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MEMORANDUM

To: **Mike Old**
Communications Director, HEU
From: **Marvin Shaffer**
Date: **October 16, 2015**
Re: **Interior Health Authority Laundry Service**

After reviewing the IHA documents obtained by the media through an access to information request, I have concluded that these documents do not contain any methodologically valid business case or financial analysis that would justify the contracting out of IHA laundry service.

The key documents where the case is made for the contracting out of the laundry service are the February 2010 Decision Brief, where it is recommended to 'test the market' for contracted service, and the October 15, 2010 Discussion Brief, where it is recommended to go forward with requests for proposals.

In the February document, IHA identifies and purports to assess three alternatives:

- the status quo, with some improvements through Lean design and processes and with equipment capital replacement as required (estimated at $450,000 per year)
- testing the market for contracted service to determine if it is likely to deliver cost savings
- developing a new central laundry facility under a P3 arrangement (where the private sector would presumably build and finance the facility, but IHA would continue operations, though the latter is not clear)

Based on some very rough numbers, IHA concluded that developing a new central laundry facility was not feasible. The estimated financing cost of the P3 far exceeded the estimated operating cost saving. The alternatives were therefore reduced to two: contracted service versus the status quo.

In the October document, IHA reports on the results of consultations with potential private sector service providers. It concluded that outsourcing could yield annual cost savings relative to the status quo option and recommended going forward with a request for proposal.

Despite the significance of the change being contemplated, nowhere in either document is a valid financial analysis of the options.

The standard approach for a financial comparison of alternatives with different capital and annual operating expenditure patterns is discounted cash flow analysis.

This requires estimating for each option the annual cash flow expenditures – the facility and equipment capital expenditures in the years they are estimated to be incurred and the annual operating expenditures, escalating with inflation or expected contract provisions.

The analysis would also take into account any revenue offset there may be (e.g. from the sale of equipment or value of freed up space) and the value of assets owned by IHA (e.g. land, useful equipment) at the end of the financial planning period.

These annual cash flows would then be discounted to determine the total net present value cost of the different options. Differences in the net present value costs could then be assessed against differences in risks, impacts on workers and communities and other factors to make an informed and balanced decision.

IHA does not appear to have done this.

- The time pattern and therefore present value of the capital expenditures are not recognized.
- Operating costs are not increased each year in accordance with expected contract provisions or inflationary pressures.
- A financing cost of the P3 central laundry option is provided with no indication of the underlying interest rate assumption (it would appear to be far higher – more than double – actual borrowing rates).
- There is no apparent consideration of the different value of assets IHA would own at the end of the financial planning period under the different options, nor differences in the cost exposure and risks at the end of assumed outsourced contract periods.

In a valid comparison of alternatives, it is also critically important that a consistent set of assumptions and estimates are used. Again, IHA does not appear to have done this.

- The estimated capital cost of an IHA central laundry facility developed under a P3 arrangement was estimated in the February document at approximately $20 million. In the October document where it was recommended to pursue outsourced private sector service providers it was reported that they said they could develop a central laundry facility for $10 million – half as much as an IHA P3. There is no explanation of why there should be such a discrepancy, particularly given that in both cases the facility would be built by the private sector.

Indeed this latter point underlines the fundamental flaw with the entire decision process. It would appear that if the laundry service is outsourced, the private sector service providers would develop a central laundry facility. There are really two basic questions IHA should have addressed in developing a business case for outsourcing.

The first question is whether laundry service could be more efficiently provided through a centralized facility. If the answer to that is yes, the next question is what is the optimum way to develop and operate a new centralized facility. There are at least three alternatives for this:

1. IHA developing the facility with a design-build private sector contract, financed with government borrowing.
2. IHA developing the facility with a P3 design-build-finance arrangement.
3. IHA contracting with a private sector service provider who would build own and operate the new facility.

The present value costs, risks and other implications of these alternatives need to be properly and consistently evaluated in any business case justification of one alternative over the others.