



BPSU REPORT: PUBLIC PRIVATE PARTNERSHIPS [PPP]

This report was developed by the BPSU for the purpose of presenting the Union's position on Public Private Partnerships (PPP). The paper will also outline the BPSU's concerns surrounding Government's plan to redevelop the L.F. Wade International Airport using a PPP.

Report on the Public
Private Partnership
August 2015

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REPORT HIGHLIGHTS

1. **HISTORY:** PPPs were attractive to the Thatcher government as PPPs are another form of privatization.
2. **BPSU** does not support that the answer to not acquiring debt on the Government's books is forgoing revenue over a long term period.
3. **In the IMF/EU 'Troika' packages** in both Portugal and Cyprus have identified PPPs as a contributory cause of the countries' fiscal problems and required an audit and renegotiation of existing PPPs as well as a freeze on new PPPs.
4. **Public Services International:** PPPs are used to conceal public borrowing while providing long-term state guarantees for profits to private companies.
5. **Shadow Minister of Finance E.T. Richards, in his reply to the 2009 Budget Statement:**
"Perhaps this model of PPP is an admission by Government that it is so terrible at managing large projects that it may be less expensive to pay a foreign entity hefty management fees rather than taking the operational risk of doing the job itself. This, Mr. Speaker, is a very sad and expensive admission."
6. **BPSU** believes that the funding of KEMH's PPP has eroded service levels within the hospital, reduced staff benefits, and, increased health care cost for the entire Island.
7. **BPSU** has concerns that the viability of the Airport Redevelopment deal being dependent on air traffic flows increasing at a rate of 1.6% per annum until 2045. If air arrivals fail to increase at this rate, the Union believes that there will be pressure to increase taxes to make up for the shortfall.
8. **Letter of Entrustment** issued by the UK Government via the Foreign Commonwealth Office was amended to include conditions that will need to be met before finalizing a contract with CCC/Aecon including: *"UK Government and the Government of Bermuda must agree on what measures are required to address the deficiencies that are identified by Deloitte in their assessment report[s]"*.
9. **Deloitte Report** noted these key gaps in the Airport Redevelopment Project procurement process:
 - *".....there is no robust evidence indicating that a sole-source PPP would offer more VFM (Value for Money) than a competitive procurement strategy for a similar concession."*
 - *"CCC's affordability components fail to encapsulate all costs to be borne by the Government during and after the project."*
 - *"The documentationdoes not set out how CCC selected AECON, how their process follows best practices, or how competitive tension in the supply chain between AECON and their competed sub-contractors would benefit the Government of Bermuda."*
 - *"There was also early indication from various sources that while the market may have been challenging, there was private sector appetite and bankability for airport deals, and the Bermuda Airport was considered a possible candidate for a PPP and private financing."*

What are Public Private Partnerships?

Public Services International (PSI), a global union federation that represents 20 million working women and men in over 150 countries, describes **Public Private Partnerships** (PPP) as a contract between government and a private company under which:

- a private company finances, builds, and operates some element of a public service; and,
- the private company gets paid over a number of years, either through charges paid by users, or by payments from the public authority, or a combination of both.

PPP History

According to PSI, the concept of PPPs was not used before the 1990s but concessions have existed for many centuries. The principle was that a private company agreed to invest its own money and, in return, the state guaranteed a monopoly to the company on supplying that service. A company could, therefore, expect to get a return on its capital through charging users for the service.

Concessions were often used in the 19th century to develop infrastructure which involved high capital investment e.g. electricity systems, water, gas, and railways. These services were often unable to deliver the required scale of investment for universal services at affordable rates and were replaced by public ownership using public finance.

The modern version of PPPs, whereby the private company is paid by the government rather than by consumers, was invented in the UK in the 1980s by the Thatcher government. The introduction of neo-liberal fiscal rules limited government borrowing but the government still wanted to be able to invest in public infrastructure.

PPPs were the solution under the heading of the Private Finance Initiative (PFI). Although the government is committed to paying for the investment just as if it had borrowed the money itself over a period of 25 years or more, accounting rules allow them to be treated as private borrowing, not public borrowing. This, therefore, allowed money to be borrowed without breaching the fiscal rules.

The policy was also attractive to the Thatcher government as it was another form of privatization.

Public Private Partnerships in Bermuda: KEMH & Airport Redevelopment

I. KEMH Redevelopment: Cost \$315 million

On December 1, 2010, the Bermuda Hospitals Board (BHB) announced that it had signed a project agreement with Paget Health Services (PHS), a consortium of local and international firms. The contract was for PHS to design, build, finance and maintain a new building on the King Edward VII Memorial Hospital site. In this press release¹, BHB officials and stakeholder representatives stated the following:

¹ PRESS RELEASE: [BHB and Paget Health Services sign contract for new hospital building project](#) - Bermuda Hospitals Board - December 1st, 2010

Chairman of the Bermuda Hospitals Board, Mr. Herman Tucker, said:

“On behalf of the Board, I am very pleased that we are entering this 33-year partnership with Paget Health Services; a three year construction phase and a 30-year maintenance phase. This new building is a clinical requirement in order to give the people of Bermuda the acute healthcare services we need going forward. PHS has provided an excellent design, construction, financing and maintenance solution that will give us the new space we specified. I must acknowledge the assistance of Government through the Central Coordinating Committee. The Committee’s support has helped PHS navigate the regulatory requirements and policies in various Government departments touched by this massive project, and to achieve price certainty. Certainty reduces risk and that means a better price for Bermuda.”

