction. The public's assessment of the merits of a public/private partnership is more often than not determined by which side has the stronger public relations campaign. Independent, unbiased assessments are hard to come by. Therefore, it is imperative that the public interest partnership process be transparent and defensible through all stages of the process.

This first stage of the partnership process is the most important. All remaining stages are built upon this foundation. Before a project should proceed to the procurement stage, the proposed partnership should have:

- clearly articulated public interest objectives AND private interest objectives
- a catalogue of benefits & risks that have been tested for plausibility with the relevant stakeholders, potential partners and independent advisors
- strong political support
- a procurement plan with milestones, checkpoints and exits
- a communications plan

The Public Interest Objective

Within this framework, the overarching public interest is to obtain public access to a capital facility under terms, conditions and/or prices that are better than the City could achieve on its own. This usually requires sharing the use of the capital facility between public sector clients and private sector clients.

The public interest objective should be stated in service terms rather than capital terms. For example, service terms for capital facility use include:

- number of affordable housing units (or affordable housing unit years)
- hours of ice time
- hours of playing field time
- number of transit trips

To add clarity, consideration should be given to articulating:

- the geographic area where these services are needed
- the time of day/week/season the services are required
- legislative/service requirements for facility design
- legislative/service requirements of service delivery (if the capital facility is to be operated by the third party)

The Private Interest Objective

The overarching objective of the private sector is to earn a return on its investment that is equivalent or better than other investment options with a similar risk profile. For example, it would not make sense for the private sector to invest in a sports facility for an expected rate of return that is no higher than a risk free government bond. The higher the perceived risk of the venture, the higher the expected rate of return is required. Therefore, it is extremely important to articulate the potential benefits to the private sector interest with some certainty.

Benefits that would be attractive to the private sector could include:

- Access to a “base” government tenant that provides a stable, long term income stream
- Access to a geographic location or facility that the City owns or controls that could be leveraged through additional commercial development or through additional consumer segments
- Access to a “monopoly” market that provides a stable, predictable revenue stream

The respective interests of the public and private sectors should be tested for plausibility before they are incorporated into a procurement document. This requires a consultation plan that would include key public stakeholders and the private sector itself.

Other Public Interest Considerations

There may be a number of ancillary but important public interests to be addressed in the process. Some of these issues may emerge through the consultation process. Other common public interest issues include:

- Impact on and reception from the neighbourhood
- Public access for the disadvantaged
- Over commercialization concerns (e.g. naming and sponsorship rights)
- Design control
- Environmental concerns

For the public stakeholders, the nature of the project and the partnership will determine the consultation required which could include:

- Briefings with the Mayor’s office and the appropriate Councillors (highly recommended)
- Briefings and consultation with relevant community groups and potential public users of the facility
- Open houses

The City’s unions and non-union associations may need to be consulted as well especially if existing positions could be affected. The appropriate consultation process should be discussed with HR.

Private Sector Consultation

For the private sector, a more formal consultation is appropriate. It is common practice to determine who is in the market and what they are in the market for through Requests for Expressions of Interest (REOIs). The REOI describes the partnership opportunity and requests the private sector to express their interest in bidding on it. The perceived public and private sector interests and benefits form part of the opportunity description. It should also include the envisioned risk allocation and risk sharing between the partners.

For large and complex projects, it is highly recommended that relevant and experienced professional service firms be retained to review the REOI before it is released. This will ensure that any obvious benefits are not overlooked and that the perceived benefits are realistic. This ensures that the City expresses itself professionally from the start.

The REOI can also request that the respondents provide feedback on the partnership proposal. This step is recommended when the perceived benefits have not been tested in other projects or other jurisdictions. Other information that could be requested through an REOI includes:

- Feedback on the proposed risk allocation and risk sharing envisioned in the partnership
- Feedback on the proposed scope of the project (e.g. facility size, partnership term, City support required, sources of financing anticipated)

Council Participation

The Project Sponsor will have to decide when and how often Council participates in this stage. If the proposed project is expected to generate considerable controversy, it may be advisable to provide Council with an overview of the proposed project before any significant consultation starts. It is highly recommended that at the very least, Council is provided an overview and is afforded the opportunity to comment prior to the procurement stage.

The Street Furniture Project, awarded in the spring of 2007, is an excellent example of proper consultation up front.

Balancing of Interests

As the views of the various stakeholders become known, decisions will have to be made as to how those views will shape the proposed terms, conditions and scope of the project. A balance needs to be struck between the wants and needs of the public interest and the private interest. Trying to please every public stakeholder request may jeopardize the basic business fundamentals of the project. On the other hand, too much emphasis on defending the basic business premise of the project could lead to public and political support withdrawal. Either way, the project will not proceed.

The project should clearly document the views provided during the initial consultation process and the decision making process that determined which views were incorporated into the scoping of the RFP and which views were not, and why.

