

# **Capital Project Plan Academic Ambulatory Care Centre October 27, 2004**

## **1. Objectives of the Project**

The Academic Ambulatory Care Centre (AACC) is a state-of-the-art health care facility planned for the Vancouver General Hospital (VGH) site at the corner of Oak Street and West 12<sup>th</sup> Avenue. The project is led by the Vancouver Coastal Health Authority (VCH) and will be completed through a design, build, finance and facility management agreement with Access Health Vancouver (AHV), a team of companies selected through an open competitive process.

Scheduled for completion in 2006, the AACC will provide single-site access to a range of outpatient (ambulatory) services along with undergraduate and post-graduate medical education facilities, teaching physician/specialist practice offices and related commercial/retail activities. The 11-storey, 365,000-square-foot facility is expected to support several hundred medical students, approximately 580 medical and allied professionals and an estimated 600,000 patient visits annually.

In doing so, it will meet the following objectives:

- Respond to the growing need for outpatient care in the Vancouver Coastal Health region;
- Support the improvement, expansion and continued accreditation of the academic program at BC's largest teaching hospital, VGH;
- Consolidate a range of health professionals and services from nine locations to a single site, creating one-stop access to ambulatory care;
- Replace aging buildings. Six on the site are slated for demolition;
- Create a safe and easily accessible environment for patients and staff that is flexible enough to meet evolving needs;
- Promote a collaborative environment dedicated to the pursuit of knowledge and best practices in health care service delivery; and
- Minimize costs and risks to taxpayers.

## **1.1 Background and Status**

Planning began in the 1990s to consolidate the hospital's ambulatory teaching functions, specialty clinics and other related services into a single facility. The current configuration of buildings is problematic for patients, health care providers, academics and students as various functions are housed in different buildings. Some are as far as five blocks away from the hospital and many are functionally and/or physically obsolete.

Consolidation is considered essential to improve patient access and support the coordination and integration of health and teaching services – which can improve both efficiency and service quality. It also offers opportunities to realize economies of scale.

The Province approved the business case for the project in July 2002. It considered a range of options for meeting service delivery needs and concluded that significant benefits, including overall value for money, could be achieved by proceeding with the project as a public private partnership.

VCH issued a Request for Expressions of Interest in October 2002, inviting submissions from private sector partners interested in entering a long-term agreement to design, build, finance, operate and maintain the facility. Nine proponents responded; three were short listed and invited to continue in the process. Two proponents committed to continuing and were issued a Request for Proposals (RFP) in June 2003. The RFP closed in October 2003.

Following a detailed evaluation process, Access Health Vancouver was selected as the preferred proponent and VCH announced in June 2004 that it was completing negotiations toward a final agreement. Key commercial terms were concluded in August and final terms, including financial terms, were concluded by September 30, 2004.

AHV applied for, and received, development permits from the City of Vancouver during the summer of 2004. An excavation permit was issued September 29<sup>th</sup> and an official groundbreaking ceremony was held on September 30, 2004.

## **2. Costs and Benefits**

### **2.1 Costs**

#### *Net Present Value cost*

The agreement with AHV, which combines design, financing, construction and facility management, will cost the public sector approximately \$64 million over 32 years in net present value (NPV) terms. This compares favourably to the estimated \$81 million NPV cost of the project if built, owned and operated wholly by the public sector. This represents present value savings to VCH of approximately \$17 million.

The figures above were calculated using a discount rate to represent the cost of capital over time and express the total project cost in 2004 dollars. A discount rate of 7.12 % was used because it most appropriately and reasonably reflected the inherent risks transferred to the private sector. To test this calculation, the project team also compared the final agreement using discount rates 2% higher and 2% lower than 7.12%. Within this range of discount rates, the partnership agreement was found to provide better value and lower cost to taxpayers.

Factors contributing to the present value savings are as follows:

- VCH starts paying for the facility only when construction is completed, protecting the public sector from any added costs during the construction phase;
- Payments will be performance-based and subject to reduction if agreed-upon standards for facility operation and maintenance are not met; and
- Cost savings are achieved by combining design, construction, financing, facility operations and maintenance under one long-term contract.

The agreement also incorporates a life-cycle approach to maintenance, ensuring that the facility is kept in an agreed-upon, market standard condition for the term of the agreement to support the highest standards of service delivery, even as the building ages.

VCH will continue to own the land and the facility. Once the agreement term (30 years) is complete, responsibility for facility operations and maintenance will revert to VCH.

***Capital, operating and maintenance costs***

The capital cost for the project is estimated at \$95 million. This represents a significant savings over the estimated cost of \$103.9 million for the project if it were delivered wholly by the public sector.

Under terms of the partnership agreement, AHV is solely responsible for capital costs, including the cost of financing.

Following construction, VCH will make payments to AHV as follows:

- For space it occupies within the new facility, including space for other health-related organizations, VCH will pay both a base rent and a facility operations and maintenance payment.
- The rent will increase at 2.5% per annum while the facility operations and maintenance payments will reflect a base amount agreed to by the two parties. After year three, if actual costs are above that base, AHV will absorb 60% of the difference, with VCH paying 40%. If actual costs are below the base, AHV will retain 60% of the difference while VCH will receive a rebate of 40%. The two parties will also share any savings achieved through energy efficiency, as well as any savings from future refinancing. This approach to sharing risks and costs provides incentives for both parties to keep the facility fully occupied and operating efficiently.
- For vacant teaching physician office space, VCH will pay a nominal base rent and a facility operations and maintenance payment. This provides incentives for both AHV and VCH to keep the facility fully leased as AHV's capital repayments are exposed to the successful leasing of this space.
- For parking, VCH will pay a base rent plus 20% of any net income it receives from parking above the base. All other net income from parking will be retained by VCH.

