

2004

The Canadian Council for Public-Private Partnerships
2004 National Award Winners

Sierra Yoyo Desan Resource Road, BC

DriveTest: Ontario Driver Examination Services

SHOAL Centre: Seniors Recreation Centre (Sidney, BC)

The Canadian Council for
Public-Private Partnerships



Le Conseil Canadien des
Sociétés Publiques-Privées

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June 2005

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Introduction

Undertaking a public-private partnership (P3) is often a complex and challenging process. Yet successful P3s demonstrate time and again the value that these partnerships can bring to the delivery of needed infrastructure and public services. Annually recognizing and showcasing the achievements of the best of these successful partnerships has become a welcome tradition at The Canadian Council for Public-Private Partnerships.

The Council's National Awards program, which was established in 1998, honours public-private partnerships that have demonstrated excellence and innovation. The Council defines a public-private partnership as "a cooperative venture between the public and private sectors, built on the expertise of each partner, that best meets clearly defined public needs through the appropriate allocation of resources, risks and rewards." The awards—gold, silver and award of merit—can be given to projects in three categories: project financing, service delivery and infrastructure.

As well as celebrating the achievements of the award-winners, the Council documents their P3 projects through case studies that examine how the partnership was established, its structure and operation, and the resulting benefits. The case studies are intended to enhance Canada's growing level of expertise in public-private partnerships and enable others to build on the experience of those who have gone before.

This is the seventh year of the awards. The Council received 17 nominations, and a national panel of experts selected the winners on the basis of established criteria. The winners were announced in November 2004 at the Council's annual conference in Toronto.

The Canadian Council for Public-Private Partnerships partners with a number of public and private organizations to host this program. Sponsors for the 2004 National Awards Program include:

- BC Ministry of Finance
- BC Ministry of Transportation
- Blake Cassels & Graydon LLP
- Ernst & Young Corporate Finance Inc.
- Fraser Milner Casgrain LLP
- Government of Canada, Public Works and Government Services
- PricewaterhouseCoopers Corporate Finance Inc.
- TERANET Inc.

The case studies are distributed to the Council's over 230 member organizations from the business community and all levels of government across Canada. In addition, the Council posts summaries of each winning project on its website. Non-members may purchase copies of the full report from the Council, which is a non-profit organization.

Award Winners

In 2004, the selection panel chose a Gold Award winner for each category of project financing, service delivery and infrastructure. In addition, for the first time, the panel presented the Chuck Wills Award, which was inaugurated in 2003 to honour a longtime supporter of The Canadian Council for Public-Private Partnerships.

Sierra Yoyo Desan Resource Road, BC

The **Gold Award for Project Financing** was awarded to the British Columbia Ministry of Energy and Mines (MEM) and Ledcor Industries Ltd. for the Sierra Yoyo Desan Road (SYD Road) project.

The SYD Road is a publicly-owned resource road that provides access to oil and gas fields in northeastern British Columbia. Under a 16-year agreement with MEM, Ledcor will finance and construct a new bypass and road upgrades in the first two years, and maintain the SYD Road for the duration of the agreement. The improved road is stronger, safer and will permit greater all-season access to the province's natural resources.

An unusual feature of this P3 is that the cost of the improvements and maintenance is borne directly by the road's industrial users through user fees. In a separate agreement with MEM these road users have a voice in the management and operation of the road. To help offset the user fees, the Province provides those companies with a royalty rebate equivalent to 50% of fees paid.

DriveTest: Ontario Driver Examination Services

The **Gold Award for Service Delivery** was awarded to the Ontario Ministry of Transportation and Serco DES Inc. for the DriveTest project.

Under this partnership, Serco has been granted an exclusive 10-year concession to operate driver examination services in Ontario. It is believed to be the first time that driver examination services across an entire jurisdiction have been delegated to a single private sector company.

Serco paid the Ministry of Transportation an upfront concession fee of \$114 million, and retains the driver examination fees charged. The Ministry retains control over examination standards and amount of fees charged through a prescriptive concession agreement.

Since the partnership began, wait times to take a driver's test have been significantly reduced from up to 15 months to an average of six weeks, and overall customer service has improved.

SHOAL Centre: Seniors Recreation Centre (Sidney, BC)

The **Gold Award for Infrastructure** was awarded to the Town of Sidney, BC, and SCH Group for the SHOAL Centre project (Sidney Healthy Options for Active Living).

The SHOAL Centre is a new building in the retirement community of Sidney, which is on Vancouver Island, that was designed, financed and constructed by SCH Group. The building combines a state-of-the-art municipal seniors recreation centre on the main floor with seniors independent and assisted living residences above, plus space for professional services such as physiotherapy. Its varied residential, recreational and health services provide Sidney's seniors with an aging-in-place community, similar to a village within the Town.

The seniors recreation centre is owned by the municipality, and was built at no direct cost to the Town above and beyond title to the air space above the recreation centre. The remainder of the building is privately owned. The project was financed by pre-selling all units through a securities offering.

Lease of Port Colborne Hydro Inc., Ontario

The Chuck Wills **Award of Merit for Service Delivery** was awarded to the City of Port Colborne in Ontario and Canadian Niagara Power Inc. (now owned by FortisOntario Inc.) for the lease of the City's electric distribution company, Port Colborne Hydro Inc.

Under this partnership, the City leased Port Colborne Hydro Inc. to Canadian Niagara Power for a 10-year period in a transaction valued at \$15.7 million. Canadian Niagara Power assumed all responsibility for the management, operation and capital needs of the utility in Port Colborne.

Canadian Niagara Power has made capital improvements, is committed to performance standards, and retains the option to purchase the utility at the end of the lease for \$6.9 million. Meanwhile the City receives monthly lease payments. Local distribution rates for electric power are comparable to rates prior to the lease and in most sectors are lower than historical rates.

This year the case studies profile the gold award-winning projects. The case studies were written with the help and cooperation of the public and private partners involved, and are based on personal interviews, written submissions and legal contracts where available. As well as providing us with detailed information, the partners have reviewed a draft of the case study. We are very grateful to them for taking the time to share their expertise with us.

Observations

The case studies provide interesting insights into public-private partnerships in Canada. Over the last few years these partnerships have demonstrated the ability of P3s to:

- get major projects built faster, sooner and at lower cost to the taxpayer than traditional methods;
- successfully deliver both large complex projects and small-scale initiatives;
- finance, design and build high-quality infrastructure;
- maintain and enhance the delivery of public services;
- gain the support of financial markets and institutions, with and without municipal guarantees;
- create community economic benefits through local procurement; and
- create opportunities for exporting Canadian expertise.

This year's case studies provide additional insights into the achievements of public-private partnerships.

Transparent process promotes public confidence

Having a transparent process can help allay potential misgivings the public may have about a P3 before they arise.

With DriveTest (driver examinations), the Ontario government was very conscious of the public's concerns about outsourcing services that affect public safety. To manage this concern, the Ministry of Transportation developed an evaluation process and criteria in advance of the final bid submission, and retained fairness auditors to oversee the procurement process and ensure it was fair and transparent. Subsequent reaction from the public was minimal.

In the SHOAL project where the developer received title to air space without any direct payment, the Town of Sidney had to avoid any appearance of having a "sweetheart" deal with the developer. It did this by ensuring that the value of the air space was equal to the value of the new recreation centre the Town received, having the appraisals conducted by a third party, and requiring that the private units be sold at fair market value.

Thorough procurement process eases implementation

Selecting the right partner is one key ingredient to successful P3s. Investing time up front to thoroughly understand what is needed both from the project and from the partner helps to ease the transition into the partnership and accelerate the benefits.

BC's Ministry of Energy and Mines commissioned studies to better understand what was required to upgrade the Sierra Yoyo Desan Road and consulted heavily during the procurement process. At DriveTest, the draft contract was circulated to bidders for comment and the final contract issued before final bid submission, which avoided a lengthy negotiation process once the preferred proponent had been selected. In both cases, the process resulted in a good fit between the partners, and their willingness to work collaboratively was instrumental to their success.

Third parties can be integral to success

Some P3 projects require more than bilateral agreements between two partners for successful implementation of the entire project. For example, the Sierra Yoyo Desan Resource Road project is effectively a dual partnership: the P3 between the Ministry of Energy and Mines and Ledcor; and a separate agreement between the Ministry and the road users whose user fees finance the P3.

Similarly, successful operation of the seniors recreation centre in the SHOAL project depends on Silver Threads, the non-profit organization that runs about 100 programs at the centre. Running these programs so they are affordable to the seniors cannot easily be achieved by either the public or private partner, yet without the programs the recreation centre cannot function to its full potential.

Performance-based standards for safety and innovation

Ensuring public safety is a critical issue for governments which they typically manage by requiring the private sector partner to meet detailed standards. The more these standards are performance-based rather than prescriptive—in other words, focus on outputs rather than inputs—the more opportunity there is for private sector innovation.

An overriding provision in the private delivery of driver examination services is that all testing is done to government standards. In this case the Ministry of Transportation generally specified a large number of outcomes and safety standards but not how to achieve them. For example, it did not specify how many examiners to use. This enables Serco to use its private-sector expertise to determine how it meets those standards.

Similarly, many of the standards in the Sierra Yoyo Desan Road project moved from prescriptive to performance-based standards which provided Ledcor with opportunities to be flexible in its operations. One example: standards that specify the required condition of the road, such as it should be capable of carrying industrial traffic at 80 km. per hour, rather than how that condition is achieved.

Financial markets back service delivery

Capital markets in the past have financed the construction of infrastructure developed through a P3. In the DriveTest project, financial markets have shown they will also support service delivery.

Using structured financing techniques Serco DES was able to place investment grade non-recourse debt in the Canadian placement market despite having no tangible assets to back the transaction. The lenders relied on cash flow to be generated during the concession term.

Another unusual and related feature of this case was that the business model featured monetization of a user-fee based service, believed to be the first in Canada.

Acknowledgements

The National Awards Program sponsored by The Canadian Council for Public-Private Partnerships provides an opportunity for the Council to shine the light on current notable PPP projects and the people who have demonstrated commitment to bring them to fruition. Each project has followed its own unique path and each emerged offering an improved level of service to the public or infrastructure or service where none existed previously. However, while the path of project development may be unique, the path to being considered for a National Award is not.

The format is similar each year. First is the Call for Nominations and the Selection Process. Second is the honouring of the winners at the Annual Awards Dinner. And finally, there is the legacy of the program—the documentation of the honoured projects in Case Studies which are published and shared with hundreds of readers throughout Canada.

Each step along the way involves the dedicated work of our members, staff and valued consultants. We looked again in 2004 to the team of Chair Cynthia Robertson and CCPPP Administrator Carla Walmsley to guide the process over the course of seven months prior to the conference. The outreach to sponsors to consider their projects for submission, the raising of the funds to run the program, the coordination of the review of the entries and finally, the planning and delivery of the actual Awards event. Thanks go to these two individuals who so successfully pull the program together each year. And thank you to Jeff Bowden who adds value to each and every stage of the process, responding to every call for assistance.

The last step involves the documentation of the award winning projects. For six years that task has fallen to Anne Anderson of Athena Research Services who very capably works with the sponsors of the projects to flesh each project's story out and to commit its path, its accomplishments and its details to the reading audience. Turning complex legal documents and financing structures into readily understood text is an art and a science. Anne Anderson accomplishes both. Thank you to Anne on behalf of the CCPPP board for the work she does on this project.

As in past years, CCPPP established an Advisory Panel made of Directors of CCPPP to review the submissions. Further, a smaller group of the Panel act as readers of the draft case studies. We greatly appreciate the work this group does on behalf of the Council and recognize that it is their contribution that ensures the highest level of integrity of this process.

An Advisory Panel drawn from the Directors of The Canadian Council for Public-Private Partnerships reviewed all the submissions. A smaller group from the Panel were also readers of these case studies of the winning projects. Their expertise and thoughtful contributions ensure that the Awards Program is conducted with the highest level of integrity. We are very grateful to them all for their work on behalf of the Council.

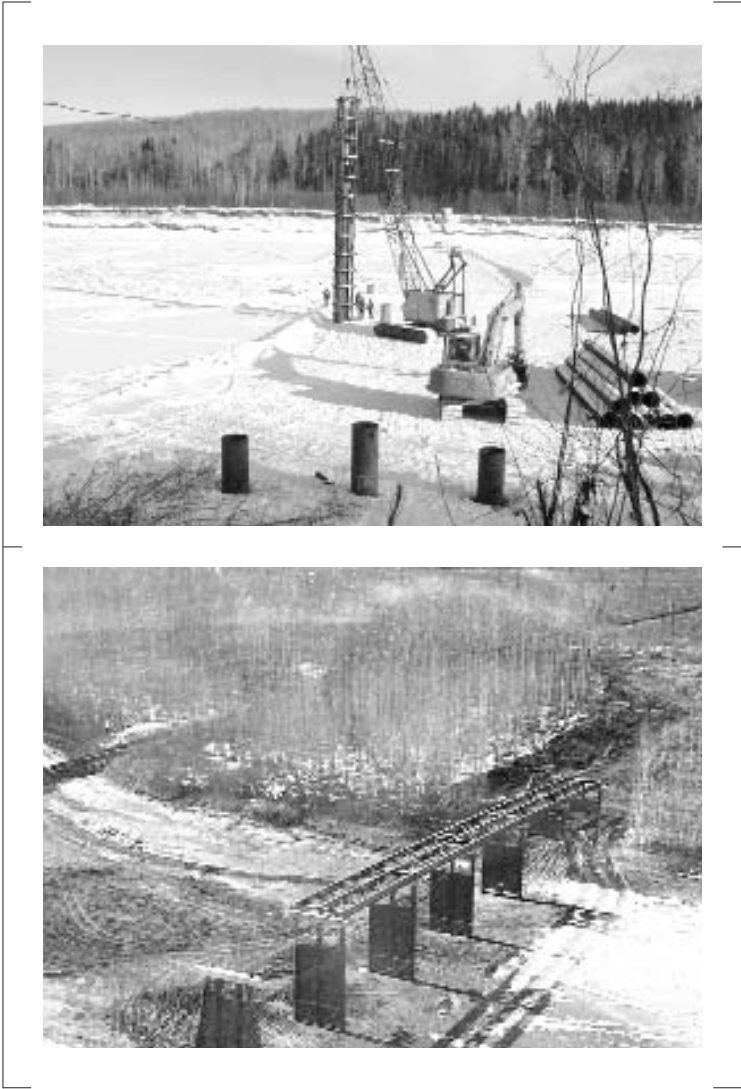
We would like to thank:

- Cynthia Robertson (Chair), Manager, Training and Certification, TSSA
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- Nicholas Hann, Managing Director, Macquarie North America Ltd.
- Pierre Le François, President, Society for Partnerships and Cooperation

The Awards Program would not be possible without our valued sponsors. Their generous support enables the Council to recognize the excellence and innovation that can be found in P3 projects, and thereby helps to develop the level of expertise in P3s in Canada. Our most sincere appreciation is extended to the BC Ministry of Finance, BC Ministry of Transportation, Blake Cassels & Graydon LLP, Ernst & Young Corporate Finance Inc., Fraser Milner Casgrain LLP, Government of Canada, Public Works and Government Services, PricewaterhouseCoopers Corporate Finance Inc., and TERANET Inc.