BHB Chief Executive Officer David Hill said:

“I am happy to report that BHB has been able to meet every milestone on time and on budget. The Public Private Partnership procurement process is entirely new to Bermuda. An enormous amount of work has taken place over the last two years that will allow PHS to start work on the site right on the heels of contract signature.”

Director of Paget Health Services Robert Wotherspoon said:

“We are very pleased to have reached financial close and are now preparing for the commencement of construction operations. Achieving this important milestone just eight weeks after the Preferred Bidder announcement is a tribute to the developing partnership between Paget Health Services and Bermuda Hospitals Board, and sets an international standard for PPP projects. We look forward to the continuing success of our partnership, and to working together to deliver state of the art healthcare facilities for the people of Bermuda.”

Minister of Health Zane DeSilva said:

“Bermuda Hospitals Board is to be congratulated on signing Bermuda’s first PPP contract. I look forward to seeing construction begin on one of the most important, and most needed, infrastructure projects in Bermuda. This new acute care building will give patients and staff the space they need. It will also ensure BHB can provide acute care services in line with Bermuda’s long term needs at the required international standard of care.”

However, this announcement of the KEMH development PPP agreement was not embraced by the then Opposition.

Shadow Minister of Finance E.T. Richards, in his reply to the 2009 Budget Statement, said:

“There seems to be much discussion of public private partnerships (PPP). The Government is planning to rebuild the KEMH and the Causeway using PPPs.

The first thing that Honourable members and the public should know about PPPs is that they are a form of off-balance sheet financing, that is a PPP enables all or part of the debt to finance a project to not appear as part of the government's debt. So it is a way for some governments to off-load public debt to private entities.

But, Mr. Speaker, there is no such thing as a free lunch. The private partner will not likely have as high a credit rating as the Bermuda Government, therefore the financing is bound to be more expensive than if Government borrowed the money itself. Today, with the credit markets demanding huge extra interest for incremental risk, this extra finance cost will be very significant. Even if the private partner were highly rated, that entity would not be renting their balance sheet to Bermuda for free. So PPPs generally add extra cost.

The Bermuda Government plans to guarantee the debt of its PPPs. This would have the debt be viewed as on-balance sheet financing and therefore become part of the national debt, an approach that defeats one of the principal rationales for a PPP. Perhaps this model of PPP is an admission by Government that it is so terrible at managing large projects that it may be less expensive to pay a foreign entity hefty management fees rather than taking the operational risk of doing the job itself.

This, Mr. Speaker, is a very sad and expensive admission.”

II. Airport Redevelopment: Cost \$250 million

On November 21, 2014, The Hon. E. T. Richards, MP, Deputy Premier and Minister of Finance advised the House of Assembly that the Bermuda Government entered into a Memorandum of Understanding with the Canadian Commercial Corporation to pave the way for the re-development of a new airport using a Private Public Partnership (PPP) model:

“Mr. Speaker, I rise today [Nov 21] to advise Honourable Members of the signing of an historic Memorandum of Agreement with the Canadian Commercial Corporation [CCC] to pave the way for the re-development of the Bermuda airport, including various sources of financing.

This re-development will involve the construction of a new purpose built terminal building.

The MOU will allow for continued dialogue, and ultimately, an exclusive negotiation in relation to the redevelopment of the LF Wade International Airport. The signed MOU will be tabled in this Honourable House today [Nov 21].

The redevelopment of the Bermuda airport represents one of the most important capital projects ever undertaken on our island shores. It will play a crucial role in the renaissance of the Bermuda economy while also being one of the most costly. Its success will be paramount to all in Bermuda.

The construction phase will initially produce hundreds of much-needed jobs for Bermudians and deliver multiple layers of public benefit including, we believe, the basis for a new prosperity.

Mr. Speaker, one might ask, “Why do we need a new airport?” The airport is Bermuda’s principal gateway, the place where travelers to our island get their first impression. What do we want that impression to be? We want that first impression to be consistent with the brand that Bermuda presents to the world and that brand can be summed up as, “First Tier, First Class, First World.”

That is the brand we want to convey, whether the traveler is arriving for business or leisure. Certainly the current terminal building, with sections dating back to the 1940's, does not convey that branded message.

The new terminal will show the arriving passenger that he/she has entered a country that is indeed First Tier, First Class and First World. The new terminal will create a buzz in tourism circles and substantially enhance the airport terminal experience for the travelling public.

For Bermudians, it will not only bring jobs, but it will engender a sense of pride, reaffirming our sense of self-esteem for our island's unique qualities as a tiny but first world nation.

For visitors, it will reinforce the island's status as a successful and sophisticated up-market tourism destination as well as a leading international business centre.

Mr. Speaker, a key and novel component of this project, and the reason I announced this signing instead of one of my colleagues, is the financing component. The fact is this project would have probably gone ahead long ago if funding were available for it. But with Government running large annual deficits and debt soaring, a new airport terminal had been impossible; – Until now.

Having carefully considered all its options, Government has decided to avail itself of a novel procurement model offered by way of an arrangement with the Canadian Commercial Corporation. CCC is wholly owned by the Government of Canada.

The proposed transaction will take the form of a type of public private partnership, [P3], a model that will allow Bermuda to build, use and eventually take possession of the most modern of facilities for civil aviation, without any burden on the Bermuda treasury.

