Chapter 14
Special Report for the Public Accounts Committee Evergreen and Wackenhut Leases

Contents

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Background

14.1 At the meeting of the Standing Committee on Public Accounts held on 1 April 1997, during the appearance of the Office of the Auditor General, the following motion was adopted by the Committee:

> *That the Auditor General undertake to review the financial terms of the Evergreen and Wackenhut leases and compare the total cost under the private sector arrangements as compared to traditional government methods.*

Evergreen School

14.2 The Evergreen School project (Moncton North School) was announced in March of 1994 as a project that would be developed through a public-private partnership. At that time, an architectural firm retained by the Department of Supply and Services had already started the design of the school.

14.3 In October of 1994, the Department of Supply and Services publicly advertised for expressions of interest in a public-private partnership for the construction of Evergreen. Five submissions were received. The Public-Private Advisory Committee, composed of individuals from the private sector and public sector, reviewed the submissions and recommended to the Minister of Supply and Services that all five developers be requested to submit proposals.

14.4 Proposals were received from the five developers by 7 March 1995 and evaluated by the Public-Private Advisory Committee on 6 April 1995 following interviews with each of the proponents.

14.5 The evaluations resulted in Greenarm Corporation of Fredericton being approved by Cabinet on 18 May 1995 to negotiate a development agreement from which a lease agreement would be finalized.

14.6 Negotiation parameters for the development agreement were as follows:[1]

- fixing the financing costs;
- accepting or rejecting alternatives to fix the final construction cost;
- accepting a lease agreement that equitably shares risks;
- committing the developer to creating a marketing plan that maximizes the revenue generation for after hours use of the facility; and
- fixing the buyout price at the end of the twenty-five year term.

14.7 The agreement with Greenarm was signed on 5 October 1995.

Wackenhut

14.8 The Department of Supply and Services issued, in September 1994, an invitation for expression of interest. This was for the designing, building, maintaining, financing, ownership, leasing back and program delivery for the Miramichi Youth Facility. The expression of interest submissions were evaluated and three proponents were invited to submit proposals. The evaluation of the proposals resulted in Wackenhut Corrections Corporation being chosen as the proponent with whom to negotiate an agreement.

14.9 On 14 June 1995 Board of Management approval was given to the Minister of Supply and Services to negotiate a development agreement with Wackenhut. The initial proposal was changed by a letter dated 6 October 1995 from Wackenhut whereby the program delivery would be deleted from the project.

14.10 A development agreement was negotiated and it included the following documents:

- purchase and sale agreement;
- plans and specifications;
- performance specifications for capital construction of young offender secure custody facility;
- construction schedule;
- lease agreement; and
- industrial benefits agreement.

14.11 The agreement with Wackenhut was signed on 20 June 1996.

Government evaluation process

14.12 The Department of Finance (Department) evaluated the two leases on an equivalent level of service basis. This means that the Province developed a generic model for each project. The generic model assumed that the Province would build, operate and finance each facility itself. It contained the same type of costs that the proponents would have to incur to meet the request for proposal requirements. To make the comparison

1. As per Memorandum to Executive Council

the Province included costs that may not be incremental such as legal, audit and overhead.

14.13 The purpose of the Department's analysis for each project was to determine which alternative would be the cheapest. Would it be cheaper to build, operate and finance by using the generic model, or would it be cheaper to enter into a public-private partnership? The Minister of Supply and Services made the following comment in the Legislature on 30 November 1994 "...the government has indicated that it would only do private-public partnership projects if they turned out to be cheaper, in the long run and in the short run than by building them themselves."

14.14 Further, the Executive Director of Budget Planning and Financial Services for the Department of Finance made some relevant comments at a Commercialization and Privatization conference in Ottawa on 21 and 22 September 1995. At that time he indicated there were a number of key outcomes expected from the two lease agreements and these were as follows:

- 7 – 15 percent saving on design and construction;
- capital financing to private partner very close to government long-term borrowing rate;
- improved level of service;
- major capital repair/replacement risk eliminated;
- increased use of traditional public sector resources;
- off-balance sheet accounting;
- efficient construction time frames; and
- long-term flexibility to government.