SIERRA YOYO DESAN RESOURCE ROAD, BC

2004 Gold Award Winner for Project Financing



Quick Facts

Project type

Design-Build-Finance-Operate

Asset

Sierra Yoyo Desan Road: approx.
180 km. of resource road in
northeastern British Columbia

Partners

BC Ministry of Energy and Mines (MEM)
SYD Road Limited Partnership

Other participants

Road Users Committee representing the
industrial companies that use the road

CIT Capital Finance

Ledcor partners and subcontractors:

- ▶ Ledcor CMI Ltd.
- ▶ Ledcor Highway Maintenance Limited
- ▶ Buckland & Taylor
- ▶ Peter Kiewit Sons Inc.
- ▶ Kledo Construction
- ▶ McElhanney Consulting Services
- ▶ Trow Associates
- ▶ Triton Environmental Consultants

Public sector advisors:

- ▶ Partnerships BC
- ▶ KPMG
- ▶ ND Lea
- ▶ Fraser Milner Casgrain LLP

Private sector advisors:

- ▶ Blake Cassels & Graydon LLP
- ▶ Tupper Jonsson & Yeadon

Financial arrangements

\$34 million senior non-recourse debt
arranged by Ledcor.

Ledcor investment:

- ▶ \$40 million in the first two years for
construction of new bypass and road
upgrades.
- ▶ \$2.5 million per year for 15.5 years for
operations and maintenance of the
road (starts during construction).

Payments to Ledcor are from fees paid by
the industrial road users.

Industrial road users receive royalty
rebates from the Province equivalent to
50% of the fees paid.

Overview

The Sierra Yoyo Desan (SYD) Road is a publicly-owned resource road whose improvements and maintenance are being financed by its industrial users. These road users will receive an upgraded road that is more durable, safer and will permit greater all-season access to the oil and gas fields in northeastern British Columbia.

Under a 16-year agreement signed in 2004 with BC's Ministry of Energy and Mines (MEM), Ledcor will invest more than \$40 million in the first two years of the agreement to construct a new bypass, which includes a new bridge over the Fort Nelson River, and upgrade the SYD Road, and \$2.5 million per year to maintain the road for the rest of the term. Industrial road users pay fees into a segregated account according to their activity in the area accessed by the SYD Road, and Ledcor is compensated from those funds. The Province makes no direct cash contribution but provides the industrial road users with a royalty rebate equivalent to 50% of the fees paid.

The road users have a separate agreement with MEM that allows them to have a voice in the management and operation of the SYD Road including the amount of fees charged.

Background and Rationale

History of the SYD Road

The Sierra Yoyo Desan (SYD) Road is a gravel resource road which, though open to the public, is almost entirely used by industry to access oil and gas fields in northeastern British Columbia. It runs through challenging and rugged terrain—mostly muskeg of poorly drained peat bogs and stunted trees—and in a climate featuring extreme winter conditions.

The road was originally built piecemeal, with different sections constructed, owned and operated separately by oil and gas companies, the Ministry of Transportation (MoT) or Ministry of Energy and Mines (MEM). To travel along the road required negotiating separate agreements with each of the owners. Furthermore, heavy equipment could only be moved when the ground was frozen—thus limiting drilling activity to the winter months. Without improvements or regular maintenance, the road condition deteriorated under its use by heavy equipment in adverse conditions, and was often unusable.

Between 1998 and 2003 a government/industry partnership was created to coordinate minor upgrades and road maintenance. All road sections were acquired by the British Columbia Transportation Financing Authority (BCTFA). Responsibility for maintenance was contracted out and financed through a system of fees (including levies) collected from the users of the road.

Drilling activity during this five-year period increased dramatically from about 50 to 400 wells per year and, in some ways, the road became the victim of its own success. Increased activity on a road not built for that volume caused further deterioration. Traffic was constrained by a deteriorating surface, inadequate bridge crossings, and unsafe road alignments.

Oil and Gas Development Strategy

In 2003, the BC Government announced its Oil and Gas Development Strategy to promote the development of the province's oil and gas resources and to capitalize on the oil and gas boom. Two components of the strategy that were relevant to this project were: better access to resources through improved road infrastructure; and the appropriation of royalty tax credits for road infrastructure. The SYD Road, with its access to oil and gas fields over an area of 27,000 square kilometres, was identified as an immediate opportunity.

Objectives of the project

To support the Oil and Gas Development Strategy and at the urging of the industrial road users, MEM initiated a project for a major upgrade of the SYD Road. It was hoped that better road conditions would remove impediments for increased use and facilitate all-season oil and gas activities. "It was obvious we had to do

something," said Patrick Smyth, Executive Director of MEM's Business Development Branch. With the initiatives the Province was putting in place and the increased level of activity over the previous five years, "it was evident that there was even more interest by the oil and gas companies in coming and working in BC."

MEM consulted with the road users to identify the upgrades needed. The overall objectives of the work were:

- to improve all-season access to the oil and gas fields in northeastern BC;
- to accommodate the movement of wide and heavy loads; and
- to improve safety by improving sight lines and the quality of the road surface.

In addition, MEM wanted:

- to ensure ongoing operation and maintenance of the road;
- to maintain involvement and support of the road user group;
- to maintain free public access to the road; and
- to respect the interests of the local community and Fort Nelson First Nations.

Description of the Project

The SYD Road

The SYD Road runs east and north of Fort Nelson. It originally started 15 kilometres from the Alaska Highway, which was accessed via the publicly maintained Clarke Lake Road, and extended 173 kilometres to end close to the South Helmet airstrip. (The connecting road to the Alaska Highway and the small number of private oil and gas roads that feed off the other end of the road were outside the scope of this project.) Local inhabitants include the Fort Nelson First Nations who have a reserve just outside Fort Nelson. The road runs through territory that is part of Treaty 8¹.

Not only was the road in poor condition but it also suffered from a bottleneck over the Fort Nelson River. The Clarke Lake Road crossed the river via a one-lane bridge that is also used as a railroad bridge by BC Rail (now CP Rail). This bottleneck hampered the efficient flow of personnel, equipment and materials to the drilling sites.

The project consisted of four components, two related to designing, building and upgrading the road, and two related to operating and maintaining it during and after the upgrade.

Design-build:

- ▶ bypass the Clarke Lake Road by constructing a new road from the end of Airport Drive (which also connects with the Alaska Highway) and including a new two-lane bridge over the Fort Nelson River; and
- ▶ upgrading the rest of the existing SYD Road from the junction with the new bypass at km. 30.5 to the end of the SYD Road at km. 121, and upgrading all bridges between km. 121 and km. 188.

Operations and maintenance:

- ▶ operating the existing SYD Road prior to completion of the bypass; and
- ▶ operating and maintaining the bypass and SYD Road after being upgraded.

¹ Treaty 8, signed in 1899, governs the relationship between First Nations and the Government of Canada. It covers the areas of Northern Alberta, Northwestern Saskatchewan, Northeastern British Columbia, and the Southwest portion of the Northwest Territories. The lands are home to 39 First Nation communities.

Project Tasks		
Connector to Alaska Highway	Sierra Yoyo Desan Road	
km. 1	km. 8	km. 30.5
km. 188		
<p>via Airport Drive (was via Clarke Lake Road to km. 15)</p>	<p>New bypass</p>	<p>Upgrade existing SYD Road</p>
<p>Connecting portion of the route designed, built and maintained by the BC Ministry of Transportation.</p>	<p>Design, construct and commission a new bypass road and bridge from km. 8 to km. 30.5:</p> <ul style="list-style-type: none"> ▶ a new road on the west side of the Fort Nelson River ▶ a new two-lane bridge over the Fort Nelson River ▶ a new road on the east side of the river which connects to the existing SYD Road 	<p>Upgrade the existing SYD Road from km. 30.5 to km. 188, including:</p> <ul style="list-style-type: none"> ▶ widen to a consistent width of 8 metres between km. 20.5 and km.121 ▶ strengthen to support 70-75% of the legal axle loads in spring conditions ▶ replace Snake River Bridge and two PetroCanas Bridges ▶ improve curves ▶ upgrade existing bridges between km. 121 and km. 188 ▶ construct two pull-out locations that can accommodate ICBC Portable Weigh Scales
<p>Operate, maintain and manage SYD Road for 16 years.</p>		

Participants

The participants directly involved in the public-private partnership were:

- BC's Ministry of Energy and Mines; and
- Ledcor Projects Inc., a division of Ledcor Group, which is a BC-based organization with extensive experience in constructing roads in the north. Ledcor Group created a special purpose company for the project, SYD Road Limited Partnership.

The public-private partnership, however, is supported by other stakeholders, including:

- British Columbia Transportation Financing Authority (BCFTA), which is a provincial Crown corporation established in 1993 through the *Build BC Act*. The BCFTA holds provincial highway assets and related lands, and finances investments in transportation infrastructure.
- Road users. There are 40-50 companies that use the SYD Road, most of them from the oil and gas industry, and each is required by regulation to pay road user fees to MEM.

SYD Road Users as of November 2003

Advantage Oil & Gas Ltd	EnCana Oil & Gas Co. Ltd.	Numac Energy
Anadarko Canada Corporation	ENCO Gas, Ltd.	Pan Oil Resources Ltd.
Apache Canada Ltd.	EnerMark Inc.	Paramount Resources Ltd.
Bonavista Petroleum Ltd.	Enerplus Energy	Penn West Petroleum Ltd.
Burlington Resources Canada	ExxonMobil Canada	Petro-Canada
Calpine Canada Resources Ltd.	FET Gas Production Ltd.	Pioneer Natural Resources Canada
Canadian Forest Oil Ltd.	High Point Resources Inc.	Provident Energy Ltd.
Canadian Natural Resources Limited	Home Oil Company Limited	Purcell Energy Ltd.
CanNet Resources Inc.	Impact Energy Inc.	Samson Canada Ltd.
Coastal Energy Ltd.	ISH Energy Ltd.	Star Oil & Gas Ltd.
Compton Petroleum Corporation	Kaiser Energy Ltd.	Storm Energy Ltd.
ConocoPhillips Canada Ltd.	Marathon Canada Limited	Suncor Energy Inc.
Devon Canada Corporation	Murphy Oil Company Ltd.	Talisman Energy Inc.
Dorset Exploration Ltd.	NCE Petrofund Corp.	Terragrande Energy Limited

Source: Joint Management Agreement, Schedule 5

Procurement Process

Selecting a P3 approach

Once it became obvious that the SYD Road needed to be improved, as a first step MEM commissioned two engineering studies so it could better understand what would be required. One study assessed the existing condition of the road, its strengths and weaknesses. The second identified three alternative locations where the road could cross the Fort Nelson River.

MEM also retained a business advisor to help analyze different delivery methods and determine the best approach. They concluded that if the road was developed privately, it would have to be as a private petroleum development road which would be the lowest cost to the taxpayer but raised concerns about public access and equity to the other road users. If the road was developed by the public sector, the public interest and access issues would be addressed but, instead, there were concerns about cost and the ability to deliver effectively (since developing a resource road was not MEM's core business), level of risk to the taxpayer and tight timelines.

On the other hand, with a public-private partnership the scope could be controlled by MEM and therefore costs could also be controlled. The expected benefits of delivering the project through a public-private partnership included:

- the work would be carried out by a company with specific expertise in building, operating and maintaining resource roads;
- the private sector would invest its resources in the SYD Road;
- the Province's only financial contribution would be an annual royalty rebate to oil and gas company road users since the private partner would be paid from road user fees;
- most risks would be transferred to the private sector;
- the road would continue to be publicly owned and the public would have free access; and
- the road users could continue to have a role in setting road management priorities.

Analysis of Delivery Options			
Critical Project and Procurement Objectives	Private Sector Delivery	Public Sector Delivery	Final Partnership Agreement
Deliver an improved, safe road with the desired characteristics	■	■	■
Minimize costs to taxpayers	■		■
Minimize risk to taxpayers	■		■
Maintain support from, and effective participation in decision making by, industrial road users			■
Ensure continued free public access to the road		■	■

Source: Partnerships BC, *Project Report: Achieving Value for Money for the Sierra Yoyo Desan Resource Road Upgrade Project*, November 2004.

Selecting a partner

Once MEM and the road users had decided on a public-private partnership, they approached Partnerships BC, a provincial agency created to facilitate public-private partnerships, to help manage the procurement process.

MEM and Partnerships BC conducted a three-step competitive process.

Registration of Interest was issued in June 2003; 21 parties indicated their interest.

Request for Qualifications was issued in July 2003.

- ▶ Five potential proponents formed teams and submitted proposals that demonstrated their experience and capabilities to carry out work to the required specifications.
- ▶ Proposals were evaluated by a team which included members from MEM, the road user group and their business and procurement advisors, as well as Partnerships BC, KPMG and engineering consultant ND Lea. They were supported by legal advisors from Fraser Milner Casgrain LLP.