Some of the benefits to using the CCC approach to redevelop the Airport are as follows:

- This model cuts the procurement time dramatically, enabling shovels to be in the ground and jobs created much sooner than traditional methods.*
- This model significantly reduces the cost of procurement.*
- The new terminal will be customized to Bermuda's needs.*
- CCC will guarantee that the project will be delivered on time and on budget.*
- There will be a Canadian infrastructure developer. CCC will conduct its own due diligence to be satisfied that the Canadian developer has the technical, financial and managerial capability to deliver on the contract.*
- The transactional approach will not require any initial expenditure for the airport by Bermuda, and with no new debt for Bermuda;*
The model demands total transparency, adhering to international best practices; in fact, as I have already mentioned, we will ensure that there will be no recourse to the balance sheet of the Bermuda government, direct or contingent.

Our intention is that the financing will rely mostly on the future revenue streams from the new airport itself.

Mr. Speaker, we will also benefit from the uncompromising standards, world class experience and expertise of CCC. Established in 1946, CCC, a federal crown corporation, was mandated to facilitate international trade on behalf of Canadian industry, particularly within government markets.

CCC will select a Canadian Developer from its already preselected stable of Canadian firms. This company will enter into a contract and Concession Agreement with the Bermuda Airport Authority to develop and manage the project. Title to the airport and adjacent property will remain in Government hands. This will be the core of our unique P3 arrangement.

This company will maximize local employment in subcontracting opportunities in the selection of contracting firms to actually carry out the work on the ground. The vast majority of these subcontracting companies will be local Bermudian firms employing local labour.

Mr. Speaker, we will be engaging an independent construction firm to review the project model in all its aspects to formally verify that Bermuda is getting value for money from this arrangement.

This structure, which is tried and tested in other countries, has a number of reduction advantages:

- reducing the risk and expense of procurement,*
- reducing the risk of budget overruns,*
- reducing the risk of late delivery,*
- reducing the risk to the Bermuda Government treasury and balance sheet,*
- reducing unemployment in our island and validating value for money issues.*

It is a winning formula on all fronts.

Mr. Speaker, we are now at the start of a long and complex process with many milestones along the way. The next important milestone will be a Go-No-Go decision, and assuming it's a Go, the final construction contract and a facility management service Agreement [and related financing arrangements], which will govern all aspects of the project, will be developed and concluded. At that time the final costs and design features will have been ironed out.

There are few options to create jobs by way of infrastructure projects, for a government that already has high debt, and is adding to it annually by running deficits. The traditional way of financing such projects would surely increase government debt. In collaboration with CCC, our unique P3 model will enable Bermuda to create significant jobs for Bermudians without putting the government further into debt.

Mr. Speaker I can confirm that we have received the appropriate Entrustment Letter from Her Majesty's Government in the UK to move forward with the project, despite the fact that a recent legal opinion established that a separate Entrustment was not necessary. I can also confirm that we have already consulted with the Accountant General, who is responsible for Financial Instructions, and have received the required approval to move forward with the engagement of CCC.

However Mr. Speaker, it is important to note that no contracts have been issued for any works, and that prior to any contractors being brought on board, this Government will establish the procurement parameters with CCC based on best practices. We will no doubt share this information with the general public.

Mr. Speaker, based on the above mentioned benefits, the Ministry of Finance is confident that this unique alternative of contracting with the CCC is the appropriate model to be used for the redevelopment of the Airport. This approach will provide the Government with a timely, efficient and trustworthy alternative.

Thank you, Mr. Speaker"

BPSU's Position on Public Private Partnerships

The BPSU support the position that Public Private Partnerships are not in the best interest of Bermuda. We believe that PPPs are a more expensive way to finance infrastructure developments and are bad for both the workers and the tax payers in the long run.

The future funding of the PPPs in Bermuda is a major concern; one that is highlighted in the KEMH PPP.

1. KEMH Redevelopment:

The KEMH hospital redevelopment cost \$315 million, however, the PPP contract guarantees revenues of \$40 million to the developer over a 30 year period. This means that the PPP contract guarantees the developer \$1.2 billion dollars over the period of the contract.

This guarantee has now placed the BHB under financial pressure. It is this guarantee that is contributing significantly to the erosion the cash flow of the BHB and is creating a critical liquidity gap. The PPP has already had negative impact on the KEMH's operations. In fact, since the implementation of the PPP, the BHB has begun to:

- reduce the staffing and service levels,
- reduce the benefits that staff receive,
- increase fees to public to increase revenue

The fiscal stress, cost cutting and increased fees have been all reported on in the media:

RG, January 14, 2013 ["Former Minister says containing cost of new hospital should be top priority"](#)

New Minister Patricia Gordon-Pamplin stated recently that the public-private partnership (PPP) underpinning the project will likely prove expensive for the Island in the long run.

Colonial Insurance CEO Naz Farrow:

"PPP and PFI [Private Finance Initiative] contracts have a very mixed track record in the UK and have been criticised in the press there because some of them have proven to be unsustainable. We agree with the Minister that a thorough review of the contract and any associated long-term business plan created for the hospital, is needed."

"The potential impact is certainly significant if revenue forecasts do not match the repayment costs and any shortfalls will almost certainly be born by the taxpayer or through the cost of care at the hospital."

RG, February 23, 2013 ["BHB faces challenging year"](#)

BHB Chairman Jonathan Brewin:

"The Bermuda Hospitals Board last night admitted it would be "challenged" by budgetary constraints after it received a Government subsidy of \$104 million, unchanged from last year."