Scope

14.15 The Department of Finance, with the assistance of several other departments, prepared an analysis of each leasing project to evaluate the alternatives of leasing and owning. We reviewed the analyses prepared by the Department for the Evergreen and the Wackenhut leases and selected a sample of the components of the analyses for testing. The items chosen were discussed with staff from the Departments of Finance and Supply and Services. Those items that were considered reasonable based on a limited review were not pursued further. The remaining sample items were examined in more detail and we attempted to obtain appropriate evidence to support the information used. In many instances it was not possible to obtain verifiable evidence to support the estimates used by the Department in their analysis. As a result of our work we too made estimates, and where they were different than those used by the Province, we provide explanations.

Results in brief

14.16 Using the Department of Finance's own figures, the capital cost of the Evergreen School would have been $594,576 less had the Province done the work itself. Our adjustments increased the difference to $774,576.

14.17 The Department of Finance calculated operating savings, in the first year of operation of the Evergreen School, of $64,628 by engaging Greenarm. We believe that costs would have been approximately the same under either option.

14.18 We conclude that the total cost of the Evergreen School would have been less under the traditional method than under the private sector arrangement. The Department of Finance has not agreed with most of the adjustments we have made. However, using the Department's own figures, the most economical option would have been to construct and finance the school in the traditional way and contract with Greenarm, or another third party, to be responsible for operations. We estimate that the cost of financing alone is approximately $400,000 more by financing through Greenarm than by the traditional method.

14.19 The Department of Finance estimated a capital cost saving of $708,384 by engaging Wackenhut to construct the Miramichi Youth Facility.

14.20 The Department of Finance estimated operating savings, in the first year of operation, of $19,536 by engaging Wackenhut. Our adjustments have the effect of making Wackenhut more expensive by $51,073 in the first year.

14.21 We conclude that the total cost of the Miramichi Youth Facility would have been less under the traditional method than under the private sector arrangement. The Department of Finance has not agreed with most of the adjustments we have made. However, using the Department's own analysis, the most economical option would have been to have Wackenhut construct and operate the facility and for the Province to be responsible for financing. We estimate the cost to the Province of financing through Wackenhut to be $700,000.

Evergreen School

14.22 We examined the Department's analysis of each project in three parts: capital (construction), operating, and financing. We will discuss our findings under each of these headings and then offer an overall conclusion for each project. The first project that we examined was the Evergreen School.

14.23 The Province developed a generic model for the evaluation. This represented the Province's potential cost of meeting the same request for proposal requirements faced by the proponent. The model was developed from the design plans of the school.

Capital costs

14.24 Exhibit 14.1 compares the capital cost of construction, if the Province had done the work itself, to the costs negotiated with Greenarm. We have made adjustments to reflect what we believe to be a more realistic comparison of the two alternatives.

Exhibit 14.1
Capital cost of construction
Evergreen School

	Government's Generic Model	Greenarm
Land	$ 275,000	$ 275,000
Construction	7,354,835	7,299,018
Equipment	600,000	600,000
Soft costs (professional fees, interim financing, etc.)	1,045,000	1,808,847
Administration fee	50,000	
Issuance cost	63,454	
Total capital costs as determined by Department of Finance	9,388,289	9,982,865
Adjustments as a result of our review		
Construction contingency	(130,000)	
Administration fee	(50,000)	
Total capital costs, as adjusted	**$ 9,208,289**	**$ 9,982,865**

14.25 It is noted that the Province's own analysis indicated that they could construct the school $594,576 cheaper than contracting with Greenarm. Adjustments which we made as a result of our review have the effect of further reducing the estimated cost of construction, had the Province done the work in the traditional way. We will now examine some of the components reported in Exhibit 14.1.