Timelines

2003	June 27	Registration of Interest issued
	July 18	Request for Qualifications issued
	September 29	Request for Proposals issued
	November 14	Request for Proposals closed
	December 15	Preferred proponent selected
	December 15	Notice to Proceed with construction of Fort Nelson River bridge issued
2004	January – June	Negotiations
	June 17	Final agreement signed

Request for Proposals was issued in September 2003 to a short list of three proponents. Proponents were to be evaluated by the same team on criteria which included determining whether the proposal:

- ▶ met all the mandatory criteria set out in the RFP;
- ▶ could be delivered within the time frame identified by MEM;
- ▶ had the lowest net cost to MEM, adjusted for risk;
- ▶ met the specifications set out in the RFP; and
- ▶ provided the best value for money and was deemed affordable to MEM and the road users.

Ledcor Projects Inc., a division of Ledcor Group, was invited to enter final negotiations in December 2003. Negotiations took place between January and June 2004 and included Ledcor, its lenders (CIT Capital Finance) and legal advisors (Blake Cassels & Graydon LLP) on behalf of the private partner, and MEM, the road users, Partnerships BC, KMPG, ND Lea and legal advisors Fraser Milner Casgrain for the public partner.

The agreement was signed on June 17, 2004.

The P3 agreement

Overall project structure

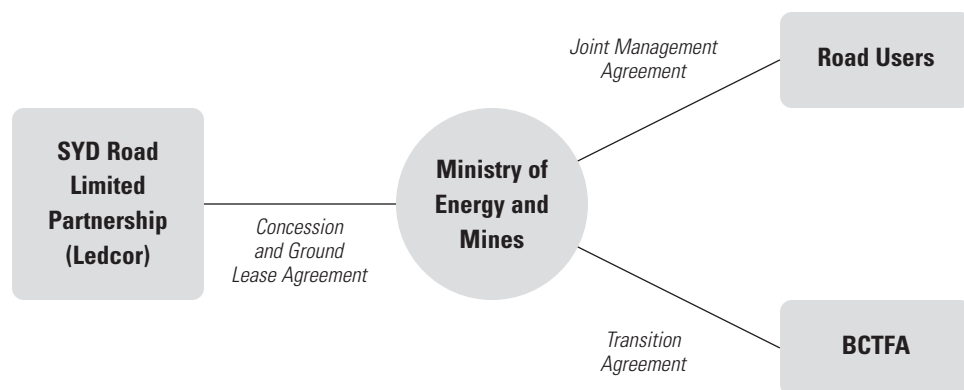
The overall structure of the project is governed by three agreements:

- | Concession and Ground Lease Agreement (the P3 agreement) between Ledcor's special purpose company, SYD Road Limited Partnership, and MEM.
- | SYD Road Joint Management Agreement between MEM and a group of road users.
- | SYD Road Transition Agreement between BCTFA and MEM.

The essential characteristics of the project are the following:

- | Ledcor will finance and construct a new bypass and upgrade of the SYD Road and will maintain and operate it for 16 years.
- | MEM collects user fees from the industrial users of the road and the surrounding SYD Road assessable area, and deposits these monies into a special account managed by BCTFA. There are no charges for use of the road by the public.
- | Ledcor is compensated from the funds in the special account managed by BCTFA.
- | The Province offers the industrial road users a royalty rebate equal to 50% of the fees paid on the SYD Road.

Project Structure



Concession and Ground Lease Agreement

The Concession and Ground Lease Agreement establishes the roles and responsibilities under the public-private partnership². It grants Ledcor the concession to design and construct upgrades to the SYD Road, and to carry out ongoing maintenance for 16 years. The agreement was signed June 17, 2004 by MEM and Ledcor's special purpose company, SYD Road Limited Partnership.

Key provisions in the Concession and Ground Lease Agreement:

- | **Lease:** MEM has leased the road to Ledcor for 16 years from June 17, 2004 to June 17, 2020. Improvements to the road are the property of Ledcor during the term.
- | **Design-Build-Finance:** In the first two years Ledcor will invest \$40 million to:
 - ▶ design and construct a new bypass from the end of Airport Drive in Fort Nelson to km. 30.5 of the existing SYD Road (to be completed by November 30, 2004); and
 - ▶ widen the remainder of the road to km. 121 to 8 metres and improve the road surface to prescribed, consistent standards (to be completed by November 30, 2005)

- | **Operations and Maintenance:** Once the upgrades are complete, Ledcor will operate and maintain the SYD Road for the remainder of the term, to June 17, 2020.

- | **Insurance:** Ledcor must arrange insurance to a prescribed level and coverage in the event of, for example, bridge failure. The actual insurance costs are a direct flow-through cost and paid from the road user fees. The Province has the right to provide insurance.

- | **Standards:** Detailed standards are set out in a schedule. For example, the road must be kept clear of snow and debris and have a good, gravel-covered, free-draining surface capable of carrying industrial traffic at 80 kilometres per hour.

- | **Default and remedies:** In the event Ledcor fails to maintain the road to the specified standards and keep it open, the Province has the right to collect liquidated damages and undertake the required improvements or maintenance at Ledcor's expense. In the extreme, should the performance failure be serious and ongoing, the Province has the right to terminate the agreement.

- | **Termination:** At the end of the term the road reverts to MEM at no cost. Ledcor is required to maintain the road in good condition until that time and return it in good condition.

² The Concession and Ground Lease Agreement and other SYD Road documents are available at the Partnerships BC website: http://www.partnershipsbc.ca/files_2/sierra.html.

Termination prior to end of term: The agreement can be terminated prior to end of term. Depending on the reason for termination prior to the end of the term, various provisions are provided for Ledcor to recoup some or all of the capital it has invested in the project. Early termination may result from one of the following:

- ▶ Ledcor defaults, as noted above;
- ▶ a delay imposed on Ledcor or an event of force majeure keeps the road closed for at least one year; or
- ▶ the Province defaults on its obligations under the agreement or decides for other reasons to terminate it.

To execute the agreement, Ledcor drew on its parent group of companies as well as other firms to assemble a team of partners with whom it would work on the project. These included:

- ▶ Ledcor CMI Ltd. who were subcontractors for the design-build component
- ▶ Ledcor Highway Maintenance Limited who were subcontractors for the operations and maintenance component
- ▶ Buckland & Taylor
- ▶ Peter Kiewit Sons Inc.
- ▶ Kledo Construction
- ▶ McElhanney Consulting Services
- ▶ Trow Associates
- ▶ Triton Environmental Consultants

Joint Management Agreement

Building on the previous government/industry partnership, MEM consulted with the road users throughout the procurement process. While developing the P3 approach, they began to formalize the relationship through an Agreement in Principle, which was initiated by the road user group. This document outlined the commitments by MEM and the road users to the project, including that the road would be financed by the road users through an increase in fees on the SYD Road, and that the Province would contribute to the agreement through a royalty rebate.

Then, while the Concession and Ground Lease Agreement negotiations were taking place, MEM and the road user group expanded the commitments outlined in the Agreement in Principle. The resulting SYD Road Joint Management Agreement (and subsequent SYD Road Amended and Restated Joint Management Agreement) formally expressed the roles and responsibilities of MEM and the road users who signed it.

Participation in the Joint Management Agreement is voluntary and each company opts in with a Step In Agreement. Most of the large industrial road users, representing over 90% of the fees charged, have signed on. Although there was no obligation to opt in, it was important to MEM that most road users supported the project. “We wanted to ensure that the majority of payers signed on,” said Nick Crisp of MEM’s Business Development Branch.

Key elements of the Joint Management Agreement:

- Participants in the Joint Management Agreement form a SYD Road User Committee with one representative from each company and two representatives from the Province. An Executive Committee, comprising four people elected by the Road User Committee and one person nominated by the Province, acts on behalf of the Road User Committee.
- The SYD Road User Committee can make recommendations to MEM on:
 - ▶ system of charges (fees and levies);
 - ▶ management of the Concession and Ground Lease Agreement;
 - ▶ management of funds and investments in the fees and levies special account;
 - ▶ reporting on the SYD Road, system of charges and management of the account;
 - ▶ expenditure of funds from the account;
 - ▶ operation and maintenance of, and improvements to, the SYD Road; and
 - ▶ any other matter incidental to the foregoing or related to the SYD Road.
- SYD Road users agree to pay the fees imposed under the system of charges (as mentioned previously, non-party road users are also required to pay those fees).

Despite these provisions, the Province retains ultimate authority. The Joint Management Agreement states that the Province “will not implement any changes to the system of charges, enter into any contracts or authorize any expenditures from the special account that would place the Province at an unreasonable risk of financial loss.”

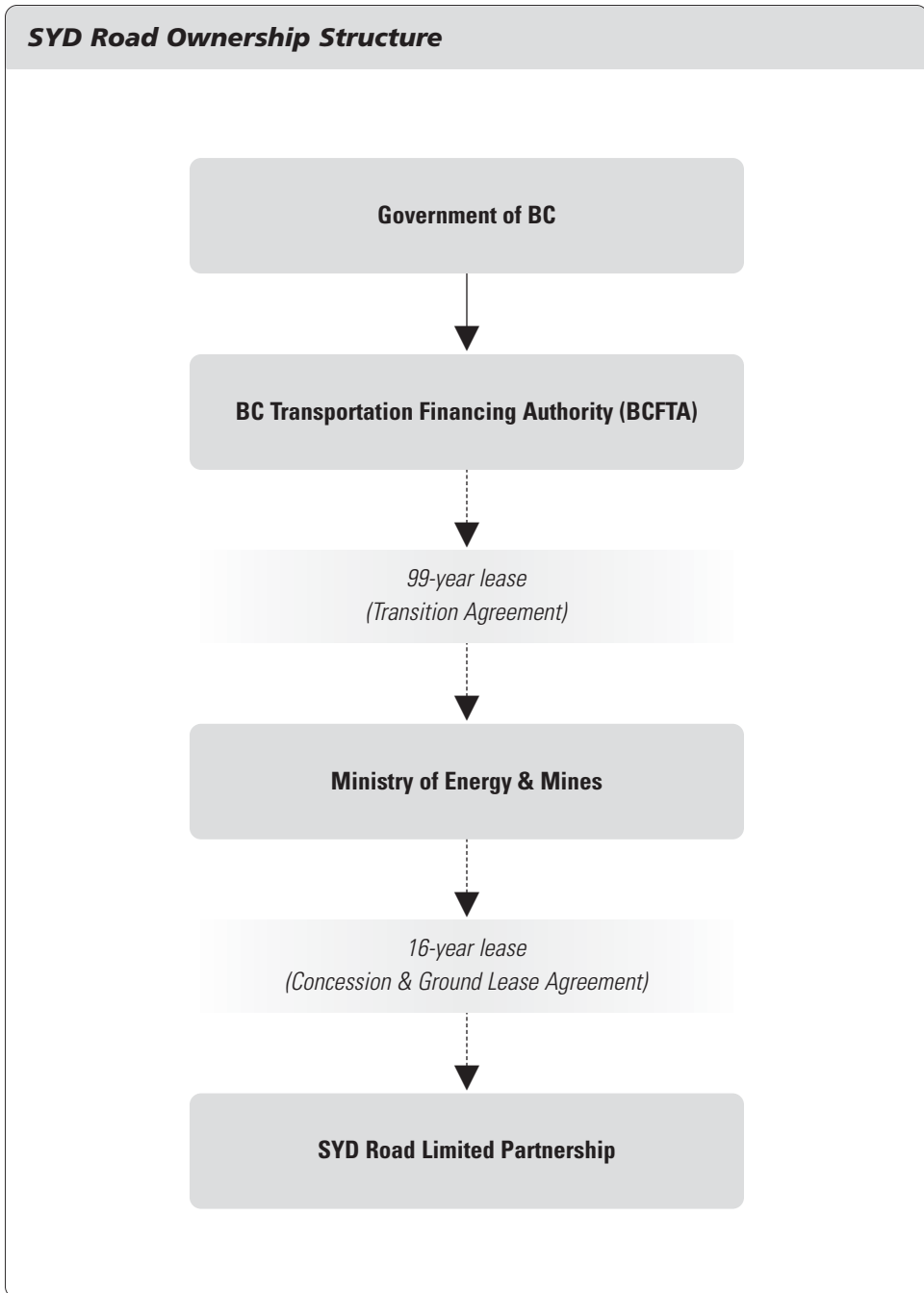
Transition Agreement

The SYD Road is owned by the BC Transportation Financing Authority and had been managed by the Ministry of Transportation. Providing MEM with the necessary authorities for the project was achieved with a lease agreement and legislative transfer of authority. The road continues to be owned by BCTFA.

The SYD Road Transition Agreement between BCTFA and MEM, effective December 1, 2003, sets out that:

- MEM is granted a 99-year lease on the SYD Road;
- when the new bypass is complete, the section of the road that the bypass replaces will be surrendered to BCTFA; and
- fees from the SYD Road users will be administered by MEM but will be deposited in a segregated account that is managed by BCTFA.

In addition, through an Order in Council, the government transferred authority for managing the road from the Ministry of Transportation to MEM, effective December 1, 2003.



Financial investments

Ledcor has provided the capital required to construct, upgrade and maintain the SYD Road. Using debt and equity financing, it has invested \$40 million in the new bypass and upgrades which includes:

- | \$34 million in senior, non-recourse debt arranged by CIT Capital Finance for a term of 14 years. The borrowing is secured by all property related to the project and Ledcor's equity investment. A Lender's Direct Agreement between Ledcor, the lenders and MEM provides the lender with step-in rights in the event of a default by either Ledcor or MEM (for example, if MEM did not collect sufficient monies to pay Ledcor).
- | \$3.8 million in equity from Ledcor through its partnership units in SYD Road Limited Partnership.

According to the terms of the Concession and Ground Lease Agreement, MEM made a lump sum payment to Ledcor of \$6 million from the road user fees collected upon completion of the bridge and bypass. This payment was to reduce the overall private capital requirements, thereby reducing the cost of financing the improvements.