Facility operations and maintenance payments for vacant teaching physician space and parking will be based on actual costs. Should rental revenue from non-VCH space exceed agreed-upon thresholds, AHV will pay VCH a percentage of the excess over the agreed threshold.

***Peer review***

An independent peer review of the major terms of the partnership was conducted by Ernst & Young Corporate Finance in April 2004. The review concluded that the agreement represented a reasonable transaction for VCH and the Province, given the level of risk transfer and current market conditions.

## **2.2 Benefits**

In addition to the NPV savings outlined in the section above, the AACC will deliver the following benefits to patients and taxpayers:

- An affordable, state-of-the-art facility to meet the evolving needs of patients and the health care system;
- Continuing control over, and responsibility for, health service delivery by the public sector;
- Integration and co-location of various speciality services, providing one-stop access for patients and a vibrant learning environment for medical students;
- Better “way finding” for patients at the site, many of whom will be frail and/or elderly; the current configuration of buildings often leads to confusion and unnecessary stress; and
- An aesthetically pleasing design which is expected to add to local property values.

Additional benefits realized through the use of the partnership model, as compared to traditional procurement, include:

- A broad competitive process, integrating all elements of building design, construction, facility operation and maintenance for the facility’s full life-cycle; experience has shown that this approach improves overall efficiency and value;
- Assumption by AHV of most of the risks associated with building and running the facility; this protects taxpayers from costs related to problems such as design flaws or delays in construction, should those occur;
- Anticipated lower costs to VCH over the building’s life-cycle, freeing up more resources for patient care;
- Design innovations, generated through the competitive procurement process, that will make the centre one of the most modern and efficient of its kind in North America; for example, academic and clinical functions will be fully integrated;
- Built-in incentives in the partnership agreement that encourage the private partner to complete the facility on time; whereas in traditional procurement, payments are made at pre-determined points in a project’s development, in this case, AHV does not begin receiving payments until the facility is completed;

- Design and construct the facility to an agreed-upon standard for a 50-year life building. This includes built-in incentives that incorporates a life-cycle approach to facility maintenance that will ensure the facility is maintained and operated in an agreed-upon, market standard for the term of the agreement to support the highest standards of service delivery, even as the building ages;
- Protection from rising construction costs as Vancouver prepares to host the Olympics; the private partner's payments are based on projections developed in 2003; with a deal finalized, costs to taxpayers will not change, even if construction costs rise due to factors such as the shortage of skilled workers in the building trades.

### **3. Project Risks**

The major risks associated with the AACC project relate to four areas: financing, construction, facility operation and maintenance. Under the terms of the partnership agreement, each party has agreed to assume the risks that it can manage best at the least cost, as described below. Plans for risk mitigation are also noted.

#### **3.1 Financing**

AHV bears all risks related to project financing, including risks related to possible increases in interest rates. The project will be financed through equity and debt. In total, AHV will invest more than \$100 million. A clause in the partnership agreement ensures that VCH will share in any gains AHV may realize through future refinancing.

#### **3.2 Construction risks – cost, schedule and inflation**

As in any multi-million dollar capital project, there are significant risks related to construction. For example, there may be shortages of skilled labour and/or materials, especially as Vancouver prepares to host the 2010 Olympic Games. This could add to capital costs and/or delay the project's schedule for completion. Inflation is also a factor. For example, the price of steel increased significantly between 2002 and 2004 and may rise further as the project proceeds.

During the construction phase, VCH assumes only those risks related to matters under its control, such as decisions on space allocation. To mitigate these risks, VCH is working to ensure its planning processes meet specific milestones in the agreed-upon construction schedule.

AHV is responsible for most other construction-related risks and has strong incentives for on-time completion, as VCH makes no payments until the facility is ready for occupancy. Furthermore, the payments are based on performance (i.e., contingent on AHV meeting specified standards) and are not related to AHV's capital expenditures.

### **3.3 Operation risks**

The primary risk associated with the facility's operation concerns the potential for vacant office space. Up to 60% of the AACC will be utilized by VCH and the UBC Faculty of Medicine for hospital clinics, related health services and academic space. The remaining 40% will be leased to teaching physicians, health-related service providers, and a small amount of retail space. There is also some risk related to the 600-stall parking lot included in the project.

AHV bears the price and demand (vacancy) risk for the retail space and the price (lease rate risk) on the clinical teaching physician space. VCH retains the price and demand risk on parking and other health-related space (about 47,000 square feet). It shares with AHV the demand risks related to vacancies in clinical and teaching physician space.

VCH accepted these shared risks in return for a reduction in its base rent cost, and participation in the upside potential of parking and lease revenues. It will mitigate these risks by working aggressively with the private partner to ensure that the facility is kept fully leased.

Risks related to inflation during operation, and to operating expense efficiency, are also shared by the public and private sectors. This provides a further incentive for both parties to keep the facility fully leased and operating efficiently.

### **3.4 Maintenance risks**

AHV bears most of the risks around maintenance. Under the partnership agreement, it is required to maintain the facility to agreed-upon market standards for the full 30 years. Performance payments to AHV are subject to reduction for any costs VCH may incur to remedy deficiencies if standards are not met.