Land

14.26 Land is included in the generic model at a cost of $275,000. This land was already owned by the Province and did not require an additional outlay of cash. The land was transferred to the proponent as part of the lease. The result of this is a sale of the land to Greenarm and a lease of the land back to the Province. The effect of this transaction is to borrow $275,000 at Greenarm's average interest rate of 9.065% and use the proceeds to reduce other government borrowing which would have incurred interest at approximately 8.787%. This is not an economic way to raise capital.

Construction

14.27 The generic model used a construction cost figure of $7,354,835. This amount was determined by using the estimate from the architectural firm of $6,874,712, and adding to that adjustments made by the Department of Supply and Services, based on that Department's experience in building schools. It was not possible to verify these adjustments. We did note, however, that $7,354,835 fell within the range of estimates received from the five proponents.

14.28 The generic model has a construction contingency of $210,000 as part of the construction costs. This contingency was provided in anticipation of there being design changes and other possible costs during construction. The design changes were anticipated due to a school design being used for the first time. Greenarm was constructing the school from the same design and the Province would have been responsible for change orders under the contract with Greenarm. A provision of $80,000 was factored into the Greenarm proposal. We have removed $130,000 of the contingency from the generic model to be consistent with Greenarm.

Administration fee

14.29 The Department of Supply and Services included as part of the capital costs an amount of $50,000 that was to represent the cost of having a departmental employee on site for the construction period. This is not an incremental cost unless the Department of Supply and Services hired a new employee. We believe the Department of Supply and Services already employed this person; therefore this amount would not be an increase to the Province's expenditures and should not have been included in the analysis.

Issuance cost

14.30 In the Province's generic model, the cost of issuing bonds was reflected as an additional cost of financing. Seven basis points were added to the Province's long term borrowing rate and used as the discount rate. To be more comparable to the private sector proposal, an amount of $63,454, approximately $0.70 per hundred dollars of the amount borrowed, could have been added to the capital costs and the discount rate reduced accordingly.

14.31 Including this amount as part of the generic model capital cost allows direct comparison of capital costs under the two models. This is a change in presentation only for the purposes of Exhibit 14.1; the net present value calculation does not change.

Opinion on capital costs

14.32 Exhibit 14.1 presents the capital cost used by the Department of Finance in preparing the analysis to evaluate the most cost-effective way of doing the project. By using the Department's own figures the capital cost would have been $594,576 less had the Province done the work itself. Our adjustments increased the difference to $774,576.

Operating costs

14.33 Exhibit 14.2 compares the operating costs, if the Province had done the work itself, to the costs tendered by Greenarm. We have made adjustments to reflect what we believe to be a more appropriate comparison of the two alternatives.

14.34 It is noted that the Province's analysis indicated that they could not operate the school, meeting the request for proposal requirements, cheaper than contracting with Greenarm. Our adjustments however have the effect of reducing the estimated operating costs to the Province under their generic model to the extent that there is really no material difference between the two options. We will now examine some of the components reported in Exhibit 14.2.

Exhibit 14.2
Annual operating costs
Evergreen School

	Government's Generic Model	**Greenarm**
Utilities and energy	$ 90,000	$ 89,000
Insurance	10,000	6,200
Legal and audit	5,000	
General maintenance and repairs	184,729	118,950
Capital reserve	73,548	15,000
Salaries and benefits	16,014	30,000
Administration	40,000	95,513
Total annual operating costs as determined by Department of Finance	419,291	354,663
Adjustments as a result of our review		
Utilities and energy	(1,000)	
Legal and audit	(5,000)	
General maintenance	(34,697)	
Capital reserve adjustment	(1,800)	
Administration	(25,420)	
Total annual operating costs as adjusted	**$ 351,374**	**$ 354,663**

Utilities and energy

14.35 The comparison of the utilities and energy cost between the generic model and Greenarm's did not use the same figure. The lease agreement states that the Province will pay the actual cost incurred so the amount should be the same in both models. The generic model was overstated by $1,000 per year.