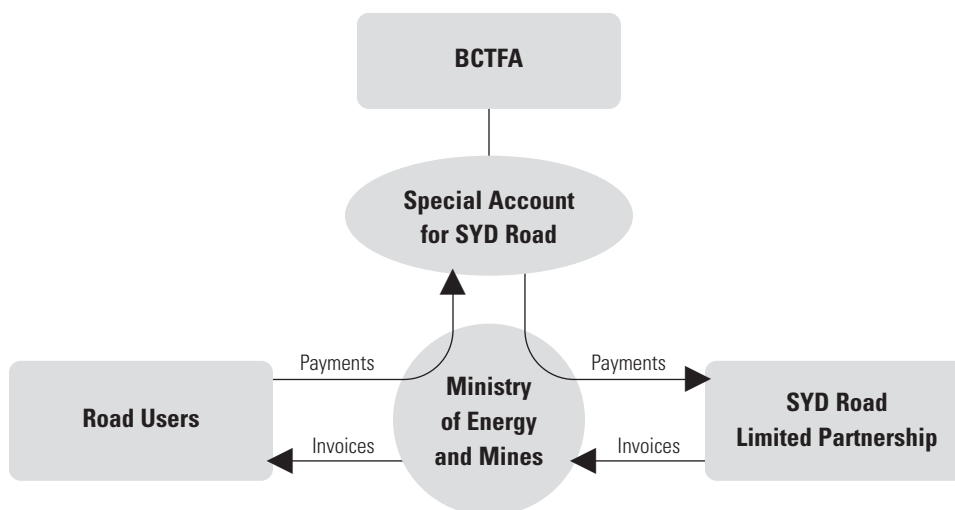
In addition to the capital investment, Ledcor will invest \$2.5 million per year in maintenance.

In total, the present value of Ledcor investments is estimated to be \$60 million.

Cash flow arrangements

In broad terms, Ledcor is compensated from fees collected from the road users by MEM (source of funds) and paid through MEM according to two different schedules for its upgrading and maintenance work (payments).

SYD Road Cash Flow



Road User Categories and Fees in effect 2003-2004

Category of Industrial Activity	Road User Fee
Existing petroleum wells:	
Active	\$1,600 per well (all wells in assessment area showing an "Active" well status on November 20, 2003)
Non-active	\$600 per well (all other wells except abandoned wells)
Drilling Operations:	
Drilling	\$7,900 per well drilled (excl. summer*) \$10,250 per well drilled (summer*)
Drilling rig move	\$23,500 per drilling rig move (excl. summer*) \$30,500 per drilling rig move (summer*)
Compressor moves	\$30,500 per compressor move (excl. summer*) \$39,650 per compressor move (summer*)
Timber hauling	\$0.68 per cubic metre of timber

* Summer is defined as April 1 to November 30

Source: Ministry of Energy and Mines, Business Development Branch, *Information Letter NV2003-12*, December 1, 2003

Source of funds

Ledcor is reimbursed for its upfront project financing and ongoing maintenance entirely through fees collected from the road users. User fees are charged on various types of industrial activity—existing petroleum wells (active and inactive), drilling operations (drilling and rig moves) and compressor moves. A small amount is also paid by forestry companies based on the volume of timber hauled. Each year MEM issues an Information Letter that includes the fee schedule and invoices the industrial companies for their operations in the SYD Road assessment area.

The fees collected are paid into an account held by BCTFA under terms of the Transition Agreement. BCTFA manages the account according to directions it receives from MEM, which bases these directions on its obligations under the Concession and Ground Lease Agreement and recommendations from the SYD Road User Committee. In this way, the road users are able to exercise some influence over the charges levied on the road.

On December 1, 2003 (during the procurement process), most of the fees for 2003-2004 were doubled, as established in the Agreement in Principle with the road users. The impact of the increase on the road users was offset by royalty rebates equal to 50% of those fees. For the Province, the amount of the rebate will be more than offset by the increased royalty revenue that is expected as a result of the road improvements (see Royalty Revenues for more detail).

To meet its obligations to Ledcor, MEM must ensure that the fees collected total at least \$8-9 million per year. It can do this by adjusting the categories and rates of fees each year. If there are excess funds one year the following year's rates may be lower; conversely if there are insufficient funds then the rates for certain categories will increase. MEM sets the fee schedule each year in consultation with the Road User Committee. It is intended that at the end of the term the inflows and outflows of the special account will balance.

Payments

Ledcor is paid under two different schedules:
(a) availability fees for the design-build; and
(b) operation and maintenance fees.

Availability fees are paid to compensate Ledcor for capital, financing and insurance costs during construction and upgrading. Rather than having long-term insurance costs and uncertainties incorporated into the bid price, MEM and the road users decided to compensate Ledcor for its actual insurance costs each year.

- The first tier of availability payments takes effect when the bridge and bypass are complete.
- The second tier takes effect when the upgrades to the rest of SYD Road are complete.
- The fee payments are structured so that Ledcor has an incentive to complete the upgrades and improvements quickly.

Operations and maintenance fees have a base and variable component, both adjusted for inflation:

- Base payment of about \$2.5 million per year. The actual payment is based on performance and adjusted for the year according to actual costs incurred.
 - ▶ If actual annual costs are above \$2.5 million, Ledcor receives 50% of the difference between actual and baseline, up to actual costs of \$3.125 million. Ledcor absorbs the full amount of actual costs over \$3.125 million.
 - ▶ If actual annual costs are less than the \$2.5 million, payment to Ledcor is reduced by 50% of the difference down to \$2.1 million. There are no further payment reductions beyond that point, and Ledcor is entitled to retain the full amount of those additional cost savings.
- A smaller, variable payment is based on the number of rig moves. Monthly payments are based on projections and reconciled at year end. If there are more than 200 rig moves in any one year, or there is a fundamental change in traffic, Ledcor will be paid the actual costs of operating and maintaining the road.

In addition, Ledcor may receive a bonus payment of up to 5% of the two operations and maintenance fees, based on a measure of road user satisfaction. In early 2005 MEM and the Road Users Committee were in the process of determining appropriate measures of performance.

Risk allocation

Ledcor's risks

Most of the project risks have been transferred to Ledcor, particularly construction, financing and operating risk. These risks include

- ▮ design risk, e.g. that the bridges are capable of bearing the appropriate industrial loads
- ▮ construction costs and delay, e.g. increases in cost of materials and labour
- ▮ financing, e.g. potential increases in interest rates
- ▮ operations and maintenance, e.g. keeping the road open during heavy rain, snow or flooding
- ▮ delays from, e.g. environmental permits

In addition, Ledcor assumed the risk associated with starting the work before the agreement was finally signed. With an aggressive timetable that required completion of the bypass by November 30, 2004, MEM issued a Notice to Proceed with the construction of the Fort Nelson River Bridge in December 2003, six months before final close was achieved.

Demand risk

The demand risk associated with volume is shared among the road users and MEM and, for a portion of the operations and maintenance costs, with Ledcor.

The volume of traffic and industrial use of the SYD assessable area plays an important role in the allocation of risk since funds available to pay Ledcor are solely derived from the user fees. In the normal course of events, most of this risk is borne by all the road users.

The risk is increased if the anticipated level of activity does not materialize. MEM, in consultation with the road users, can manage this risk by adjusting the category and level of fees. For example, if drilling activity declines over the term, other activities that are associated with servicing wells at a different stage in the production cycle, such as compression, are likely to increase. In this example, fees for compression moves would be increased to compensate for reduced funds from drilling activity. In the extreme, however, if those oil and gas fields are exhausted before the end of the term and there is very little or no activity, it is MEM who bears the ultimate risk and will have to use provincial funds to pay Ledcor.

In addition, there is some shared demand risk related to operating costs. The payments to Ledcor for operations and maintenance are based on actual costs within maximum and minimum limits. Consequently the risk that actual costs are higher than the maximum is borne by Ledcor. Conversely, if Ledcor meets all the standards and keeps the road open and available at a cost that is lower than the minimum, it keeps the difference between actual costs and the minimum guaranteed payment – the risk of paying Ledcor an additional return is borne by the road users and MEM.

Finally, since insurance costs on the road are flowed through to the road users, they (and MEM) also bear the risk of increases in insurance.

MEM's risks

Apart from being ultimately responsible for paying Ledcor if activity on the road diminishes to unsustainable levels, the Province's risks are generally limited to force majeure events and regulatory changes.

One other risk that MEM assumed is related to First Nations. The SYD Road is located within Treaty 8 territory which provides certain rights to the First Nations. Under Article 19 of the Concession and Ground Lease Agreement, MEM bears the risk of any disputes with First Nations arising from infringement of treaty rights. Under this article, MEM must compensate Ledcor for any damages that may arise from a court determination of infringement of treaty rights.

Risk Allocation			
Type of Risk	Ledcor	Road Users	MEM
Design failure	■		
Construction (budget and timelines)	■		
Financing costs	■		
Operation and maintenance costs related to volume	■ (majority of risk)	■	■ (minority of risk)
Traffic volume (revenue)		■	■ (ultimately)
Environmental and permitting requirements	■		
Regulatory change			■
Force majeure (major catastrophic events)	■ (minority of risk)	■ (shared with MEM)	■ (shared with users)

Communications

During the planning stages of the project, Patrick Smyth of MEM led the initial consultations with the residents and Council of Fort Nelson, and with the Fort Nelson First Nations. Once Ledcor was selected, the private partner was also heavily involved in communications. Though maintaining good community relations was required under the Concession and Ground Lease Agreement, Ledcor also understood it needed to have community support or it would risk having any public discord disrupt its schedule and affect costs.

The Concession and Ground Lease Agreement specifies that:

- | Ledcor must maintain good community relations and liaise with persons residing or doing business near the SYD Road for the purpose of minimizing inconveniences resulting from the work.
- | Ledcor will implement the communications plan set out in an attached schedule to maintain good relations with the industrial road users, First Nations, and others with an interest in the SYD Road.

There were no contentious issues as far as the public were concerned, though there were some who wanted a better quality road than was specified in the contract.

Fort Nelson First Nations' concerns included control over access to their traditional territory, increased traffic in front of their reserve, the safety of the road which many of their members would use to work in the oil and gas fields, and what they perceived as a larger environmental footprint. The partners worked with the First Nations to resolve their issues by, for example, using existing roads as far as possible.

Scott Lyons, Senior Vice President at Ledcor, said, "We went the extra mile in terms of what we could commit to the community, to be good corporate citizens." He added, "I would say that on the whole right now everyone is pretty pleased, including Fort Nelson First Nations."

Labour

Maintenance on the road had previously been carried out by a private contractor, not by provincial staff, so there were no labour transitional issues.

The last maintenance contractor had employed two to three full time maintenance workers on the road. When Ledcor took over maintenance, its team had six full time employees. To fill these positions, it advertised in the local paper and with the Fort Nelson First Nations. The team of maintenance workers, including interested employees from the previous contract, was selected from the applicant pool. All the work force including supervisory staff was local.

Benefits

Improved road conditions

Upgrading the SYD Road has resulted in a safer road and reduced driving times.

Improving sightlines, removing hazards such as switchbacks, widening the road in places and adding pull-outs means safer driving conditions. The road is built so drivers can maintain a consistent speed of 80 km per hour.

The new bypass features a two-lane bridge over the Fort Nelson River, replacing the old one-lane bridge which was shared with the railway. Removing this bottleneck will save approximately 20% of the time it takes to reach km. 30.5 from the Alaska Highway, a benefit for both industrial road users and residents.

Construction of the bypass section of the SYD Road was completed in October 2004, two months ahead of schedule and in time for the winter, so the road users have an early benefit.

Enhanced industrial activity

The initial five-year partnership demonstrated the impact of minor road improvements on the level of oil and gas activity in the area served by the SYD Road. During that period the number of wells drilled increased from about 50 wells per year in the mid 1990s to over 400 wells in 2004. The largest relative increase was in summer drilling activity.

It is anticipated that, by removing impediments such as bottlenecks at the Fort Nelson River bridge and seasonal road conditions, the upgraded road and maintained SYD Road will further enhance economic activity in that area. The industrial road users will have:

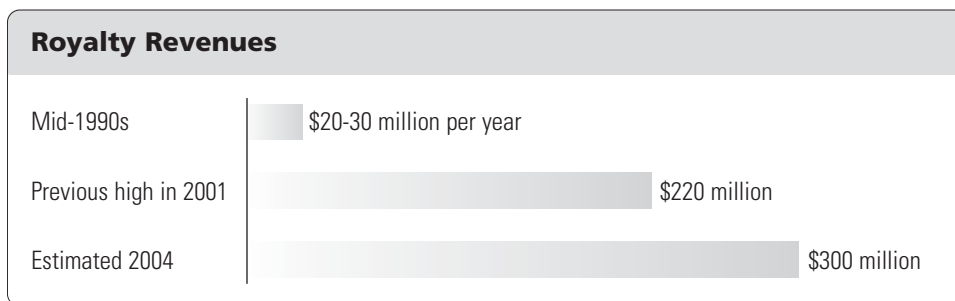
- | multi-season access to the oil and gas fields, avoiding the “pig in a python” activities when drilling is only possible in the winter;
- | safer transportation between the oil and gas fields and the Alaska Highway; and
- | increased oil and gas exploration opportunities.

Expansion of oil and gas activity in the area will also benefit the local community and First Nations since services will be required to support the industrial activity. Fort Nelson can become a staging area in northeastern BC with increased demand for the service sector, local employees will have easier and safer access to their work sites, and First Nations will have better access to employment and business opportunities.

Royalty revenues

The major benefit to MEM is that enhanced industrial activity results in increased royalty revenues to the Province. Royalty revenues have increased tenfold since the mid-1990s and are expected to be \$300 million in 2004. The upgraded road is expected to facilitate a net increase in royalty revenues of approximately \$60 million per year.

Royalty rebates to the road users of approximately \$4.5 million per year are easily offset by expected royalty revenue growth.



Cost savings

No public sector comparator was developed during the procurement phase because resource road development is not part of MEM's core business. Furthermore, no government agency had the mandate for, or experience in developing this type of road for the oil and gas sector. Consequently, a public sector comparator would have incorporated many uncertainties which would reduce its utility.