Procurement Process

Depending on the number of respondents to the REOI and the size and complexity of the project, a two stage procurement process may be advisable: Pre-qualification and Request for Proposal.

Pre-qualification

Capital facility PIPs are usually complex and long term. The effort required to respond to an RFP is significant and the public interest is better protected if the private sector partner is credible, experienced and trustworthy. Therefore, a pre-qualification process is recommended so that RFPs are sought from private sector partners that are capable of a credible response and that the City will be comfortable working with.

Purchasing and Materials Management Division (PMMD) will work with the Divisions with respect to the pre-qualification process, but essentially the object here is to put the potential partners through a quality and experience screen before they are asked to respond to the RFP. In general, the quality screen will scrutinize the partners for:

- Track record and experience with similar projects
- The quality of their management team that will oversee their end of the project
- Their financial strength
- Their experience with working with the public sector

The pre-qualification document will outline the qualities the City is looking for and ask the respondents to provide information that will allow an evaluation of their credentials.

Request for Proposal

Again, PMMD will provide assistance with the development of the RFP process. However, internal and external legal, financial and relevant program experts will likely be required to assist the Division in developing the scope section of the RFP and the proposed contract terms and conditions. As well, the Toronto Office of Partnerships (TOP) and the TOP Advisory Group (TOPAG) chaired by the City Treasurer should be consulted as the document is developed. TOP and TOPAG can provide a valuable sounding board for the project and can provide access to the appropriate internal experts that the project requires.

The RFP scope and proposed contract terms are critical in terms of receiving a favourable response from the bidders and in terms of setting the groundwork for the long term relationship envisioned. While experts should be consulted to create a comprehensive document, the following areas should be addressed as a minimum:

The Financials

- Financial outlays – Who pays for what: initial capital, capital maintenance, operations?
- How will the project be financed?
- Revenue streams – What are they?, How firm are they over the contract term? Are they shared?

The Services

- What are the minimum facility standards?
- What are the minimum service standards over the life of the contract?

The Risks

- Cost overruns – who is responsible for them?
- Revenue shortfalls – who bears the burden?
- Who benefits from cost savings and excess revenue?
- What are the insurance requirements and who bears the cost?
- What are the indemnity requirements?
- What are the early exit provisions (both voluntary and involuntary)?
- How will inflation and interest risk be managed?

Contract Management

- What is the expected contract management staffing structure for both parties?
- How will performance of the contract be monitored (measurement, reporting, frequency)?
- Who is to be notified when performance is deviating from the contract?
- How will discrepancies and disputes be addressed and resolved?
- What incentives (penalties and rewards) should be put in place to ensure performance?
- Will there be an ability to periodically review the contract and negotiate revisions during the term (if so, how often, what is open for re-negotiation and what is not, who does the negotiation and who approves)?

Public Interest Management

- What will be the process for channelling public concerns and issues?
- How will this be communicated to the public?
- Who addresses them in the first instance?
- How will they be resolved?
- What reporting will be required during the contract term?

Development of a Base Case

As stated in the introduction, a PIP is one of several options to acquire public access to infrastructure. In order to demonstrate that a PIP is indeed a viable and preferable alternative, a base case should be developed for comparison to the preferred PIP option. The base case is the City building/buying the facility infrastructure, financing it in the traditional manner and operating the facility using City personnel (or contractors if that has been the practice).

It is important that as much rigour be applied to the base case as to the development and evaluation of the PIP RFP. Two key areas will come under scrutiny when the base case is compared to the PIP option: Costs and the interest rate (discount rate) used to discount the costs and revenues over the contract term to a net present value.

Interest (discount) rate

In order to compare options that have different expense and revenue patterns over a series of years, the net cash flows must be brought to a net present value. This is accomplished by using a discount rate, which is usually the cost of financing that the entity would incur to “buy” the cash flows.

The interest rate to be used as the discount rate has been a source of controversy between the pro and anti 3P camps. On one side of the debate, the discount rate should be the government’s cost of borrowing interest rate, which in the City’s case is significantly lower than what the private sector can borrow at. Because of this, applying the government discount rate inherently makes the PIP option appear more costly.

Therefore, the private sector promotes the use of a “risk adjusted” interest rate that is closer to the private sector cost of borrowing.

For the City purposes, the discount rate to be used will be the government’s cost of borrowing as it is the most understandable and defensible for our political decision makers. The “risks” that the private sector are expected to assume should be built into the costs of the base case through the use of contingency budgets for risks that the City would retain under the base case (e.g. construction cost overruns & delays, operating cost overruns, revenue shortfalls, inflation risk, etc.).

The Corporate Finance Division should be consulted on the discount rate to be used.

Costs

The costing of the base case should be done in conjunction with internal or external experts. The Special Projects Division – Finance is a source of internal expertise and can source external financial expertise as required.