Legal and audit

14.36 Some amounts shown as operating costs in the Province's generic model will likely not represent additional cash outlays. These amounts were included by the Province to meet the request for proposal requirements and in an attempt to make the comparison between the two alternatives valid. We do not believe these will be incremental costs and for this reason we have excluded them.

General maintenance and repairs

14.37 Within the estimated costs for general maintenance and repairs is an amount of $124,697 for cleaning. This amount was calculated by following the terms of the collective agreement with the cleaning staff. The Province however is not required to use that union contract to staff a new school. They have the option to contract out the cleaning similar to what the proponents did in their tender documents. For example, Greenarm factored in a cost of only $60,000 for cleaning as compared to the Province's $124,697. We feel that had the Province built the facility and contracted out the cleaning they could have conservatively obtained a tender of approximately $90,000, based on our review of the bids actually received. Therefore, we reduced the Province's generic model by $34,697 ($124,697- $90,000) to reflect a more realistic figure.

14.38 The lease agreement allows for an increase/decrease in the cleaning and maintenance portion of operating costs for years after the first year (base year). The Province pays any increase, or benefits from any decrease, in subsequent years' costs that exceed the base year's costs. There is a risk in that there is no limit on possible increases. The analysis did factor in an increase of 3% per year for years after year one, in cleaning and maintenance costs.

Capital reserve

14.39 The generic model includes $73,548, as an estimate of the amount that the Province would pay for minor and major repairs over the term of the lease period. This is calculated at 1% of construction cost. The provision of $15,000 under the Greenarm proposal is for minor repairs only. We understand, from the Province, that Greenarm has made adequate provision for major repairs within the administration category of expenditures.

Administration

14.40 The generic model included $40,000 to reflect how much it would cost the Province to open the school after hours for public use. We reviewed the breakdown of this amount and noted that only a portion of the estimate was incremental cost to the Province. A large portion, $25,420, was for overhead and we do not believe it is appropriate to charge such costs to the generic model.

Opinion on operating costs

14.41 Exhibit 14.2 presents the operating costs used by the Department in preparing the analysis to evaluate the most cost effective way of doing the project. We reflect our adjustments on the same exhibit. The Department calculated operating savings, in the first year of operation, of $64,628 by engaging Greenarm. We believe that costs would have been approximately the same under either option.

14.42 The annual operating costs as adjusted in Exhibit 14.2 show a slightly lower cost for the generic model. Exhibit 14.3 considers the whole lease term and shows a lower present value cost for the Greenarm option. This is caused by the Greenarm costs escalating at a rate of 2.5% per year while the generic model costs increase by 3% annually.

Financing issues

14.43 The sections on capital and operating costs examined and compared costs in terms of current day dollars. These costs however will be paid in the future. The capital costs would be paid either by way of principal and interest on bond issues if the Province had proceeded in the traditional way or by lease payments under the public-private partnership arrangement. In order to compare the two alternatives on an equal basis we must look at the present value of the respective cash flows. The Province has an administrative policy, called “Present Value Analysis of Expenditure Decisions”, which we have used as a basis in performing our analysis in this area.

Exhibit 14.3
Total cost summary – Evergreen School
(Summary prepared on a present value basis)

Analysis prepared by Department of Finance	Government's Generic Model	Greenarm	Potential (Cost)/Saving
Capital costs/purchase option	$ 9,324,835	$ 10,188,449	$ (863,614)
Operating cost	5,562,524	4,514,238	1,048,286
Total costs as prepared by Department of Finance	**$ 14,887,359**	**$ 14,702,687**	**$ 184,672**
Analysis as a result of our review	**Government's Generic Model**	**Greenarm**	**Potential (Cost)/Saving**
Capital costs/purchase option	$ 9,144,835	$ 10,188,449	$ (1,043,614)
Operating cost	4,658,213	4,514,238	143,975
Total costs as a result of our review	**$ 13,803,048**	**$ 14,702,687**	**$ (899,639)**

14.44 Exhibit 14.3 presents figures from the present value analysis prepared by the Department of Finance. The exhibit also includes the impact of the differences noted as a result of our work.