However, a couple of indicators help demonstrate the project's financial benefits:

- If the road was built to Ministry of Transportation specifications, which would be a higher standard than required by industrial users, it would have cost an estimated \$100 million.
- If the road had not been improved, MEM estimates that the level of foregone revenue would be \$25 million per year.

Applicability to other jurisdictions

This model is unusual with its dual partnership involving (a) private road operator and government, and (b) government and industrial road users. It is the first major public-private partnership to be implemented in BC, and can be used as a template for other projects by Partnerships BC.

The partners have said it has the potential to work wherever "there is a user group with a long-term robust business, a governing entity with a will to facilitate, and a climate that promotes private investment."

In conclusion

This partnership in which the costs are borne by the users is an innovative approach to developing a resource road.

Its most unusual feature is that there is a defined user group that is paying for the improvements. Although the road is a public one, it is almost entirely used by the industrial users so it is very clear who gets the benefit of the upgraded, maintained road. At the same time, there is no direct arrangement between those paying (the road users) and the operator (Ledcor). The arrangement is actually a dual partnership with MEM playing a central role in managing the obligations of all sides.

Having three entities involved in the ongoing management and operation of the SYD Road accentuates the importance of communication and transparency among the parties. "What this does is distribute accountability rather than leaving everything on our shoulders," said Patrick Smyth. "If something goes wrong, we have all participated in this decision and we will all work to overcome it."

The three entities work together in an ongoing informal manner. For example, Ledcor is invited to participate in portions of the SYD Road User Committee meetings to discuss operations and answer questions. With the two different agreements, it is MEM who manages the ongoing dynamic in reconciling the more fluid nature of the Joint Management Agreement with the fixed obligations of the Concession and Ground Lease Agreement.

The other unusual feature of the P3 agreement is that the public sector makes no cash contribution to financing the upgrade or maintenance of the road. It does provide royalty rebates but, if the expected growth in oil and gas activities from improved accessibility materializes, those rebates will be more than offset by the increased royalty revenues.

What makes this agreement work? “Consult, consult, consult,” said Patrick Smyth. He said that the key to making the project work was selecting the right partner and MEM worked hard to get all the information it needed to prepare for the procurement process. “We did invest in doing the diligence and having a thorough procurement process,” said Nick Crisp, “And we picked the right partner.”

From Ledcor’s perspective, the key to success is being able to think like a partner rather than having an adversarial mindset. There has to be give and take on both sides, neither partner can act solely in its own interests. “It almost requires a fiduciary thought process,” said Scott Lyons. And, he added, “the more the public sector can move from prescriptive to performance specifications, the more innovative a contractor can be ... we did well on SYD in moving from a prescriptive to performance-based contract.”

By improving access to the oil and gas fields in northeastern BC, this public-private partnership is good for industry and good for government. As Partnerships BC’s first P3 to close, it also provides a model for Partnerships BC to use with other public-private partnerships.

Testimonials

Public sector

The development and implementation of the Sierra Yoyo Desan Resource Road partnership with Ledcor is the culmination of over four years of planning and hard work by ministry staff and the team of experts that we engaged. In delivering this project, the Ministry of Energy and Mines is able to ensure safe and dedicated year-round access to an area that is rich in oil and gas potential. The road, once upgraded, will result in the generation of increased oil and gas exploration and development activities for the benefit of all British Columbians.

Our goal from the onset was to work with industry and find the solution that met the needs of all stakeholders. This project serves as a good example of how an innovative public-private partnership will create employment and economic opportunities for the province of BC.

Patrick Smyth
Executive Director, Business Development Branch
BC Ministry of Energy and Mines

The Sierra Yoyo Desan resource road project marks an important milestone for British Columbia. As one of the first public-private partnerships to reach financial close and begin construction, this project is an important model for future projects.

Partnerships BC managed the procurement process for this project on behalf of their client, the BC Ministry of Energy and Mines.

The SYD road project would not have been undertaken by either the public or private sectors in isolation. It required an innovative partnership structure, designed and implemented by the Province acting as a catalyst. In this structure, the project will be delivered as a partnership with the upfront costs of final design, financing, construction and maintenance provided by the partner. The Ministry and industrial road users will jointly administer the fees collected from industrial activity within the area serviced by the road. The fees will provide funding to ensure the

private partner is reimbursed for constructing improvements and upgrades, and maintaining the road over the term of the agreement. In addition, significant risks are transferred to the private partner.

I include a quote from [former] Finance Minister Gary Collins: "The SYD road partnership has all the elements of a valuable public-private partnership by benefiting the community and providing a solution to resource companies in the northeast to facilitate expansion and create jobs."

For Partnerships BC, the SYD project is our first completed partnership on behalf of the Government of British Columbia. Partnerships BC is proud to have been part of a project that will benefit BC's oil and gas sector with improved area access, and will benefit all BC taxpayers through increased royalty revenue.

Larry Blain
CEO, Partnerships BC

Private sector

Ledcor's first project, back in 1947, was the building of the access road and well site for Imperial Oil's famous oil discovery, Leduc No. 1. The SYD Road project, therefore, fits nicely into Ledcor's field of work. As a private company with more than 50 years of experience in the design and construction of roads and highways, Ledcor has a keen interest in the future of the transportation infrastructure in the province. In projects such as this one, Ledcor is strongly committed to achieving the efficient delivery of a safe, high quality road while minimizing costs, commitments which are easily recognizable with the SYD Road.

Ledcor is very excited to be a part of this pioneering partnership and is proud to be working so closely with the Ministry of Energy and Mines and Partnerships BC to set a precedent for future projects of this magnitude in British Columbia. As a BC based company, Ledcor has an interest in investing in BC projects and the resulting positive economic effects.

Dave Lede
Chairman and CEO
Ledcor Industries Inc.

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DRIVETEST: ONTARIO DRIVER EXAMINATION SERVICES

2004 Gold Award Winner for Service Delivery



Quick Facts

Project type

Concession

Asset

All driver examination centres
across Ontario

Partners

Ontario Ministry of Transportation

Serco DES Inc.

Other participants

Public sector:

- ▶ PricewaterhouseCoopers Securities Inc. – lead advisor
- ▶ Fasken Martineau LLP – legal advisor
- ▶ BearingPoint (formerly KPMG Consulting Inc.) – fairness auditor

Private sector:

- ▶ Osler, Hoskin and Harcourt LLP – legal advisor
- ▶ Deloitte and Touche Corporate Finance Canada Inc. – financial advisor
- ▶ BMO Nesbitt Burns – debt arranger
- ▶ Davies, Ward, Phillips & Vineberg LLP – lenders' legal counsel

Financing

\$119.5 million in senior secured
amortizing notes

Other features

10 year concession.

Concession fee of \$114 million.

Serco retains user fees, which are fixed
by government.

Almost 100 performance standards.

Overview

New drivers in Ontario are the big winners in this public-private partnership. They no longer have to wait up to 15 months between applying for and taking a road test; the wait time has been reduced to less than six weeks on average and can be as short as one week.

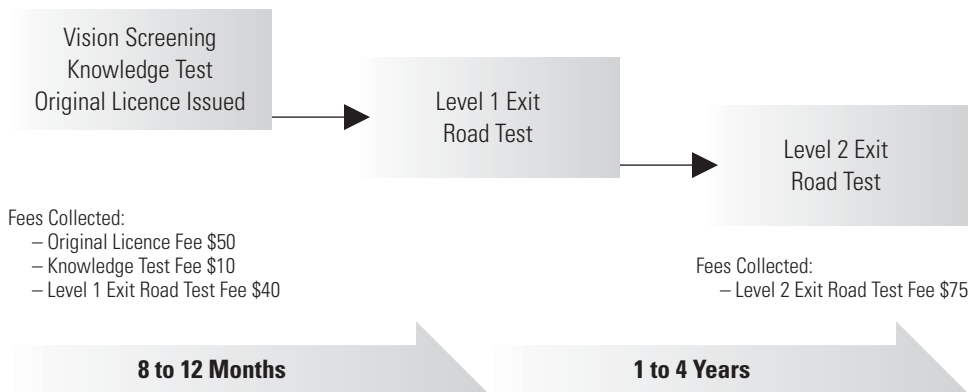
These reduced wait times as well as improvements in overall customer service are the result of private delivery by Serco DES Inc. of driver examination services across Ontario. The Ministry of Transportation (and Ontario's taxpayers) also benefit financially from the partnership, having received an upfront concession fee of \$114 million. The Ministry retains control over examination standards and fees charged.

Background and Rationale

In 1994 the Ontario Ministry of Transportation (MTO) introduced a graduated driver licensing system with the objective of reducing collisions among new drivers and improving road safety. Instead of a single driving test, there would be a more rigorous two-step process that takes about 20 months to complete. New drivers had up to five years to complete the two steps or, failing completion, they had to begin again.

Original Driver Licensing Process

New Driver Applicant



** fees are at the time of transfer*

The new system has been a success in meeting its objectives. However, having a second test effectively doubled the number of driver examinations required and MTO, which ran the driver examination centres, faced significant pressure in service delivery. In 1999 new drivers in certain locations could wait up to 15 months for a test. New driver applicants complained loudly.

MTO received emergency funding to hire more staff and set a target wait time of six weeks, but in early 2000 wait times could still be as much as eight months. There were also no guarantees that the emergency funding would continue. MTO needed to find a way to reduce these wait times and improve the quality of the driver examination experience, and to do so in a manner that maintained the integrity of the driver licensing system and provided value for money.

Description of the Project

Driver examination services are primarily the knowledge, vision and road tests required to obtain a driver’s licence. They are provided across Ontario through 55 driver examination centres,

which operate full-time, and 37 remote service points, which provide services on a less frequent, rotating basis.

Each year the driver examination centres:

- conduct approximately 400,000 vision and knowledge tests;
- conduct 750,000 driving tests; and
- receive 1.5 million visitors.

In addition, a telephone call centre answers enquiries and makes appointments for road tests.

The overall goal of the government was to find a partner that would be responsible for the day-to-day management of driver examination services.

MTO’s specific objectives were:

- to improve customer service levels and enhance consumer safeguards;
- to maintain or improve road user safety;

Key Driver Examination Services	
Conduct vision tests.	Exchange drivers’ licences issued in other jurisdictions.
Conduct knowledge tests.	Issue temporary licences.
Conduct road tests.	License driving instructors.
Process changes to a driver’s licence (e.g. class change, downgrade, reinstate, conditions/endorsements).	Initiate criminal record searches for school bus licences and driving instructor licences.

- to provide a sustainable driver examination program with quality assurance and accountability mechanisms;
- to maintain government control over policy, fees, test processes and quality; and
- to provide demonstrable value to government.

The government was also interested in developing a brand with the private partner, a new look-and-feel to differentiate the new driver examination services. The name selected by MTO was "DriveTest".

Procurement Process

Selecting a P3 approach

MTO undertook a study of three alternative service delivery options with its advisors, PricewaterhouseCoopers. The options were: to continue to provide the service (public sector comparator); to set up a not-for-profit corporation to deliver the service; or to offer a 10-year licence to a private sector provider.

In developing the business case they looked at other jurisdictions and found that the few that had outsourced driver examinations had done so to many independent operators, similar to the way vehicle and driver licences are renewed in Ontario. It decided that maintaining consistency of standards and managing relationships with multiple operators was neither as effective nor as efficient as having a single operator.

It also believed that the private sector would be able to harness efficiencies in delivering driver

examination services. "We thought the private sector would bring a lot more flexibility, ingenuity and delivery competence to what is essentially a commodity-like business," said Ernie Bartucci, MTO's Executive Director - Road User Safety Operations.

The potential benefits that MTO thought a private partner might be able to capture through its capabilities included:

- improved workforce scheduling, productivity and flexibility;
- focused management expertise;
- enhanced queue management; and
- improved information technology.

Based on the analysis, MTO decided that the P3 model offered the best value. The private partner would be responsible for all the key operational roles while MTO would retain responsibility for policy and standards, fees to be charged, key information systems, quality assurance, compliance monitoring and oversight.

Enabling legislation

Delivering driver examination services through a public-private partnership required a legislative delegation of authority.

MTO had the authority to issue a driver's licence to anyone who met the prescribed requirements under Part IV of the *Highway Traffic Act*. The purpose of that Part is to protect the public by ensuring that licences are only granted to those who demonstrate they are likely to drive safely, and that full driving privileges are only granted

after new drivers acquire experience and develop safe driving skills in controlled conditions.

In order to provide a private partner with the authority to conduct driver examination services, the Government introduced enabling legislation, Bill 65: *Improving Customer Service for Road Users Act, 2001*. Under this Act, the Minister of Transportation may delegate the responsibility to deliver all or some of the services of a road user program. Explicitly prohibited, however, is any delegation of the power to make regulations or establish program standards or policies.³

Although it was introduced in May 2001, debate on Bill 65 in the Legislative Assembly was delayed until October. The Act finally came into force on December 14, 2001.

Selecting a partner

Meanwhile, beginning in late 2000, MTO initiated a two-stage competitive selection process to find its private partner.

- Request for Qualifications (RFQ) – issued in November 2000 to prospective bidders who were invited to indicate their qualifications in areas prescribed by MTO as vital to success.
- Confidential Information Memorandum (CIM) – issued in December 2001 (after the enabling legislation was in place) only to those bidders MTO considered as qualified, based on responses to the RFQ.

The CIM included a draft contract which was highly prescriptive in terms of service levels and

the change management structure, and bidders were provided with one opportunity to provide written comments. Following a review of their comments, MTO issued the revised contract in advance of final bid submission. This was the final form of the contract, the Delegation Agreement, and there were no subsequent negotiations on its terms and conditions once the preferred proponent was selected.

The concession—the exclusive right to operate driver examination services across Ontario—was awarded to Serco DES Inc. as the bidder submitting the highest offer who also submitted a business case deemed acceptable to MTO.

Serco Group plc is one of world's largest management services companies. It has more than 25 years of experience in delivering public services, the majority in the United Kingdom and Europe, and it has a highly successful record in structuring and implementing outsourcing and public-private contracts. Serco DES Inc. is the wholly owned subsidiary of Serco that is dedicated to the project; it forms part of the Serco North America division which has more than 2,500 employees in Canada, the U.S. and the Caribbean.