And BHB is also in the midst of preparing to meet the financial obligations of the new acute care wing. Payments will start next year in 2014."

"Services and standards won't be affected, he said, but BHB needs to take "a serious look at what we do and consider if we need to reshape our service offering, in order to work within the budgetary constraints".

RG, June 26, 2013 [“BHB could go into debt within a year”](#)

BHB Chairman Jonathan Brewin:

“We are concerned, however, that revenue caps imposed on BHB essentially cut the hospitals’ ability to charge for the services used. A KPMG report has highlighted that more work should have been undertaken at the Ministry to understand the impact of these caps. This has left BHB in an extremely challenged position, with an expected serious shortfall of cash over the coming five years.”

RG, March 8, 2014 [“Hospital facing squeeze in year of ‘hard decisions’ ”](#)

Health Minister Trevor Moniz:

“The Island’s hospitals face a tough Budget, along with an arduous financial reappraisal in the coming fiscal year, Health Minister Trevor Moniz told MPs.

With healthcare costs running high, and the Bermuda Hospitals Board facing bills for millions of dollars upon the completion of the acute care wing, BHB has been permitted an extra one percent on fees each year to raise funds.

For the coming fiscal year, Government also cut contributions to the Standard Hospital Benefit for seniors, realising some \$8 million in savings.”

RG, September 6, 2014 [“Fundraising for hospital Short of target”](#)

“Fundraising to cover the \$40 million payout for the Island’s new hospital wing remains several million short of its goal, even though the facility’s completion is just days away. Government has pledged to back up the Board if BHB proved unable to meet its obligations.”

RG, February 12, 2015 [“BHB unveils cost saving measures”](#)

BHB Chairman Jonathan Brewin:

“More needs to be done for us to meet our targets, especially as revenues are declining, and we are feeling the impact of no longer being reimbursed in full for CCU services.”

BHB’s Chief Executive Officer Venetta Symonds:

Acknowledged that the board would “fall deeply into debt” if it did not save costs and make operations more efficient. “If we do not, BHB will fall deeply into debt and will add to the already stretched financial burden of the country.

RG, March 11, 2015 [“House: hospital board cash ‘running out’](#)

Minister of Health Jeanne Atherden:

“Last year, the Bermuda Hospitals Board forecast it was going to run out of money at the end of 2014.

“It has taken all the steps it can, and while it has been able to postpone this day, at some point in the near future cash will be exhausted.”

“In the coming year there are some uncertainties which will have to be managed. The coming on stream of the new acute care wing is a very welcome event for the country as a whole, but as we all know the facility will have to be paid for. The additional costs per annum of the new acute care Wing to the Bermuda Hospitals Board will be in the order of \$40 million.”

“This amount is too great to be absorbed by the Bermuda Hospitals Board and it’s unfair for the public to expect to benefit from the new facilities without any additional charges.”

RG, June 1, 2015 - ["Acute care wing cost passed on"](#)

Minister of Health Jeanne Atherden:

"The cost of the hospital's new acute care wing is about to be passed on to consumers through higher premiums, as the price of the Standard Hospital Benefit goes up by more than ten per cent this month. The Standard Health Premium (SPR) is set to rise from \$301.85 a month to \$338.07 — roughly two thirds of which will go to the Bermuda Hospitals Board (BHB). Announcing new health insurance amendments at the last sitting of Parliament, Jeanne Atherden, the Minister of Health, said that \$23.64 of that increase would go towards addressing the "crisis of funding" confronting the BHB."

RG, June 26, 2015 - ["BHB accounts show cost-cutting success"](#)

BHB Chairman Jonathan Brewin:

"In a guardedly optimistic assessment, BHB Chairman Jonathan Brewin said that two years ago BHB had expected to run out of cash by the end of 2013, but has now extended the deadline "well into this fiscal year".

RG, August 19, 2015 ["House: Health fee hike before legislators"](#)

"A fee increase for hospital medical and dental procedures has gone before legislators.

This 2015 Order, brought before the House of Assembly, sets a 3 per cent increase for medical procedures and sets dental rates at the Ontario standard."

II. Airport Redevelopment:

The BPSU has a number of concerns with the Airport Redevelopment PPP which are centered on the procurement process used, the high level of costs, the type of financing and privatization and believe that this deal will:

1. negatively impact Government financial position,
2. increase fees for users, and,
3. disadvantage the current workforce.

On December 12th, 2014, the Bermuda Public Services Union submitted a number of questions to the Minister of Finance E.T. Richards for response. Below is the list of questions posed and the corresponding responses given by the Minister of Finance:

Q.1 Will there be full public consultation about the new airport project, including the question of whether the project should be publicly or privately delivered?

A.1 This question has already been decided. With Government finances in their present state: i.e. having about \$2 billion in debt and running an over \$265 million annual deficit, public funding of such a project is virtually impossible. If there were no private option to public financing and delivery, there would be no airport. As Finance Minister this decision basically lies with me, and it has been made. There will be public consultation opportunities going forward on the many other aspects of this project, and you and your members will be apprised as they arise.

Q.2 Will elected officials be fully informed about the alternatives and be able to speak freely about the information they receive concerning development of the P3?

A.2 As you know, I have made several public statements and Ministerial Statements in Parliament already, all of which have prompted much debate. There will be many similar opportunities in the ensuing months.