14.45 It is noted that on a present value basis the Province, by their calculations, would save $184,672 by entering into the agreement with Greenarm.

14.46 This saving arises as a result of the cash flows for operating costs (as calculated by the Province) being more favourable under the Greenarm alternative. These savings however are substantially reduced as a result of the cash flow related to construction and the fact that Greenarm's average borrowing rate is higher than the Province's borrowing rate. The Greenarm borrowing rate, as calculated under the agreement, and used in the analysis, was 9.065%. The Province of New Brunswick bond rate was set at 8.787%. This difference in rates has cost the Province approximately $400,000.

14.47 Our adjustments have the effect of changing the analysis from a potential present value savings of $184,672, as prepared by the Department, to a potential present value cost of $899,639.

Conclusion on Evergreen School

14.48 We were asked by the Standing Committee on Public Accounts to "compare the private sector arrangements as compared to traditional government methods".

14.49 We have done this by making adjustments to the figures presented by the Department of Finance in their generic model. As a result of these adjustments, we would conclude that the total cost would have been less under the traditional method than under the private sector arrangement. The Department has not agreed with

most of the adjustments we have made. However, using the Department's own figures, the most economical option, as summarized in Exhibit 14.3, would have been to construct and finance the school in the traditional way and contract with Greenarm, or another third party, to be responsible for operations. We estimate that the cost of financing alone is approximately $400,000 more by financing through Greenarm than by the traditional method.

Miramichi Youth Facility

14.50 A generic model was developed by the Province to represent the potential cost of constructing, operating and financing the facility in order to compare with the Wackenhut proposal. In addition, the Province entered into an Industrial Benefits Agreement as part of the Miramichi youth facility project. This agreement had a major impact on the Department's final decision to proceed with Wackenhut.

Capital costs

14.51 Exhibit 14.4 compares the capital cost of construction, if the Province had done the work itself, to the costs negotiated with Wackenhut. According to the analysis performed by the Province there was a saving of $708,384 by proceeding with Wackenhut.

Exhibit 14.4
Capital cost of construction – Wackenhut

	Government's Generic Model	Wackenhut Corrections Negotiated Contract
Land and site preparation	$ 1,475,000	$ 1,355,700
Construction	13,270,945	11,985,300
Soft assets (professional fees, interim financing, etc.)	5,248,452	6,083,142
Furnishing/equipment *	850,000	850,000
Issuance cost	138,129	
Total capital costs as determined by Department of Finance	**$ 20,982,526**	**$ 20,274,142**

* Financed by the Province

Generic model is larger facility than the one constructed by Wackenhut

14.52 We have not made any adjustments in the figures prepared by the Department of Finance with respect to the capital cost of the Wackenhut project. We are concerned however that the generic model was costed on a larger facility than the one designed and constructed by Wackenhut.

14.53 The generic model costs were developed based on program space requirements of 101,568 square feet. The Wackenhut design for the facility was finalized at 96,114 square feet. The Department of Supply and Services informed us that the fact the Wackenhut facility is smaller is a reflection of their success in meeting program requirements in a more efficient way. The analysis performed by the Department of Finance compares the cost of the Province constructing a 101,568 square foot facility to Wackenhut constructing a 96,114 square foot facility. This difference in square footage resulted in the Wackenhut proposal being $1,073,659 less than the generic model.

14.54 Under the traditional approach, the Province would have completed a detailed design before proceeding to construction. Without this input it is difficult to give full credit to the Wackenhut approach, because a detailed design by the Province may have also realized space reduction.