Transparency was an important element in managing the process, not only for the bidders, but also for the public given high-profile concerns about the effect of outsourcing on public safety—concerns that were magnified following the problems with the quality of Walkerton's water supply. MTO had developed an evaluation process and criteria in advance of the final bid submission to ensure fair evaluation was conducted. Also, it

³ *The Improving Customer Service for Road Users Act, 2001* and enabling Regulation 352/03 can be accessed through e-laws at <http://www.e-laws.gov.on.ca>.

retained BearingPoint (formerly KPMG) as fairness auditors to oversee the procurement process and verify that it was both fair and transparent.

In deciding whether to bid on a project, one of the factors Serco looks for is whether there is a level playing field. And it was, said Simon Chapman, Executive Vice President, Serco North America, the process “was transparent, equitable and fair”.

The P3 agreement

Overall framework

As mentioned above, Serco established a special purpose company for the project, Serco DES Inc., whose sole business is the provision of driver examination services in Ontario.

The Delegation Agreement, which was signed by MTO and Serco DES Inc., defines the roles and relationships of the partners and includes detailed

service requirements and implications for non-performance. Overall it establishes that:

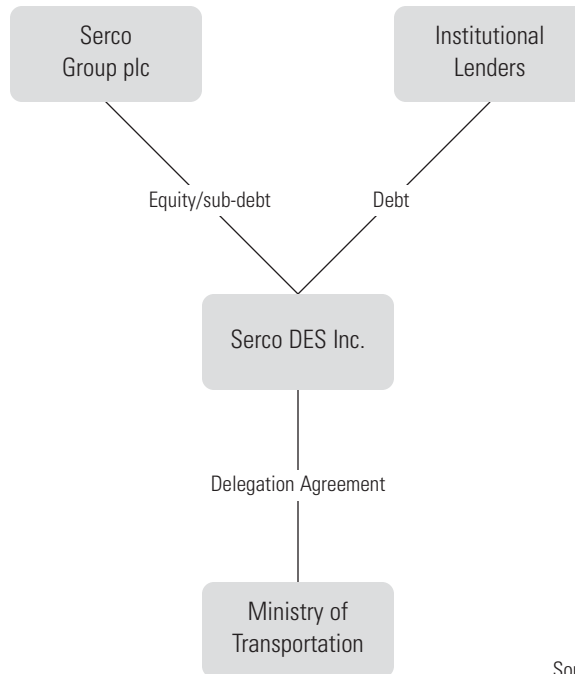
- | Serco is granted the exclusive right to deliver all driver examination services across Ontario and to collect and retain fees for a term of 10 years in return for a one-time concession fee of \$114 million.
- | All testing is to government standards; all fees are fixed.
- | At the end of the 10-year term there is an option to extend the agreement for two years, at MTO’s discretion. In addition, either party can indicate its desire to begin negotiations for a further ten years.

Serco’s activities are guided by Ontario’s regulatory framework including the *Freedom of Information and Privacy Act (Ontario)*—important because Serco collects confidential information—as well as the *French Language Services Act* and the *Ombudsman Act*.

Timelines

2000	November 17	Release of Request for Qualifications
2001	February 15	Close of Request for Qualifications
	May 31	Introduction of Bill 65, <i>Improving Customer Service for Road Users Act, 2001</i>
	December 14	Bill 65 proclaimed
	December 18	Release of Confidential Information Memorandum to qualified bidders
2002	November 12	Close of Confidential Information Memorandum
2003	February 25	Notification of award to Serco
	September 2	Financial close and first day of operations

Corporate Structure



Source: Serco North America

Roles and responsibilities

Serco is responsible for the day-to-day management and operation of Ontario's driver examination services. More specifically, Serco:

- will provide knowledge and driver examinations according to standards and performance levels specified in the Delegation Agreement;
- will assume (by sublease) or replace, as specified in the Delegation Agreement, 55 Driver Examination Centres and 37 remote service points in locations determined by the Government;
- is granted the authority to collect and retain fees for the delivery of specified driver examination services;
- will provide MTO with a concession fee of \$114 million; and
- at the end of the term will hand back all property to MTO in good condition, as specified in the Delegation Agreement.

MTO retains control over all government policies affecting the delivery of driver examination services. It will:

- continue to set road user policies in Ontario over matters that directly and indirectly affect the delivery of driver examination services;
- establish and maintain the legal framework and certain IT systems and data;
- provide for its own quality assurance, monitoring and oversight functions; and
- provide training curriculum to Serco.

Service standards

Service standards formed a critical part of the agreement. The government, and the public, needed to be assured that delegating driver examinations to the private sector did not mean delegating the responsibility for ensuring drivers had the skills and experience to drive safely. Simon Chapman agreed, adding “service standards are a key element – they focus both sides on what is important.”

An overriding provision is that all testing must be conducted according to government standards, policies and procedures, as set out in the Delegation Agreement. Furthermore, MTO approves the road tests, routes to be used, and training personnel and curriculum.

Recognizing their importance, the Delegation Agreement prescribes almost one hundred performance-based service standards. These are generally output- not input-based standards. “We didn’t tell them how many examiners they’d have to have,” said Ernie Bartucci, “that is where they can use their private sector panache.”

Some of the primary performance measures include:

- Wait times – Serco must provide a road test within 42 days (6 weeks) of an applicant coming forward and requesting one anywhere in Ontario.
- Customer service – Serco must provide service over the counter within 20 minutes of a client coming into the driver examination centre.
- Fail rates – Examiners must stay within a prescribed range of pass/fail rates. This provision is intended to prevent Serco from enhancing its revenue by increasing the number of repeat tests required.

Other standards ensure that Serco is consistent with service standards in the public sector over items such as:

- dispute resolution and dispute handling;
- privacy requirements;
- staffing qualifications including criminal reference check; and
- provision of services in French in those communities designated in the *French Language Services Act*.

Access to information systems

As well as having prescriptive performance standards, a significant portion of the integrity of the licensing system rests in the secure capture and storage of accurate driver licensing information. Associated with this is the issue of maintaining the confidentiality of driver information and preventing access by unauthorized people.

MTO had developed its own information systems for driver licensing. Under the Delegation Agreement, Serco was provided with the controlled use of MTO's existing hardware and software; MTO will provide the specified maintenance services on these systems. To ensure confidentiality, MTO spent considerable resources in isolating the parts of the application that Serco could access. In effect, Serco is provided with specific screens that it can use to input data and send to MTO for processing, but has no access to the databases. Serco is solely a conduit for information.

In addition, there are strict confidentiality provisions in the Delegation Agreement. For example, Serco is prohibited from using the information that passes through the centres for commercial purposes such as mailing lists.

Simon Chapman stresses that Serco would not divulge confidential information for ethical reasons alone. The strong contractual and infrastructure provisions reinforce this position.

Quality assurance

Serco must meet or exceed the performance levels set out in the Delegation Agreement, and failure to do so results in deficiency payments and/or a cure plan. Protracted failures run the risk of termination, in which case Serco's investment would be forfeited and its reputation harmed.

MTO had planned to have an independent third party audit Serco's compliance with the performance standards but, with new directions from a change in government, will in fact perform this function in-house. Serco pays \$200,000 per month into a special account to cover this oversight function regardless of who performs the audit.

MTO is taking a two-phase approach to the auditing process.

- Initially, MTO has hired auditors through its internal audit services branch to do audits on its behalf.

- Meanwhile, MTO is hiring its own staff for this function and building a network of staff in the field and head office who will monitor and evaluate performance. This network will replace the hired auditors.

Since all transactions are captured in the driver examination information systems and databases, monitoring tools will largely focus on verifying that transactions are properly transcribed to the database and diagnostic reporting (such as deviation from the pass/fail rate) using data in those information systems. In addition, MTO may use "mystery shoppers" and, if required, the services of a specialized forensic auditor.

Serco DES Inc. – Source of Funds



Financial arrangements

For its investment in this project, Serco DES Inc. raised \$119.5 million by issuing non-recourse, senior secured amortizing notes, and Serco Group plc contributed an additional \$14.1 million in equity and subordinated debt. It was also required to provide a letter of credit to underwrite its performance.

These funds were used to pay the upfront concession fee, closing and transition costs, capital expenditures and debt service reserve fund, and to provide some working capital.

The method by which Serco raised the funds was unusual. Before submitting its bid, Serco held a global funding competition with several financial institutions. It selected the financing proposal of BMO Nesbitt Burns. Standard and Poor’s ratings service assigned the proposed notes an investment grade rating of A-. With no tangible assets, the notes were secured primarily by cash flow to be generated during the term, but also taking into account the reputation of Serco Group plc. Some innovative structured financing techniques ultimately enabled Serco to offer MTO a high concession fee.

“We did introduce some innovation through the funding competition and utilization of structured financing techniques,” said Simon Chapman.

“The funding competition was designed to use competitive tension to solicit the most efficient debt financing proposals, in order to provide the highest possible upfront fee to MTO. We entered into the process with an open mind, and were very pleased with the final financing solution provided by BMO Nesbitt Burns.”

Fees and revenues

Serco receives its DriveTest revenue from several sources: road test fees, a driver’s first licence, and ancillary revenues. The road test and licence fees are estimated to generate approximately \$60 million in annual revenues.

First, Serco can collect and retain all fees related to driver examinations. The fee rates that Serco can retain are fixed in the Delegation Agreement for the 10-year term regardless of inflation or whether the government later raises the actual rates. However, Serco is compensated if it incurs additional costs as a result of actions by the government.

“Under the change management process,” said Ernie Bartucci, “if we change the standard and they incur additional costs, there are mechanisms for us to increase the fee or increase their portion if it’s a shared fee. That is a critical component.”

From the point of view of the public interest, it was important to fix the fee rates since Serco has been granted a monopoly in providing driver examination services. The fees would not, therefore, be subject to competitive pressures.

Secondly, Serco keeps the fee charged a new driver the first time he or she is issued a licence. The fees for subsequent licence renewals are retained by MTO.

Finally, Serco is provided with the opportunity to generate ancillary revenue from the sale of certain other products and services in accordance with provisions in the Delegation Agreement.

DriveTest Fixed Fees	
Knowledge test	\$10
Original licence fee*	\$50
First road test (G1)	\$40
Second road test (G2)	\$75

*at the time of transfer

Risk allocation

A major risk for MTO is that the prescribed standards are not met and that road safety is ultimately compromised. It has managed this risk through highly prescriptive performance outcomes.

Other risks retained by MTO are:

- Policy risk – MTO must compensate Serco for changes to policy or to service requirements that result in a higher service delivery cost.
- Political risk – MTO must compensate Serco for termination due to convenience.

Most of the operating risks have been transferred to Serco. It bears the risk of delivery and has significant capital at stake. These risks include:

- Financial – that it can raise the financing, cover costs and debt payments, and earn a return.
- Volume – that the number of examinations and other services may be more or less than expected due to external factors, such as demographic changes as a result of federal immigration policies (the risk of provincial policy changes is borne by MTO – see above).
- Operating – that it can provide the services at the standards required.
- Economic – that inflation does not increase given the fees are fixed and not scheduled to rise during the 10-year term.
- Labour – that it can employ and train suitable and sufficient staff.

Risk Allocation		
Risk	Assumed by MTO	Assumed by Serco
Political	■	
Policy	■	
Financial		■
Volume		■
Operating		■
Economic		■
Labour		■

Communications

There are broad statements in the Delegation Agreement concerning a joint communication plan with the public, both during the transition process and to handle complaints once the handover had taken place. Internal communication with MTO’s employees whose jobs would be affected was critical, too, and is discussed below (see Labour).

Keeping the public informed was handled jointly through press releases and a strategy for answering questions as they arose.

The partners also developed protocols for how to respond to complaints. Since between one-third and one-half of the applicants who take a test do not pass, the complaint level is likely to be high with some applicants blaming their failure on the testing process. In this case, the complaint is forwarded to Serco who investigates and takes whatever steps are necessary.

It was also a requirement of the Delegation Agreement that Serco develop a new brand (“DriveTest”) that would reinvigorate the image of the driver examination centres, project good customer service, and distinguish DriveTest services from other similar services provided by MTO, such as vehicle licensing.

Labour

There were approximately 750 positions in driver examination services at MTO prior to the transition. Almost all staff were members of the Ontario Public Service Employees Union (OPSEU) and a few belonged to the Association of Management, Administrative and Professional Crown Employees of Ontario (AMAPCEO).

Communicating with staff

The unions, particularly OPSEU, were philosophically opposed to the public-private partnership. Under the collective agreements MTO was obligated to disclose intentions to outsource the work. MTO went beyond its contractual obligations (transition options for staff are described below) and kept up an open dialogue with employees during the transaction process. For example, it provided them with:

- information about the process and the impact on affected employees;
- access to trained and skilled advisors to support and educate employees on transition issues such as their collective agreement entitlements, pension matters, and employment insurance benefits; and
- informal fact sheets.

In addition, during transition prior to transfer Serco made presentations to the employees and started introducing them to the Serco culture.

Transition process

The collective agreements for each union, though different, both contained provisions in the event of an outsourcing of the work of their members. The winning proponent had to accommodate these provisions in its bid. In general:

- If an employee chose to opt in, that is to move to the new employer, he or she maintained their seniority and was entitled to at least 85% of the salary they received with MTO.
- If an employee chose to opt out, he or she was entitled to receive an enhanced severance package. They could subsequently apply to work with Serco.

In this situation, all but about 2% of the employees chose to opt out and take the enhanced severance package. Many then immediately applied for employment with Serco. Since driver examiner skills are specialized and few people outside MTO would be qualified to start immediately, many were subsequently hired by Serco. Thus, though few staff were directly transitioned to the new employer, many ended up working with Serco.

Ernie Bartucci was proud of how the staff conducted themselves during the transition. His measure for success was that the transition to a new service provider would happen over a weekend, and no one would notice. And that is what happened. "I cannot tell you enough how proud we were of the professionalism of the staff ... they acted professionally right to the last day they were working for the province."

