P3s and the risky business of risk transfer

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Perhaps the most ubiquitous justification for the P3 model is the notion of "risk transfer." The City of Regina's argument for the P3 wastewater treatment plant borrows heavily on this argument, regularly touting the **transfer of risk** from the public to the private sector as a primary reason for the superiority of the P3 model. More recently, the minister responsible for SaskBuilds, Don McMorris, also highlighted the argument of risk transfer while **championing** the proposed P3 long-term care facility in Swift Current:

"I think the most important is they really do take on the risk of the whole facility through the time of the agreement, including the design and the build. You know there could be quite large escalations in costs. We don't have to bear that as a government. That needs to be factored in by the winning proponent. Also issues on delays on construction. We get it at a certain time, and if we do not get that facility at the certain time there are extra penalties paid. So there are a number of benefits for government through the P3 model, most of which is it diverts the risk from government onto the private sector."

So what is this much ballyhooed notion of risk transfer that is often the go-to argument in favour of the P3 model? Put simply, risk transfer is the cost of things going wrong. Risk transfer is the supposed amount of potential dollars in risk the government transfers to the private sector for things like cost overruns, delays, etc, that might inflate the overall cost of the project were it solely in public hands. The government pays the private partner a "risk premium" in exchange for the private partner accepting responsibility for any cost inflation associated with the project.

So far, so good. So what price should we put on such a risk transfer? This is where things can get dicey. How risks are monetized can be notoriously **subjective,** with empirical evidence rarely provided to "substantiate the risk allocations, making it difficult to assess their accuracy and validity." The recent revelations from the Ontario Auditor-General's **report** into the Brampton P3 hospital certainly supports this assessment, noting that "the "value for money" assessment was overestimated by $634 million, while the cost of construction using the P3 model nearly doubled. The value of "risk transfer," the estimate of what it will cost the consortium to deliver the project on time, was also overestimated by a wide margin, according to McCarter. Proponents of P3s say risk transfer is one of the major benefits of this funding model."

In an absolutely damning **study** of risk transfer for P3s -- called private finance initiatives or PFI's -- in healthcare in the United Kingdom, Jean Shaoul and Allyson Pollock and Neil Vickers argue in the *British Medical Journal* that "risk transfer" is more an accounting trick designed to make the P3 model more attractive:

"What is striking, however, is that in all cases risk transfer almost equals the amount required to bridge the gap between the public sector comparator and the PFI. This suggests that the function of risk transfer is to disguise the true costs of PFI and to close the difference between private finance and the much lower costs of conventional public procurement and private finance."

As economist Hugh Mackenzie illustrates in his **study** of the wastewater P3 model, the same dubious accounting appears in the Deloitte report justifying the P3 model:

"The public model had a cost advantage over the P3 model until Deloitte added in risk transfer. The application of Deloitte's risk analysis system to the project changed those figures from an estimated total project base cost disadvantage for the DBFOM option of just over $26 million to a cost disadvantage of under $1 million after adding the values assigned to risk to each of the leading options."

Mackenzie concludes, "this difference in risk cost is critical to Deloitte's value for money conclusion. Without the assumed risk transfer, there is no value for money case." Of course, how Deloitte came up with its risk-transfer estimates that magically pushes the P3 model over the finish line ahead of the public option is impossible to know, as the entire risk analysis section of the full report has been **redacted**. So we have no way of knowing if the risk estimates made by Deloitte are actually sound and reasonable or exaggerated and fanciful.

Of course the one risk that can never be transferred is **statutory risk**, or the ultimate risk for the project being completed. No matter what, the public sector is ultimately responsible for the provision of essential infrastructure and services undertaken by the P3 partner. Should the private partner decide to terminate the contract or declare bankruptcy, the government is obligated to finish the project -- whatever the cost. Given we the public bear the ultimate risk for these projects, you would think we would have full access to the risk estimates the City is basing its decisions on. Or we could just take the City's word for it. Care to risk it?

Blog piece by Simon Enoch:
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