

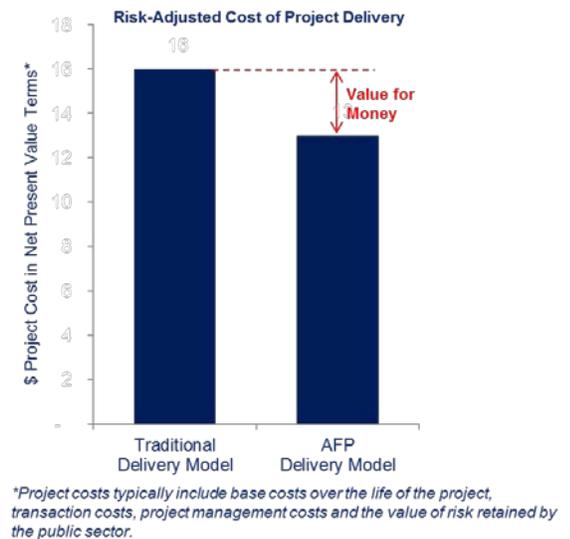
Primer on Ontario Value for Money (“VFM”) Methodology

Background

The infrastructure challenges faced by both developed and developing countries and the task of resolving the existing infrastructure gap is an important current global issue. Governments around the world have adopted public private partnership (“P3”) delivery models as one approach to address these challenges by leveraging the skills and expertise of the private sector by combining the responsibilities of design, construction, financing and/or long-term maintenance in order to deliver public infrastructure projects efficiently. Ontario has demonstrated a renewed focus on investing in public infrastructure, particularly in areas that support economic growth, competitiveness and a high standard of living. Since 2003, Ontario has invested nearly \$100 billion in hospitals, schools and transportation infrastructure in order to achieve those objectives. Today, Ontario is recognized as a global leader, having pioneered the use of Alternative Financing and Procurement (“AFP”), a made-in-Ontario model, to consistently deliver the necessary infrastructure to meet public needs.

What is VFM?

VFM is a project management planning tool that is used to determine the merits of using advanced project delivery techniques, such as AFP, versus more traditional project delivery techniques. Advanced project delivery techniques often involve some element of private financing. Private financing in AFPs aids in achieving the transfer of risk from the government to the private sector for larger, more complex projects. Private financing, however, is typically more expensive than that of the public sector. The key is to determine whether the cost premium associated with private sector financing within the AFP delivery model is at least offset by the value of the risk transferred to the private sector. VFM is a tool that helps governments make this determination by quantifying and comparing the risk-adjusted estimated cost of delivering a project through the traditional delivery model against the cost of delivering the project through an AFP model. Undertaking a VFM assessment is one component of the project evaluation process that identifies whether a project should be delivered through an AFP model or not.



Who uses VFM?

The use of a VFM assessment as part of a P3 project evaluation is common practice globally – a recent study by the OECD found that 19 out of 20 countries surveyed adopt a VFM assessment for proposed P3 projects. Leading jurisdictions around the world, particularly in Canada, have been successful in establishing standard methodologies to guide the application of VFM assessments in support of their decision-making process with respect of P3 infrastructure programs. In Ontario, one of the key principles underpinning projects delivered by Infrastructure Ontario (“IO”) is that the projects must demonstrate VFM. Not all jurisdictions publish their VFM methodologies; Ontario is considered a leader in this regard having published its original VFM methodology in 2007 through IO, as well as multiple project reports presenting the results of their VFM assessment on IO’s website. Deloitte participated in the development of this methodology which was best practice at the time. IO is set to publish an updated methodology shortly that takes into account data and experience gained from its track record in delivering essential infrastructure projects in Ontario.

How accurate is VFM?

The purpose of VFM is to serve as a planning tool and to provide a basis for sound decision-making purposes. VFM results are typically used as confirmation that an AFP delivery model should be pursued and is indeed expected to result in greater value for money to the public. Every VFM assessment contains a large number of assumptions relating to project costs and the likelihood and impact of various project risks under both AFP and traditional project delivery

models. Changing any of these assumptions will change the VFM results. A typical challenge is that comprehensive, comparable data related to historical delivery of projects is not readily available. Recent research from the University of Melbourne found that P3 projects in Australia were 31.5 percent better than traditional projects in terms of on-budget performance and that P3 projects had an average cost escalation post-contract award of 4.3 percent compared to 18 percent for traditionally-delivered projects. The key from an analytical perspective is to use assumptions based on the best available data and the advice of relevant experts in the field where data is not available. This has been the practice followed by IO, which has relied on organizations such as professional cost consultants and quantity surveyors to provide professional advice on the probability and impact of risks under various project delivery models, reflecting the best available industry experience and perspective on infrastructure project delivery. VFM methodologies are constantly evolving to reflect new data and insights. This can also be expected of the Infrastructure Ontario methodology. Like any planning tool, people can always take different positions on the many assumptions that form the basis of VFM. However, the purpose of VFM is not to land on a precise calculation of value but rather to force a disciplined conversation about risk and the merits of managing, mitigating or transferring those risks through different project delivery techniques.

What are the benefits of applying VFM?

One of the most valuable contributions VFM has made to public sector infrastructure project delivery is to better understand and allocate the risks inherent in large complex projects. Good project planning involves a robust assessment of project risks. Unfortunately, for many years, governments seldom embarked on large complex projects with a rigorous understanding of the risks involved and/or a clear plan to manage those risks. Many jurisdictions have learned the hard way through major project cost overruns and schedule delays. Some such as Ontario have responded by adopting modern project delivery techniques that transfer risks to the private sector through appropriate contractual structures. There are obviously costs to doing so, but these costs may be significantly smaller than the costs of bearing those risks. VFM helps governments assess risk and make the appropriate trade-offs between managing those risks themselves and transferring them to the private sector through carefully implemented AFP project delivery methods. The underlying risk allocation principle is commonly expressed as “allocating risk to the party best able to manage it”. VFM also helps deal with the overly simplistic observation that is often made that project delivery methods that involve private financing must, by definition, be more expensive. It facilitates a more comprehensive assessment of costs and risks in order to ensure that the risk-adjusted estimated cost of any infrastructure project is clearly understood and also to recognize when it is advantageous to deliver that project via an AFP delivery model.