The driver examination centres are staffed with a mix of full-time and part-time employees in order to meet demand that fluctuates daily, weekly and seasonally. Serco expects to have a lower base staffing level than MTO as a result of factors such as efficiency improvements—for example having the flexibility to move examiners to different centres within a region to meet varying demand levels—and the fact that the additional personnel hired to deal with the backlog will no longer be needed.

While the Serco employees are not initially represented by a union, they have the right to apply for union certification. Meanwhile, they are adapting to the new culture and work environment, and morale has improved.

Results

MTO has achieved its objectives. It has improved customer service and captured financial benefits for Ontario taxpayers. At the same time, it has maintained government control over policy, test standards and quality, and continues to ensure that drivers' capabilities contribute to road safety.

Customer service

Customer service has been significantly improved since Serco began operations in September 2003. Particularly noticeable is the reduction in wait times:

- wait times have been reduced to an average of five weeks and some are less than one week;
- calls to the call centre were down 25% within the first three months;

- hours of service have been expanded in selected locations; and
- 27 DriveTest centers have been refurbished.

The improved customer service has been achieved by reengineering the organizational structure and processes to improve productivity and by leveraging technology—activities that are central to Serco's expertise. The Serco team introduced cultural and other changes through a change management process.

Some of the specific changes Serco has made or is in the process of making include:

- introducing technology that will streamline appointment scheduling and allow applicants to book tests online, replacing examiners' clipboards with handheld computers, and taking advantage of new communications channels such as the Internet and interactive voice response;
- creating a more flexible and responsive organization by allocating examiners to centres where demand is higher, and being open for longer hours in the summer and on Saturdays; and
- introducing overall cultural change by providing employees with more accountability, more decision-making ability and better tools so they have the opportunity to be more effective.

Further improvements are planned such as new communication facilities (posters and flat screen TVs) in the centres for communicating safety and associated messages, and accreditation to ISO 9000 standards.

The partners note that the public appears to have accepted the initiative with the service level improvements already being achieved, and employee professionalism and job satisfaction has improved.

Financial benefits

One of the government's objectives was to ensure that the taxpayer received value from the partnership. The way the agreement was structured, and in particular the financial arrangements that enabled Serco to create, capture and share additional value from the productivity improvements it could bring about, enabled MTO to receive a concession fee of \$114 million. Not only does this capture an enhanced value of driver examination services, but MTO receives the total amount upfront rather than spread out over ten years. This is good value for the taxpayer.

In terms of cost savings, MTO did include a public sector comparator in its business case analysis and had concluded that private sector delivery provided the best value. In addition, by not having to use its resources to plan for and deliver driver examination services, MTO can focus on the delivery of its core public services.

For Serco, it expects to earn a fair return on its investment from revenues from the fees which are expected to be \$60 million per year, or \$600 million over the life of the agreement, as well as any additional benefits from operational efficiencies and other related business it develops.

Applicability to other jurisdictions

This public-private partnership may be the first example of the private delivery of driver examination services across an entire province or jurisdiction. The project demonstrates that it is possible to improve customer service and provide value to the taxpayer (including substantial upfront cash proceeds) without compromising public safety. The business model incorporates high levels of quality assurance and monitoring, was accepted by the capital markets, and provides an allocation of risks that is acceptable to both partners.

The partnership has attracted attention from around the world. Its structure provides a template that can be used not only for driver examination services but for any fee-based public service where public interest and safety are at stake.

In Conclusion

Apart from being the first time that driver testing has been outsourced to a single operator across an entire jurisdiction, the business model of this public-private partnership incorporates several innovative features.

To begin with, it is believed to be the first time in Canada that a government has converted a fee-based service into cash.

Secondly, the agreement enabled Serco to estimate the value of the agreement over 10 years including any improvements it could make, and to pay this total value to MTO as an upfront concession fee. The risk and returns are allocated differently: Serco has assumed the risk of delivery and will earn its return over ten years while MTO receives its value immediately and on a risk free basis.

And supporting these characteristics is the innovative financing. Using structured financing techniques, Serco was able to place investment grade non-recourse debt as a private placement despite having no tangible assets and relying solely on cash flow projections.

Do the partners have any advice? Both emphasize the importance of developing a true partnership. "A genuine partnership ethos must be developed," said Simon Chapman.

Ernie Bartucci believes the key to success was the culture and relationship that was created. "We had an easy time of it in fitting hand to glove with them on the objectives." He added that having the terms of the Delegation Agreement established beforehand meant that, once Serco had been selected, there was no time lag caused by negotiations and the partners could immediately start working together on what had to be done for the handover.

From the private partner's perspective, having well defined objectives for a project together with political commitment and a realistic timetable are vital. In this case, the procurement process was drawn out, given the legislative delays, and ended up taking three years. Engaging bidders in a dialogue before the agreement is finalized provides added scope for innovation to be introduced. And a demonstrated capability by the government to actually implement a public-private partnership is an important factor. This capability is reflected in any previous P3 experience and in the strength of its legal and financial advisors. "It was a strong team in this case," said Simon Chapman.

As the partners have concluded "MTO successfully crafted a transaction which met all of its objectives, including ongoing provision of a key public safety program in a manner that was generally transparent to MTO's customers, and successfully closed a process outsourcing transaction where no developed service provision market existed."

Testimonials

Public sector

It's working like a real partnership should. We're impressed by Serco's professionalism and are already seeing tangible improvements in customer service—it's an excellent showcase for the outsourcing model. What we're doing here has attracted a lot of interest from other governments in North America and elsewhere; we've had delegations visiting from as near as Quebec and as far away as China.

Blake Forrest
Director, Business Services Branch
Road User Safety Division
Ontario Ministry of Transportation

Private sector

The Ontario Driving Examination Services Concession represents an innovative business model developed by the Ontario Ministry of Transportation which was designed to enhance public services as well as create economic value for the taxpayers of Ontario. This design has been matched by the successful execution provided by Serco staff during the first year of operations.

This epitomizes the fulfillment of the key objective of a public-private partnership—to harness the best attributes of the public and private sectors working together to deliver win-win outcomes. This is largely attributed to the authentic partnership ethos developed between MTO and Serco management staff.

Serco believes that MTO has established a global precedent with this transaction, which goes beyond the delivery of driver examination services in the Province of Ontario to provide a new business model that could be utilized for any user-fee based government service in order to achieve enhanced service levels at the same time as achieving value for money.

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**SHOAL CENTRE:
SENIORS RECREATION CENTRE (SIDNEY, BC)**

2004 Gold Award Winner for Infrastructure



Quick Facts

Project type

Design-Build-Finance

Financing

\$10 million construction mortgage.

Mortgage taken out by a securities offering.

Asset

Seniors Recreation Centre and Residences

Other features

Town sold title to airspace over its land.

SCH Group built independent and assisted living residential units above the seniors recreation centre.

Financing contingent on pre-selling all the private units.

Partners

Town of Sidney, British Columbia

SCH Group, as owner of the special purpose (numbered) company

Other participants

Silver Threads Society

Peninsula Community Services

Compass Group of Canada

Vancouver Island Health Authority

British Columbia Housing Authority

Lidstone Young Anderson – legal advisors for the Town of Sidney

Gary Kinar Law Corp – legal advisors for SCH Group

SHOAL Centre Building Components



Overview

Seniors in Sidney, British Columbia, are the main beneficiaries of this public-private partnership. A new building, the SHOAL Centre (Sidney Healthy Options for Active Living), combines a state-of-the-art municipal seniors recreation centre on the first floor with seniors independent and assisted living residences above.

The Town of Sidney needed to greatly expand its seniors recreation centre to accommodate the needs of its growing population of seniors. It accomplished this by providing SCH Group with title to the air space above a proposed new recreation centre. In return, SCH Group built an expanded recreation centre at no direct cost to the Town and developed the remainder of the building to include not only seniors housing but also a commercial kitchen and dining room and space for professional services such as a medical clinic, physiotherapy and massage therapy. The Town retains ownership of the land and recreation centre; the remainder of the building is privately owned.

The SHOAL Centre was built for \$13 million, \$10 million of which was financed through a securities offering and based on pre-selling all the privately-owned space.

Background and Rationale

Sidney is a seaside community located on the Saanich Peninsula, on the east side of Vancouver Island and about 30 km. north of the city of Victoria, British Columbia. It is a popular retirement community; almost one-third of its 12,000 residents are seniors and their numbers are projected to increase dramatically as the Baby Boomers age.

The old seniors recreation centre was in a building of 5,000 sq. ft. and built 25 years ago when Sidney's population was 5,000, less than half its current size. It was owned by the Town of Sidney and leased to Silver Threads, a non-profit organization that ran seniors programs for the community; it was used by up to 600 seniors each day from Sidney and neighbouring North Saanich.

With the more than doubling of the seniors population, the recreation centre was no longer large enough to accommodate the seniors' needs even with the use of additional portables. The Town needed to build a larger recreation centre.

Description of the Project

With little vacant land available and reluctant to go into debt, the Town decided to offer the title to the air space above the land to a developer who, in exchange, would provide the Town with a larger recreation centre. It was interested in exploring options for the airspace that would accommodate a range of seniors housing but did not dictate how this housing should be developed.

The new building has four components:
(see diagram on page 56.)

I Public space:

- ▶ over 20,000 sq. ft. seniors recreation centre and underground parking.

I Private spaces:

- ▶ 25 assisted living units;
- ▶ 54 independent living units; and
- ▶ commercial kitchen and professional space, for activities such as a medical clinic or physiotherapy.

Procurement Process

Deciding on a P3 approach

The Town knew that it would have to borrow funds if the municipality was to finance the construction of a new recreation centre. Borrowing not only meant going into debt, but also would require a referendum. It was by no means certain that the citizens would approve as they were typically reluctant to go into debt, even with the large seniors population who would benefit. Also, debt financing would result in a 3% increase in taxes, approximately \$200,000 per year.

Instead, the Town decided to seek a private partner. It would offer title to air space above the recreation centre and in return the developer:

I had to provide a new recreation centre at no cost to the Town over and above the value of the air space; and

I could develop the air space above as they wished but with the expectation it would include seniors housing.

Selecting a partner

The Town issued a proposal call in February 2000 through the media and by word of mouth that invited proposals for “a public-private partnership so that new seniors’ facilities may be constructed in exchange for air space development rights above.”

It received three bids which were evaluated by staff and Council. The proposal by SCH Group to develop an aging-in-place community with the seniors recreation centre was attractive, and it was selected as the successful proponent in May 2000.

The winning proposal by SCH Group was for a building that incorporated independent and assisted living units for seniors, including round-the-clock home support services, with the recreation centre. The concept outlined by

Timelines

2000	February	Proposal call issued
	May	SCH Group selected as preferred proponent
	June-December	Public hearings
2002	March	Financing arranged and agreement signed
2004	September	Building completed

SCH Group was based on the belief that seniors are healthier if they can remain as independent as possible and have opportunities to participate in social interactions, such as conversation, entertainment, recreation, and exercise. The new building would both serve the recreational needs of the broader community and enable the seniors living there to be integrated into that community.

SCH Group has been working with projects that develop seniors community housing (hence “SCH”) since the mid-1990s. It had been talking with the Town about the benefits of engaging seniors in the community instead of excluding them in stand-alone facilities, and doing so in an affordable manner. The private partner also has significant experience in innovative financing arrangements for these types of real estate transactions.

The P3 agreement

SCH Group set up a special purpose (numbered) company dedicated to the project.

The negotiations towards the final Agreement of Purchase and Sale were complex, and the structure of the agreement included unusual features that took time to work out. For example:

- ▮ Providing title to the airspace but not the land beneath it meant arranging easements to separate the airspace; it also created complexities around the guarantees needed to register a mortgage on the Town’s land (see Financial arrangements for more on this).
- ▮ Incorporating social and medical services, assisted living, supportive living and independent living in the same building required developing a model that complied with many different pieces of legislation, e.g. separating the delivery of medical services from social and recreational services, legally dividing the building into separate entities (*Canada Health Act, BC Assisted Living Act, BC Strata Property Act, Local Government Act, etc.*)
- After almost two years, the financing arrangements were completed and the agreement between the Town of Sidney and SCH Group’s special purpose company was finally signed in March 2002.
- Overall structure**

The key elements of the Agreement of Purchase and Sale were that:

 - ▮ The Town retains ownership of the land, about 1.2 acres.
 - ▮ SCH Group would design, build and finance a multi-storey building on this land.
 - ▮ The Town would own the ground floor, part of the first floor and basement of the building to be used as a seniors recreation centre including parking.
 - ▮ SCH Group would develop airspace above the first floor to include independent and assisted living units which would be privately held and would be for sale or rent:
 - ▶ 30 of these units had to be for rent-geared-to-income residents;
 - ▶ at least 20 of the independent units had to be sold for fair market value.

- A \$10 million construction mortgage was registered to the Town's land and guaranteed through a securities offering in which all units were presold before construction began (see Financial arrangements below).
- The value of the recreation centre had to equal the value of the air space since, under provincial legislation (*Local Government Act*), the Town is prohibited from providing financial assistance.

Physically, the centre is one building, between two and four floors high, and legally divided according to B.C.'s *Strata Property Act*. The Town owns the land, recreation centre, parking spaces and a portion of the exterior of the building. The private spaces comprise one strata with three divisions (each division can have separate rules and regulations).

The strata corporation manages the common elements of the building. It also looks after the areas owned by the Town based on a maintenance agreement.

Other stakeholders

Silver Threads was an essential third partner in the project, as the organization that could provide affordable seniors programs. It is a nonprofit organization that had run senior recreational programs in Sydney for over 30 years, and it has chapters that provide similar services to seniors in other communities.

Recognizing the important role that Silver Threads would play in delivering the recreation centre programs, SCH Group consulted with it over the

course of a year so that the design of the new recreation centre could accommodate Silver Threads' requirements as much as possible.

The recreation centre is leased to Silver Threads. The Town provides Silver Threads with an operating grant (estimated to be \$75,000 in the first year) to cover expenses so it can operate the centre at no cost. The Town, in turn, bills the neighbouring District of North Saanich for a proportionate share of the cost of the grant (approximately 25% of users are from North Saanich).