Q.3 Have the full, lifetime costs of delivering the project through a P3 been calculated and compared to public alternatives delivering the same level and quality of service and will the detailed information and calculations be made public?

A.3 While I can tell you that the full lifetime costs of the project as proposed have not been determined as I write this letter, there is a team of experts currently engaged in that very exercise now. As I have stated, there is no public alternative. I would not expect the details of the calculations to be made public, but I am committed to public disclosure of the salient points supporting the mathematics of the financial model.

Q.4 How important are assumptions of risk transfer in the P3 proposal and could any promised risk transfer instead be delivered through a public procurement process that involved a fixed price contract?

A.4 To answer this question, let me reiterate the principal risks that the Government had to address in order to make this new terminal a reality, and which explains why we have chosen this model:

- a) The risk to the Government balance sheet. Public debt is at dangerous levels and expenses versus revenues are currently unsustainable. Therefore the risk to government solvency had to be eliminated. This airport will be mainly financed by the developer and the debt will not have any recourse to the Consolidated Fund. So that risk is covered.
- b) There is a real risk of overruns. Bermuda has a very bad history of overruns in capital projects: - going back 30 years. The government cannot afford to take that risk. We eliminate this risk with this model because CCC guarantees the agreed construction price, once set. CCC also guarantees the delivery date. So that risk is covered.
- c) The traditional process using an RFP process resulting in a fixed price for projects of this nature requires use of expensive consultants. We spent over \$10 million in consultant fees with the new hospital wing. Government cannot afford to take that risk. The model we have chosen dramatically reduces these consultants' costs thereby mitigating this risk.
- d) There is the value for money risk. Open competitive bidding is supposed to ensure we get value for money. History in Bermuda instructs us otherwise. To ensure value for money we are committed to hiring an independent international construction firm to review all the details of the arrangement and verify that Bermuda has received value for money.
- e) The last risk is the risk to unemployed Bermudian workers. The traditional RFP process is very time consuming in addition to being very expensive. The model we have chosen cuts the procurement time by about half, thereby creating jobs twice as fast. Therefore this risk is addressed.

Q.5 Will the Government be responsible for guaranteeing the private sector's revenues? Who will be liable for cost over-runs, or project deficiencies?

A.5 The answer to this question is simply no. No one is going to guarantee the private partner's revenues after construction – that will be part of their business risk. That is why the up-front rigorous study and analysis of future passenger traffic and revenue and expense profiles, work which is being done now, is so important. CCC guarantee construction costs only.

Q.6 Does the Government have the capacity and resources to properly evaluate, administer and monitor a contract of the length, scale and complexity of the P3?

A.6 No we do not, so we have had to retain a world class consultant with long experience in such projects for this. This will be for the construction and planning phase only. We have personnel at our airport who are already fully qualified and experienced insofar as operations going forward.

Q.7 Does the P3 permit the Government the flexibility to make future changes in service delivery or other public policy decisions, to end the P3 in the procurement stage and to terminate the contract if it is not meeting the public interest?

A.7 The government will have oversight of airport operations under the concession agreement in the public interest. It's a good question, but I am not in a position to be specific about our termination powers at this time, but the concession agreement will be presented to the public in due course when all the details are worked out.

Q.8 What impact will the P3 have on the local economy and on workers' jobs, pay and benefits?

A.8 The project will have a definite stimulative effect on the Bermuda economy. It's basically a stimulus package without incurring the usual increased debt burden. I can't precisely say how many jobs it will create but I would estimate it will be in the hundreds. The vast majority of the on the ground work will be performed by local construction firms who will be providing their services using compensation parameters typical for the local market.

Q.9 What are the prospects of small and medium-sized local businesses bidding on the project?

A.9 I expect there will be plenty of work for medium to small businesses bidding on this project.

Q.10 Why should this project not be considered as a form of privatization?

A.10 To answer this question let us first define the entity in question – the airport. The airport consists of a large campus consisting of the current terminal, the actual runway and all its lightings etc., the control tower, the air and ground radar and comms. gear and many other buildings on that campus including the general aviation facility. The replacement value of all of this is over \$4 billion. The runway alone is worth over \$2 ½ billion. None of these assets will be transferred from the ownership of the people of Bermuda. The concession agreement will involve a management contract but government will have oversight of that on an ongoing basis. Therefore this will be a partnership between the public sector, who will continue to own the assets, and the private partner who will build the new terminal (which government will also own)

and will have a mutually agreed management agreement through which they will recoup their investment. This is a P3.

Despite receiving the answers the BPSU remains concerned that:

- An airport redevelopment estimated to cost \$250 million will end up costing taxpayers hundreds of thousands of dollars over a 30 to 35 year period. The BPSU does not support that the answer to not acquiring debt on the Government's books is forgoing revenue over a long term period. This option is more costly to the taxpayer.
- Fees will also increase for the usage of the new redevelopment. The planned fees will see an increase in the maximum total departure tax to \$78, including a \$16 airport improvement fee. This is more than double the previous \$35 paid for departure tax.
- Once the airport management is privatized and the new management takes over, there is no guarantee that the current employees of the Department of Airport Operations will continue employment or, if retained, will keep current salary and benefits.
- There is no guarantee that we have received the best deal or that we will receive value for money.
- The Deloitte Report highlighted that the **Base Case** assumes:
 - *financing is set at 65:35 (D:E ratio),*
 - *11.78% WACC,*
 - *\$40 departure tax,*
 - *30 year concession,*
 - *traffic grows 1.6% per annum until 2045*

BPSU has issues about the viability of this deal being dependent on air traffic flows increasing at a rate of 1.6% per annum until 2045. If air arrivals fail to increase at this rate, there will be additional stress to increase taxes to make up for the shortfall.