Issuance cost

14.55 In the Province's generic model, the cost of issuing bonds was reflected as an additional cost of financing. Seven basis points were added to the Province's long term borrowing rate and used as the discount rate. To be more comparable to the private sector proposal, an amount of $138,129, approximately $0.70 per hundred dollars of the amount borrowed, could have been added to the capital costs and the discount rate reduced accordingly.

14.56 Including this amount as part of the generic model capital cost allows direct comparison of capital costs under the two models. This is a change in presentation only for the purposes of Exhibit 14.4; the net present value calculation does not change.

Opinion on capital costs

14.57 Exhibit 14.4 presents the capital costs used by the Department of Finance in evaluating the most cost-effective way of doing the project. The Department of Finance estimated a saving of $708,384 by engaging Wackenhut.

Operating costs

14.58 Exhibit 14.5 compares the operating costs, if the Province had done the work itself, to the costs negotiated with Wackenhut. We have made adjustments to reflect what we believe to be a more appropriate comparison of the two alternatives.

14.59 It is noted that the Province's analysis indicated that they could not operate the facility, meeting the request for proposal requirements, cheaper than contracting with Wackenhut. Our adjustments have the effect of reducing the estimated cost of operations, had the Province done the work. We will now examine some of the components reported in Exhibit 14.5.

Provincial overhead

14.60 The amount shown as provincial overhead in the Province's generic model will likely not represent additional cash outlays. This amount was included by the Province to meet the request for proposal requirements and in an attempt to make the comparison between the two alternatives valid.

Exhibit 14.5
Annual operating costs – Wackenhut

	Government's Generic Model	Wackenhut Corrections Negotiated Contract
Maintenance*	$ 75,000	$ 75,000
Grounds*	25,000	25,000
Utilities*	181,000	181,000
Provincial overhead	20,000	
Trust profit (to beneficiary)		10,000
Insurance	20,000	13,464
Capital repairs and maintenance	388,000	385,000
Furnishings and equipment	12,750	12,750
Total annual operating costs as determined by Department of Finance	721,750	702,214
Adjustments as a result of our review		
Provincial overhead	(20,000)	
Capital repairs and maintenance	(50,609)	
Total annual operating costs as adjusted	**$ 651,141**	**$ 702,214**
* Province pays actual		

Capital repairs and maintenance

14.61 This number was developed when it was decided that Wackenhut would not get the program delivery side of the operations. Capital repairs and maintenance is an estimate of expenditures that may be needed for capital repairs and day-to-day operating expenses. The back-up provided for this number is a spreadsheet of Wackenhut numbers. The Province then rationalized, for reasonableness, the cost of the different factors used, to develop the annual cost of $388,000 (which increases by 3% per year). Our review of the costs shows that a management fee of 15% is factored into the amount. This cost, which is calculated at $50,609, would not be incurred if the Province operated the facility.

Opinion on operating costs

14.62 Exhibit 14.5 presents the operating costs used by the Department of Finance in evaluating the most cost-effective way of doing the project. The Department of Finance estimated operating savings, in the first year of operation, of $19,536 by engaging Wackenhut. Our adjustments have the effect of making Wackenhut more expensive by $51,073 in the first year.

Industrial Benefits Agreement

14.63 An Industrial Benefits Agreement was signed as a part of the Miramichi Youth Facility project and as such was factored into the analysis by the Department of Finance. This is an agreement which requires Wackenhut Corrections Canada Inc., the general contractor Maxim Construction Inc. or their project subcontractors, or any other mutually agreed to companies, to create a certain level of employment and to make a significant capital investment in New Brunswick. The Department assigned a value to these undertakings and included them in the analysis supporting the decision to engage Wackenhut.