The structure of the new arrangement deliberately provides Silver Threads with the opportunity to generate revenue. Silver Threads actually owns the commercial kitchen (except for a small ownership by the Town) and leases that to Compass Group, a foodservice corporation. Also, included in its leased space is 4,000 sq. ft. that Silver Threads can rent to professional service providers such as physiotherapists. The rental period for the professional space is flexible—it can be on an hourly, daily, weekly or monthly basis—and this flexibility allows the professional to select the service package they require. It is hoped that the proceeds of these business arrangements will remove, or at least reduce, the need for an operating grant from the Town.

Patrick Lenihan, President of SCH Group, believes these new arrangements for Silver Threads are important. "As a society, we need to give nonprofits the tools to be able to make some of their own money," he said.

Several other partners that had to be in place for the integrated senior's building to function were:

- Peninsula Community Services: to provide round-the-clock home support services such as assistance with bathing, meals and housekeeping to residents of the assisted living units.
- Compass Group: to provide meals to the assisted living residents, community restaurant in the recreation centre, and for the Silver Threads Meals on Wheels program.
- BC Housing Authority and Vancouver Island Health Authority: for assessment and subsidy for the assisted living units, and subsidy for some of the independent living units.

Financial arrangements

Financing the construction of the building was complex and required an innovative approach. Traditional financing sources were unfamiliar with a project like this one so the partners had to use nontraditional financing.

SCH Group needed to raise \$10 million in the form of a construction mortgage in addition to the \$2-3 million equity it invested. At issue was the fact that the Town owned the land on which the mortgage would be registered and it did not want to risk going into debt. David Bartley, Sidney's Chief Administrative Officer, said, "Our biggest concern was we went from owning a seniors recreation centre and land with no debt to accepting a risk of \$10 million on our land."

To provide the Town and lenders with financial guarantees, SCH Group pre-sold a securities offering that was designed so it had enough collateral to secure the Town's debt. The securities offering had to be pre-sold before construction could begin.

Within the securities offering SCH Group sold shares in the building to investors, many of whom were local residents or stakeholders. The shares could be converted to a unit within a certain time frame. The offering required predetermining the prices of the units, in other words there could be no subsequent escalation due to cost increases, inflation or overruns.

Each investor had to provide financial guarantees, cash and personal guarantees to pay out once the project was finished. Once the building was complete the construction mortgage was taken out through monies from the securities offering. "We had to have guarantees in place for the Town and the mortgage lenders to refinance the construction mortgage, to have take-out mortgages in place," said Patrick Lenihan.

In summary, the financial process had the following steps:

- \$10 million construction mortgage registered against the land which was owned by Town.
- The lenders and Town required guarantees that SCH Group could refinance the construction mortgage.
- SCH Group put together a securities offering – Offering Memorandum – and sold shares to investors.
- The building was constructed, legally divided (according to *BC Strata Property Act*), and finished.
- Construction mortgage taken out through the securities offering.

On completion, some investors sold their units and others kept them as rental units. The Town had mandated that 20 independent living units had to be sold as a public offering at fair market value as determined by an appraiser selected by the Town. There was such a demand that the selection of purchasers was done on a “draw” basis.

Risk allocation

For the Town, the main risk was the \$10 million mortgage against its land. Its liability was limited to the land—the finance company could not seize other town assets.

The Town managed this risk in several ways:

- It insisted that SCH Group presell all of the units to avoid the risk that, after assuming the \$10 million mortgage, the market for the residential units would drop and the construction mortgage could not be paid off. This was also a requirement of SCH Group itself. (In fact, the opposite happened and the property market continued to rise so investors received a better deal than expected.)

- In the event that SCH Group had failed in any way, the agreement provided for the Town to take over construction itself. “We would not have let the financial institution foreclose on the Town’s property,” said David Bartley, “we’d have stepped into the developer’s shoes.”

- The Town controlled the financial draws; when SCH Group reached a certain point in construction, the building department would verify the level of work was complete, and then authorize the financial company to advance funds.

All other financial and construction risks were allocated to SCH Group. These risks included:

- structuring the financial arrangements given the issues of air space and Town ownership of land;
- preselling the securities offering; and
- accurately pricing the units to cover costs and allow a return since there was no allowance for increased costs.

Risk Allocation		
Risk	Assumed by Town	Assumed by SCH Group
Financing	■	■
Preselling units		■
Pricing		■
Construction		■

SCH Group has had more than 30 years of experience in negotiating these types of arrangements, and used this experience to manage the risks. The company has an extensive and specialized program to predetermine pricing and control costs. For example, all contracts with its subcontractors are turnkey arrangements, and it splits contracts between material and labour. By purchasing materials directly rather than through subcontractors it can control both price and product quality.

In addition to financing and construction risk, SCH Group took upfront risk. It invested \$800,000 during the two years between selection and final agreement in activities such as arranging the securities offering, pricing and preselling the securities offering, and designing the building.

Communications

There was no formal public communications plan. Town staff kept Council briefed and explained the risk involved, and Council accepted the provisions taken to mitigate the risk. The Council meetings were open to the public and press.

Transparency

A key factor in the negotiation process was the need for transparency and in particular to avoid the perception that, without direct payment for the airspace, the Town was entering a “sweetheart” deal with the developer. The partners took several actions to avoid this perception:

- The value of the recreation centre had to equal the value of the air space – this was also a requirement under the *Local Government Act*.

- A group of investors owned the private space not just the developer (SCH Group) as a single owner.

- The units to be sold had to be appraised for fair market value.

Public meetings

The Town had to rezone the land for the project, and held two sets of public hearings to do so.

The first plan, which allowed for more landscaping around the building, involved expanding the site over an adjoining road and going into a rose garden that was beside the Library. At public hearings in June 2000, the partners received several negative comments about the impact on the rose garden. They developed an amended plan which avoided disrupting the garden. Six months later, new rezoning hearings based on the amended plan received no negative comments and the revised plan went ahead.

Silver Threads hosted a public information meeting about the building after which those interested in the residential units put their name on a list. When the building was complete, SCH Group contacted everyone on the list and invited to them to an open house; in other words, the units were not just advertised impersonally in the newspaper.

Labour

No municipal staff were involved so there were no labour transition issues.

Results

Community benefits

The SHOAL Centre was completed in September 2004. The Town's objective for the project—a larger recreation centre—has been realized with a seniors recreation centre that is four times the size of the old one. As well as arts and craft rooms, the recreation centre includes an auditorium, dining room and chapel. Residents of Sidney and North Saanich are offered an extensive range of recreational, educational and fitness programs and services for seniors. Silver Threads runs about 100 programs from the centre.

The new building's mixture of public and private spaces and its accessible design promotes social interaction both through shared facilities within the building and with the broader community. Seniors with powered scooters, for example, can easily move from their home in the centre to the nearby Library. And seniors, friends and family living in the community come into the centre for the recreational programs.

Incorporating a commercial kitchen and professional office space provides further benefits to the community. As well as being close to the Library, the building is conveniently located near other seniors residences so a wide range of people in the neighbourhood can use the dining room or take advantage of professional services such as massage or physiotherapy. The kitchen prepares between 300 and 400 meals each day that are delivered throughout the community by Silver Threads' Meals on Wheels program.

Financial benefits

The Town benefits financially from this public-private partnership in several ways:

- Avoidance of tax increases. For the Town to borrow the money required would have resulted in 3% increase in taxes, or approximately \$200,000 annually.
- Additional tax revenues. The Town expects to receive approximately \$50,000 per year in additional municipal tax revenues assessed on the private portions of the building which did not exist before.
- Increase in asset value. Since the building opened in September 2004, the value of the recreation centre is estimated to have increased by at least 50%, based on assessed value and escalating construction costs; it is estimated to be worth \$3-4 million compared to \$2 million at the beginning of the project.
- Reduced financial support for Silver Threads. It is hoped that with the new structure Silver Threads will be able to generate its own revenue thus reducing or eliminating the need for an operating grant from the Town (currently budgeted at \$75,000).

Construction costs had escalated since the project began but SCH Group avoided these increases since the contractor's bids were fixed. The private partner realized a fair return, and benefited from the increase in property values, as did the other investors.

SHOAL Centre

Seniors recreation centre	<p>Approximately 21,000 sq. ft. used for:</p> <ul style="list-style-type: none"> ▶ games and hobby rooms for woodworking, pottery, lapidary, billiards, cards, crafts ▶ auditorium ▶ computer training facilities ▶ lounge and dining area ▶ chapel ▶ underground parking <p>Operated by Silver Threads:</p> <ul style="list-style-type: none"> ▶ expected to have 1,500 members and between 1,000 and 2,000 daily users; ▶ multi-service centre offering programs that include referral and counselling, community and onsite meals, arts and crafts, recreation, fitness, education, travel programs, and social events
25 assisted living units	<p>Bachelor suites, average 400 sq. ft.</p> <ul style="list-style-type: none"> ▶ personal residence, e.g. own furniture, internal locks, can have overnight visitors ▶ affordable, rent geared to income <p>Home support services</p> <ul style="list-style-type: none"> ▶ housekeeping once a week, 24/7 supervision, provided by Peninsula Community Services ▶ three meals per day delivered by Silver Threads
54 independent living units	<p>1 and 2 bedroom units</p> <ul style="list-style-type: none"> ▶ fully equipped ▶ for sale or rent; includes 5 subsidized units <p>Residents can use home support services if desired.</p>
Professional and commercial space	<p>Commercial kitchen, which is owned by Silver Threads and leased to Compass Group, serves:</p> <ul style="list-style-type: none"> ▶ recreation centre dining room/restaurant ▶ meals for assisted living units ▶ 300-400 meals daily for Silver Thread's Meals on Wheels program. <p>Included in the space is 4,000 sq. ft. of professional office space for services such as a medical clinic, massage therapy or physiotherapy.</p>

Integrated seniors services

Although the Town's primary purpose for the P3 was to provide its growing seniors' population with better recreation facilities, it has realized an additional benefit. Integrating seniors housing and 24/7 home support with the recreation centre, and enabling health and social services to be delivered on-site means that seniors can access the help they need when they need it in a convenient and cost-effective manner.

The partners describe the new building as an "aging-in-place community" or "village within the Town" where seniors can live in a complete community and age on site. It allows a natural progression through the aging process from total independence to significantly assisted. For example, senior citizens in an independent living unit can either cook meals themselves, go to the dining room in the recreation centre, or have meals delivered to their unit. Or they can get professional health assistance in their own home or in the building rather than travelling to a separate medical facility. If necessary, they can move from an independent unit to assisted living within the same building.

Patrick Lenihan believes that having an on-site clinic and round-the-clock care in the same building as seniors housing represents a cost-effective way to deliver government health services. It reduces the need for stand-alone long term care facilities because:

■ on-site home support services enable residents to stay independent as long as possible; and

■ publicly-funded medical care provided to residents on site or in their own home reduces the need for health care to be provided by institutions such as hospitals or long-term care facilities.

With a shortage of long-term care beds across the province and lack of resources for municipalities to build more dedicated facilities, an aging-in-place community such as the SHOAL Centre addresses the needs of those seniors who need support. "We can't afford to put in care facilities, so this process responds to the need to keep people at home," said David Bartley, "and delivering services at home is cheaper than putting in facilities."

Applicability to other jurisdictions

This model of an aging-in-place community can act as a template for long term care services elsewhere. The partners have been approached by the governments of other jurisdictions in British Columbia and elsewhere in Canada who are interested in exploring cost-effective ways of providing long-term care.

There was a long learning curve with this project. "Now we have the documentation and the process is understood," said Patrick Lenihan, "we can probably deliver a similar project in 6-8 months instead of the several years this one took."

In conclusion

The Town started out wanting a larger seniors recreation centre, but ended up with much more. By being open to innovative approaches from the private sector, Sidney has acquired an integrated seniors community at no direct cost to Town.

Key elements in the success of this public-private arrangement were the use of air space and innovative financing arrangements including the requirement that the project be completely presold. Transparency was also important to ensure that the Town was not seen to be subsidizing the developer.

David Bartley said that using air space made the transaction complex as the agreements that followed from that decision were very complicated. "It would be easier to do it based on a normal piece of real estate," he said. An important advantage, however, is that the Town kept ownership of the land.

Patrick Lenihan agrees that it was not easy. "It took a long time to put together a model that was responsive to all the legislation in effect," he said.

He believes this is the first public-private partnership of its kind in North America: a building for seniors housing that promotes social interaction with the community at large, can provide space so health professionals can make house calls, and has people living in their own units and/or assisted by the provincial government. With governments across Canada facing increased demand from seniors for public services, he believes this model offers an effective way to deliver seniors health and social services.

The Town has more than met its objectives. It has gained a recreation centre which not only serves residents but also the needs of the whole community at no cost. And initial feedback from seniors in Sidney has been highly positive.

Testimonials

Public sector

Silver Threads is a not-for-profit society dedicated to providing services to seniors. We have operated this facility in Sidney for over 37 years and look forward to continuing these services in the new facility.

It has become increasingly difficult for non-profit organizations to provide services at a reasonable cost and Silver Thread is no different. While our membership continues to expand, accessing grants and other funds become more problematic every year. This facility provides an incredible opportunity for Silver Threads to generate additional income, helping the organization become self-sufficient and even expand its programming for seniors. Silver Threads plans for expanding the dining and catering services will help us reach self-sufficiency. It is probable that the need for operating subsidies from the Town will decrease.

The new facility approximately doubles the floor space available to cater to our expanding membership. Demographic forecasts of the Sidney area indicate a dramatic continued increase in the number of seniors over the next twenty years. The larger facility will help in our plan for accommodating the future need for increased

seniors programming. The expanded seniors centre has been made possible at no capital cost to Silver Threads. There is little doubt that without the PPP the new facility would not have been built and Silver Threads would have struggled to provide services in inadequate and temporary facilities.

Edie Copland
Executive Director
Silver Threads Service

Private sector

This public-private partnership is unique in design and purpose. Its concept has brought a new focus and meaning to aging in place. By design we have brought the community, professionals, services, housing and entertainment together to support our aging population.

Patrick Lenihan
President
SCH Group

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