- BPSU notes that according to the Deloitte Report, the **Source of Funds** proposed that there is a *"9% funding gap covered by BDA Government"*.

U.K.'s Position on the Airport Development Project:

Letter of Entrustment

In July 2015, the United Kingdom Government, through the Foreign and Commonwealth Office (FCO), amended its original Letter of Entrustment for the airport redevelopment deal with CCC. The amended Letter of Entrustment now requires that:

1. *"UK Government and the Government of Bermuda must agree on what measures are required to address the deficiencies that are identified by Deloitte in their assessment report[s]", and,*
2. *"The Government of Bermuda must publish a written and evidence-based assurance that the required measures have been taken, before the Contract can be concluded."*

The Deloitte Report²

In March 2015, the Government of Bermuda in conjunction with Her Majesty's Government in London, through the representatives of the Foreign and Commonwealth Office (FCO), commissioned an independent appraisal of the procurement method used for the Airport Development Project and the selection of CCC.

Deloitte was hired to conduct an evaluation of the existing analysis carried out by the Bermuda Government to determine if it was comprehensive enough to support the proposal. Deloitte was tasked to make this assessment using the **HM Treasury's Green Book** guidelines for the evaluation of public sector spending proposals. According to the Green Book guidelines, a Full Business Case (FBC) is based on the Five Case model which encompasses:

1. The Strategic Case
2. The Economic Case
3. The Commercial Case
4. The Financial Case
5. The Management Case

This 200 page report was released on May 8th, 2015 and contained these key highlights:

1. Strategic Case

The purpose of the Strategic Case is to ensure that there is *"a compelling case for change that provides holistic fit with the other parts of the organization and public sector."* This is done by:

- defining the rationale for the proposal,
- setting out the background to the proposal, and,
- explaining the objective that is to be achieved

The Strategic Case must also identify the main benefits, risks, constraints and dependencies.

DELOITTE FINDINGS:

According to the Deloitte Report, there are several reports and documents spanning over a number of years that were in support of the argument that *"the current terminal does not meet Bermuda's or international requirements."*

Deloitte deemed that generally the Strategic Case was well-defined however *".....a significant part of the most recent evidence base for change has be produced subsequent to or in parallel to the agreement with the perspective supplier. Recognizing this, Government may want to be clear that it owns its own strategy for the airport and ongoing evaluation of the strategy, which is distinct from that of any prospective concessionaire."*

² REPORT: [Deloitte Report: Appraisal of the Airport Business Case](#) - May 8th, 2015

2. Economic Case

The purpose of the Economic Case is to determine whether *“the intervention represent(s) best public value”*. This is done by:

- assessing the economic costs of the proposal to the society as a whole, and,
- assessing both the benefits of the proposal to the society as a whole.

The Economic Case considers both the economic costs and benefits over the entire duration of the proposal and is the essential core of the business case.

DELOITTE FINDINGS:

Deloitte stated that *“the Economic Case does not yet appear complete”* and highlighted these key gaps:

- i. *“Key, integral steps are not present in the case. These include an economic assessment of a defined list of options to identify the most economically advantageous solution for Bermuda, and some specific Green Book and wider best practice considerations, such as use of a Public Sector Comparator, and optimism bias assessment. Under Green Book guidance, this analysis is expected to be performed by Government prior to engaging with potential suppliers such that the most economically advantageous solution for the Government is identified in isolation from private sector influence.”*
- ii. *“.....do not provide an options analysis or compare and contrast different options side-by-side to arrive at the most economically advantageous option to reverse the identified negative trend”,*
- iii. *“...no long-list of options identified, short-listed and assessed for NPV (the time value of money), the wider economic impact, risks, and non-monetary benefits”,*
- iv. *“Taken as a whole, there is no clear or structured assessment of all options performed in order to appraise the Economic Case of short-listed options and arrive at a preferred solution.”*

These gaps *“make it difficult to assess that the most economically advantageous solution has been selected. This is particularly significant in satisfying Government that the optimal solution for Bermuda has been selected prior to engaging with potential suppliers.”*

In particular, Deloitte noted that *“It will be important to ensure that key drivers of the investment are appropriately assessed, including the wider socioeconomic benefits for the local economy e.g. job creation and stimulating the tourism industry.”*

3. Commercial Case

The purpose of the Commercial Case is to determine the commercial feasibility of the proposal and must prove that *“the proposed deal is attractive to the market place, can be procured and is commercially viable.”*

DELOITTE FINDINGS:

According to Deloitte, solidifying the Commercial Case is particularly more important when a project is sole-sourced because there is an *“absence of competitive tensions that may make achieving VFM (value for money) more challenging.”*

While Deloitte noted that *“significant evidence exists of considerations on the Commercial Case, including procurement strategy, commercial options analysis, and approach to the procurement”* the report identified these major concerns:

- i. *“.....there is no robust evidence indicating that a sole-source PPP would offer more VFM (Value for Money) than a competitive procurement strategy for a similar concession. There is therefore a potential gap in the evidence to support the sole-source procurement strategy opted for from June 2014, as compared to previous evidence suggesting a competed PPP procurement process could be viable.”*
- ii. *“As with the Economic Case, Green Book guidance typically expects this procurement strategy to be conducted by Government in isolation from the private sector, including a detailed commercial options analysis to determine the optimal commercial structure for the project, the terms and provisions with which Government are willing to engage the market, and how to conduct the procurement in order to obtain best-value from the private sector.”*
- iii. *“The Government has signed both an LOA (Letter of Agreement), and an MOU (Memorandum of Understanding) with CCC. There are a number of terms within the two agreements that may affect the economic viability of exiting negotiations with CCC and choosing an alternative option. For example, if the Government developed a PSC (Public Sector Comparator) at this stage and discovered it yields better VFM (Value for Money) than a PPP with CCC, the financial penalties for withdrawing from the CCC arrangement may offset the benefits of the proposed PSC.”*
- iv. *“CCC’s internal processes will naturally consider their own commercial position rather than the position of the Government of Bermuda. While their proposed deal may aim to offer VFM, a supplier’s estimation of VFM will not consider all components affecting the Bermuda Government.”*
- v. *“In a sole-source procurement approach, the lack of competitive tension and pressure on supplier pricing can make it more difficult to achieve VFM. For this reason, buyers in sole-source arrangements typically need to take a more pro-active approach to achieving VFM than in a competitive RFP process.”*
- vi. *“The documentationdoes not set out how CCC selected AECON, how their process follows best practices, or how competitive tension in the supply chain between AECON and their competed sub-contractors would benefit the Government of Bermuda.”*
- vii. *“.....we identified key gaps in evidencing that the sole-sourced procurement approach that was selected will offer the best VFM, and in the Government approach to delivering VFM through commercial negotiations.”*

In addition, Deloitte discovered that: *“There was also early indication from various sources that while the market may have been challenging, there was private sector appetite and bankability for airport deals, and the Bermuda Airport was considered a possible candidate for a PPP and private financing.”*

It is important to note this identification of other possible investors for this project as it contradicts an analysis provided by CCC: *“It should be noted that the conclusion in favour of a sole-source procurement (notably citing lack of investor interest) is made by CCC, and Government may want to perform independent analysis on procurement strategy to satisfy itself on the validity of this analysis.”*

4. Financial Case

The purpose of the Financial Case is to determine the affordability of the proposal as well as the sources of funding and it assesses whether or not a Government can afford its obligations. This is done by:

- demonstrating that funding has been obtained,
- confirming that funding falls within appropriate spending & settlement limits,
- determining to what extent the stated objectives will be achieved with a minimal impact on Government's balance sheet.

DELOITTE FINDINGS:

Deloitte deemed that the Financial Case was still a work in progress and *"while many elements of the Financial case have been developed, or continue to be in process, the case is not yet complete."* Some key concerns included:

- "the extent of focus on 'affordability' appeared to be on making a bankable deal for the private sector, rather than focused on the overall position of Government."*
- "The main element missing from the affordability of the project is that the perspective it has been developed under leaves several cost components of the Government amiss. It is therefore not robust enough to make an investment decision and requires further development."*
- "Many of the key studies and models were developed by the prospective supplier rather than Government." "While there has been a great deal of work on the affordability of the project, it has been developed by CCC as opposed to the Government. CCC's affordability components fail to encapsulate all costs to be borne by the Government during and after the project."*
- "we would expect the Government and their advisors to broaden their assessment of affordability beyond the SPV (Special Purpose Vehicle) to the wider Government perspective by incorporating any retained services or responsibilities of Government (such as overseeing the concession), continuing to test key assumptions (including concession structure and terms), and considering specific key treatments of the project's financials such as accounting implications and balance sheet impact and associated factors such as government borrowing metrics and credit ratings."*
- "Financial Model and study need to be updated, and expanded to study the concession structure and all Governments costs related to the airport."*
- "CCC's proposed design shows an affordability gap of \$35m."*
- "CCC's affordability components fail to encapsulate all costs to be borne by the Government during and after the project."*

5. Management Case

The purpose of the Management Case is used to assure that a project can be delivered successfully. This is achieved by:

- defining management responsibilities,
- defining governance framework,
- establishing reporting arrangements, and,

- including a delivery plan with clear milestones

DELOITTE FINDINGS:

Deloitte noted that this was the “least mature of the Five Cases, indicating that the overall business case is not yet advanced enough for implementation and delivery considerations to be detailed. The Management Case is an important tool to be completed prior to the investment decision being made, in order to ensure Government’s ability to deliver its responsibilities and manage dependencies under the contract, understand wider areas of project scope, manage the supplier effectively, and to have risk management and contingency plans in place.”

Some key concerns included:

- i. “One point in the Management Case which could add significant value to the Bermuda Government at the present time is a contingency plan should the current proposed deal with CCC fall through.”
- ii. “There is limited detail on the practical arrangements to ensure the successful implementation of the project. Additionally, the detail that does exist is high level and typically relates to CCC’s delivery of the project, rather than considering the overall programme plan and Government delivery responsibilities.”