Employment creation commitment

14.64 The commitment calls for the creation of forty new jobs for New Brunswickers, which are in addition to the direct construction related jobs at the Youth Facility. The additional positions may result from increased employment by Wackenhut or other companies in New Brunswick through expanded business opportunities in New Brunswick. The Department attempted to quantify the benefit to the Province based on the required job creation. To calculate the benefit the Department made an estimate that assumed a benefit over a ten-year period. This benefit calculated on a present value basis is $525,826 and is shown on Exhibit 14.6 as a favourable consideration in supporting the Wackenhut decision.

14.65 We do not accept the Department's calculation in this area for two reasons. In the first instance the Province estimated the benefit on the basis that jobs would be created for a ten-year period, whereas the agreement only covers five years. The second reason is there is no assurance that the jobs will ever materialize, or that any job created could be linked to this agreement. We did note however that the agreement does provide for Wackenhut to make a financial contribution to the Province should any of the forty jobs not be created. Although we considered the value of the "guarantee", we have reservations as to whether it will be realized.

Capital investment commitment

14.66 According to the agreement, Wackenhut and the other companies must invest in New Brunswick at least $2.6 million, by 31 December 2002, to take advantage of expanded business resulting from new industrial opportunities in New Brunswick. The Department assumes that the benefit to the Province is equal to the present value of the $2.6 million capital investment commitment, and for this reason reports $1,721,172 on Exhibit 14.6, as a favourable consideration in supporting the Wackenhut decision.

14.67 At the time of preparing our report no capital investment had been made, nor were we made aware of any plans that will see this commitment fulfilled. Because of this, and the fact that the Province has no protection in the agreement, we did not give any value to this factor. Another concern we had with respect to this matter was the assumption that the financial benefit to the Province would be equal to the amount of the capital investment. The Province would certainly benefit from sales tax and income taxes arising from such a capital investment, but there is no evidence supporting the conclusion that the Province would benefit dollar for dollar.

Financing issues

14.68 Exhibit 14.6 presents figures from the present value analysis prepared by the Department of Finance. The exhibit also includes the impact of the differences noted as a result of our work.

Exhibit 14.6
Total cost summary – Wackenhut

(Summary prepared on a present value basis)

Analysis prepared by Department of Finance	Government's Generic Model	Wackenhut Corrections Negotiated Contract	Potential (Cost)/Saving
Construction and operating costs			
Capital costs/purchase option	$ 20,844,397	$ 20,578,368	$ 266,029
Operating costs	9,553,456	9,264,328	289,128
Total costs as prepared by Department of Finance	30,397,853	29,842,696	555,157
Industrial benefits			
Employment creation commitment		(525,826)	525,826
Capital investment commitment		(1,721,172)	1,721,172
Total value of industrial opportunity benefits as determined by Department of Finance		(2,246,998)	2,246,998
Net costs as prepared by Department of Finance	**$ 30,397,853**	**$ 27,595,698**	**$ 2,802,155**

Analysis as a result of our review	Government's Generic Model	Wackenhut Corrections Negotiated Contract	Potential (Cost)/Saving
Construction and operating costs			
Capital costs/purchase option	$ 20,844,397	$ 20,578,368	$ 266,029
Operating costs	8,593,920	9,264,328	(670,408)
Total costs as a result of our review	**$ 29,438,317**	**$ 29,842,696**	**$ (404,379)**

14.69 It is noted that on a present value basis the Province, by their own calculations and without considering industrial benefits, would save $555,157 by entering into the agreement with Wackenhut.

14.70 This saving arises as a result of the cash flows for operating and capital costs (as calculated by the Province) being more favourable under the Wackenhut alternative. The potential savings however are substantially reduced as a result of the fact that Wackenhut’s average borrowing rate is higher than the Province’s borrowing rate. The Wackenhut borrowing rate, as calculated under the agreement, and used in the analysis, was 8.8% and the Province of New Brunswick bond rate was set at 8.6%. This difference in rates has cost the Province approximately $700,000.

14.71 Our adjustments have the effect of changing the analysis from a potential present value savings of $2,802,155, as calculated by the Department, to a potential present value cost of $404,379.