The Accounting Services Division has prepared a “Full Costing Model” that was developed to assist City Divisions in costing their services when making pricing decisions. While not strictly applicable to building a PIP base case, it does provide useful guidance in developing operational costs for the base case.

Approval and Communication

Once the RFPs are evaluated and compared to the base case, the recommended option and the supporting analysis is incorporated into a staff report to Council. PMMD, Legal

Services and Financial Planning should be consulted in drafting the report. Pre-consultation with TOP and TOPAG before the report is formally circulated is advised.

In the staff report, Council should be reminded of the terms of reference and the consultation process that they may have originally approved and it should be demonstrated how the process adhered to both. At this stage, it is too late to debate the main terms of the partnership. Changing course at this late stage could result in legal action.

Committee and Council have the right to receive the detailed comparison of bids and the base case and such information would normally be provided in camera. However, in some circumstances it may be appropriate to publicly disclose the comparison of the preferred bid to the base case option. This may be advisable for a number of reasons:

- It fosters transparency, especially in a project that has been controversial from the start
- It can demonstrate the strength of the process, especially where the public interest is significant

In addition to the Council reporting process, a communication plan should be prepared that addresses:

- The original objectives of the project
- The consultation process used
- The strength of the procurement process used
- The public interest benefits of the partnership (or the public interest benefit in not proceeding).

Start-up and Operation

Upon approval of Council, the contract will require finalization and the public and private staff teams will need to come together to put the contract terms into action. A good start would be to prepare a partnership protocol that lays out in practical terms how the two teams will work together so that problems are avoided or dealt with before they escalate to the remedies provided for in the contract.

This process encourages the senior partners from each side to set the right “tone at the top” before the contract commences. After all, this is a partnership and good partners work together cooperatively for the common good of both.

Appendix #1 **Current Public Interest Partnerships**

BMO Field – National Soccer Stadium

In June, 2007, the City hosted the FIFA U-20 World Cup at the new BMO Field on the Exhibition Place grounds. Toronto was able to host this event, which drew significant international attention to the City, as a result of a partnership between the Federal and Provincial governments, Maple Leaf Sports and Entertainment Ltd. (MLSEL), and the City of Toronto. The four partners in this project contributed \$27 million, \$8 million, \$18 million and \$9.8 million respectively towards the construction of a \$62.8 million facility built to FIFA international soccer standards. As a result of an innovative partnership approach which successfully leveraged MLSEL's sports facility experience, the facility was completed in April, 2007 on time and on budget. Furthermore, the facility is likely to experience ongoing success given the high attendance recently experienced at the "Toronto FC" matches being staged at the stadium.

Ricoh Coliseum

Through a partnership with BPC Coliseum Inc. (Borealis), the City was able to complete a \$38 million renovation of the Coliseum at Exhibition Place on time and on budget in the fall of 2004. This renovation project resulted in the preservation of this heritage structure and ensured its continuing availability as a home for the Royal Winter Fair. Although the first minor league hockey tenant in the building was unsuccessful, Borealis was instrumental in successfully reaching a new sub-lease agreement with Maple Leaf Sports and Entertainment Limited in 2005. As a result of this new agreement, rental revenues have been secured which will ensure that the \$20 million construction loan guaranteed by the City will be repaid.

First Waterfront Place

As the result of an innovative use of City financing, construction has begun on the first major commercial office development to be built as part of the City's waterfront revitalization initiative. Corus Entertainment Inc. has entered into an agreement with the project's developer, the Toronto Economic Development Corporation, to lease the majority of the space in the \$159 million development. This project will help to spur the creation of a critical mass of media-based employers in the waterfront and, therefore, make significant progress towards the City's overall goal of a creative live-work environment. The project will also buffer proposed residential development to the east from the continuing industrial operations of the Redpath Sugar Complex just west of First Waterfront Place.

Sony Centre For the Performing Arts Redevelopment

The City is currently completing an agreement with Castlepoint Realty Partners Ltd. that will result in funding for the renovation of the existing Sony Centre theatre. In addition, it

will result in a new public square that will provide an attractive outdoor area for the hosting of major cultural events. The redevelopment project will generate this funding through the fees paid by Castlepoint for the lands used by the developer for the construction of a residential condominium tower above the site.

Yonge-Dundas Redevelopment

In 1998, the City initiated an important city-building initiative that leveraged private sector funding to revitalize a section of its most important downtown artery. As a result of an agreement with Pen Equity Corporation, the City was able to create:

- A one-acre public square
- A 250-space below-grade public parking garage
- High quality retail and entertainment space
- Additional lecture space for Ryerson University through an innovative partnership with Pen Equity for the shared use of cinemas

By entering into an up-front agreement with Pen Equity Corporation, the City was able to assemble the necessary lands for this revitalization while minimizing the City's own financial risk exposure.