Public Services International’s Position on PPPs³

Public Services International (PSI), a global union federation that represents 20 million working women and men who deliver vital public services in 150 countries, produced a report highlighting flaws in PPP’s including:

- PPPs are used to conceal public borrowing while providing long-term state guarantees for profits to private companies. Private sector corporations must maximise profits if they are to survive. This is fundamentally incompatible with protecting the environment and ensuring universal access to quality public services.
- For the private companies involved – the banks, the builders and the service companies – they represent an extremely attractive business opportunity. A single contract gives them a flow of income for 25 years or more – usually underwritten to a great extent by the government itself. The companies can lobby politicians to ensure that governments create PPPs and renegotiate them as necessary during the long years of the contract.
- Although PPPs are often promoted as a solution for countries under fiscal constraints, the evidence suggests rather that they worsen fiscal problems. According to the **European Investment Bank**, the six countries which have made the greatest use of PPPs in recent years are Cyprus, Greece, Ireland, Portugal, Spain and the UK.
- Four of these countries are subject to ‘Troika’ rescue packages, and the other two – Spain and the UK – both face large fiscal problems. In both Portugal and Cyprus, the IMF/EU ‘Troika’ packages have

³ **REPORT: [Why Public Private Partnerships Don’t Work: The many advantages of the public alternative](#)**
by David Hall, PSIRU - February 2015

identified PPPs as a contributory cause of the countries' fiscal problems, and required an audit and renegotiation of existing PPPs and a freeze on new PPPs.

- Despite the massive promotion effort, PPPs struggle to provide more than a tiny portion of the infrastructure investment in the world. Public finance remains the overwhelmingly predominant model worldwide providing for well over 90 per cent of infrastructure investment.
- PPPs would have become prohibitively expensive, even for their greatest supporters but the adoption of austerity policies means that governments are constrained from borrowing or spending more: so, in order to build infrastructure, PPPs remain an attractive way of concealing the long-term public liabilities. The result is a very expensive contradiction: instead of scrapping PPPs and using cheaper public finance, governments and international public sector bodies are supporting PPPs through substantial state aid, in the form of privileged access to government guarantees or public finance.
- Money is borrowed from the same financial institutions – banks, pension funds and other investors. PPPs do not open access to special 'new' sources of finance. A PPP can spread the cost of a new building over many years, like any form of borrowing but it does not reduce the overall cost of e.g. building a hospital: it just spreads it into the future, like any form of borrowing.
- The notion of 'risk transfer' plays an important role in justifying PPPs. It has been used, especially in the UK, to justify use of PPPs which could not demonstrate that they were better value than a public sector option. The transfer of risk is a key element in accounting rules which decide whether a debt falls off a government balance sheet but transferring risk is not free. PPP contracts normally transfer the risk of construction delays to the contractor – but these 'turnkey' contracts cost about 25 per cent more than conventional contracts
- Bribes or political donations form the currency with which these benefits are obtained, as summarised by the Nobel prize winning economist Paul Krugman (talking about the USA): *"As more and more government functions get privatized, states become pay-to-play paradises, in which both political contributions and contracts for friends and relatives become a quid pro quo for getting government business... a corrupt nexus of privatization and patronage that is undermining government across much of our nation."*⁴
- PPPs also generally worsen the employment conditions of workers and their collective organisation in unions. These effects are caused, firstly, by the employees being transferred to a separate private employer, and secondly, by the dominant role of the PPP contract itself, which forces public authorities to prioritize payments to the PPP company over all other expenditures.
 - Workers normally lose their status as public employees. Possible future returns to public sector employment become more complex. Workers may lose the benefit of public sector pension schemes.
 - It is more difficult to protect and improve pay and working conditions. This depends on the enforceability of indirect mechanisms such as fair wages clauses or legal rules on sectoral pay agreements. The PPP contract itself may not guarantee funding for nationally agreed pay increases. Private employers may apply different employment conditions for new entrants compared with transferred workers, creating a 'two-tier' workforce.

⁴ ARTICLE: New York Times, [Prisons, Privatization, Patronage](#) by Paul Krugman - June 21, 2012

- Union organisation is weakened because employees are divided into smaller units with different employers thus weakening solidarity and forcing unions to deal with a number of different employers. The management of private companies is not directly subject to considerations of public policy in relation to employment issues, and may thus be less supportive of union organisation and workers' rights.
- Other public service workers may also be affected as a result of the existence of the contract. If the income of a public authority is reduced, or if the PPP itself becomes more expensive than expected, the cuts are concentrated on the remaining direct employees, because the PPP contract cannot be broken.
- PPPs do not create themselves or monitor themselves. There are costs involved in setting them up, negotiating and renegotiating the details, and the monitoring and liaison between the public authority and private company, including legal processes. These 'transaction costs' are a key reason why it is often more efficient for public and private organisations to do things themselves, in-house, rather than contract an outside specialist to do so. PPPs are much more complicated than ordinary contracts, and so the transaction costs are expected to be higher
- The complexity of PPPs means that there are very high legal and accountancy expenses involved for both government and companies, with tendering periods lasting an average of 34 months.

The evidence from international experience and studies of PPPs can be summarised as follows:

- The cost of capital is always cheaper without a PPP for high income and developing countries alike.
- The cost of construction is higher under a PPP because the financiers require a turnkey contract which is about 25 per cent more expensive.
- The private sector is not more efficient in operation and the public sector has the advantage of greater flexibility.
- The transactions costs of tendering and monitoring PPPs add 10-20 per cent to their costs.
- The public sector faces real risks from PPPs including incomplete contracts, the likelihood of renegotiations, and the potential public liabilities in case of bankruptcy or default by the private company.
- There are negative impacts on public services, the environment and workers, from cost-cutting or from distorted selection of projects to suit the need for profitability in PPPs.