Conclusion on Wackenhut

14.72 We were asked by the Standing Committee on Public Accounts to “compare the private sector arrangements as compared to traditional government methods”.

14.73 We have done this by making adjustments to the figures presented by the Department of Finance in their generic model. As a result of these adjustments, we would conclude that the total cost would have been less under the traditional method than under the private sector arrangement. The Department has not agreed with most of the adjustments we have made. However, using the Department's own analysis, the most economical option would have been to have Wackenhut construct and operate the facility and for the Province to be responsible for financing. We estimate the cost to the Province of financing through Wackenhut to be $700,000.

Ownership

14.74 In comparing these two private sector arrangements with traditional government methods, we wish to make a further observation. In both cases the Province will pay over 100% of the cost of the land and building, over the lease period, and they do not intend to take ownership. The Province would have ownership under the traditional approach.

Observations from the Department of Finance

14.75 We provided a copy of our findings to the Department of Finance. The following is an extract from their response.

14.76 *The basis upon which the Auditor General has compared the leases (i.e. traditional government methods) is not consistent with the basis upon which government evaluates alternatives and makes final decisions with respect to public-private partnerships (i.e. value for money). The major differences between the Auditor General and the government can be summarized under the following headings:*

- *Total Package Concept*
- *Incremental and Overhead Costs*
- *Industry Practices*
- *Additional Factors*

Total Package Concept

14.77 *'Traditional government methods' as defined by the Auditor General implies that government would have designed, tendered, constructed, financed and operated the facilities under the same terms and conditions which it has historically used in the past. That is, each item is a separate component within the process for the acquisition and operation of an asset and should be evaluated independently. Such an approach does not take into account changing circumstances, objectives, or any intention to improve upon past practices. The Auditor General assumes that the best deal for the public is to evaluate each component separately.*

14.78 *However, the Auditor General does not recognize the rationale or merit of tendering projects on a "total package basis" which promotes the concept that a more economical price can be obtained when the ownership, construction, financing, operations and maintenance are unified under one procurement request and, eventually, one contract. This total package approach recognizes not only the long-term nature of the relationship between the government and the private sector, but also the* *allocation of certain risks to the private sector which will result in value for money to the public.*

Incremental and Overhead Costs

14.79 *The Auditor General has come to the conclusion that the only valid additional costs when comparing the Generic Model to the private sector proposal are those classified as incremental or which result in "additional cash outlay." The Auditor General does not recognize the validity of overhead costs or certain construction/operational costs which may normally be absorbed in the overall administration of government.*

14.80 *All costs provided in the Generic Model reflect the "full cost" to government. Costs which would be incurred or any costs which would be otherwise avoidable have been included. To presume that certain costs can be absorbed in the overall cost of government is untrue. Resources are required to provide these support services and must be quantified.*

Compliance with Industry Practices

14.81 *The general philosophy applied by the New Brunswick government in these evaluations is consistent with accepted practices and advice provided by private sector consultants; and consistent with practices accepted by industry.*

Additional Factors

14.82 *As more experience is gained, government is learning more about two key factors, those being:*

- *risk transfer – identifying all risks that would be retained by the government or transferred to the private sector;*
- *confidence level – quantifying all estimates and risks with a reasonable degree of certainty.*

14.83 *In developing its proposals, the private sector has taken these cost elements into account and quantified them. Reliable evaluation criteria for these two factors had not been developed when these two early projects were being reviewed. However, for later initiatives, the evaluation of these two elements enhanced the savings opportunities for the private sector proposals….*

14.84 *It should be noted that both these projects were among the first public-private partnerships undertaken by this government. The learning curve inherent in the delivery of these projects provides that processes and practices applied are improved as more experience is gained. For instance, current reviews involve significantly more evaluation in the areas of risk transfer and confidence levels. This learning curve is a necessary and evolutionary aspect, both in New Brunswick and across Canada.*