Canadian world series?

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The Highway 407 deal has given rise to a number of preconceptions about the future of the Canadian PPP programme. Not all of them are helpful, however. The Canadian Provincial governments are not allowing themselves to be rushed into a speedy series of bids, in stark contrast to Ireland and Spain, for instance, where getting a solid body of projects out to bid is a priority.

Perhaps the main difference will be the players that shape the developing framework. Whilst the French, Spanish, and to a lesser extent, British construction firms have been capable of putting up equity to support their investments, many of the firms with strong economic and political connections to Canada may have different structures in mind. Competition could resemble the baseball World Series ? nominally global, but essentially a US and Canadian affair.

The two most frequently cited examples of progress in the market are the Nav Canada air traffic control deal and the Highway 407 acquisition and subsequent financing. The two could easily be represented as the main poles of around which the debate will hinge. Nav Canada used a trust structure without equity to provide what was viewed as an essential public service. Its purchase price of C$1.5 billion ($960 million) was met by a $2 billion, RBC-led bond financing, and its AA-rating an low spreads makes it an attractive asset.

Highway 407, on the other hand, was the acquisition of a commuter toll road in Ontario with state-of-the-art collection technology and a healthy user base. The 99-year lease on the road fetched C$3.1 billion (plus another C$900 million for an extension route and debt service), of which C$1.55 billion came direct from the sponsors. The 407 International consortium consisted of SNC Lavalin, Capital d'Amerique and Cintra, all of whom have deep pockets. MacQuarie Infrastructure Group has subsequently bought out Capital's stake, and has also taken a position in Cintra.

But both deals worked outside of any formal PPP programme ? Ontario's launch of its SuperBuild initiative came a few months after the first tranches of 407 bonds came out ? C$1.5 billion in 1999, led by Nesbitt Burns and Salomon Smith Barney. Since that time, 407 has issued C$425 million in subordinated bonds ? a 3.5-year issue of C$220 million led by BMO Nesbitt Burns, RBC Dominion Securities, Casgrain, CIBC World Markets Scotia Capital and National Bank Financial in June 2001 and C$205 million in two year notes through BMO, RBC, Scotia, National and Merrill Lynch Canada.

Progress on further projects, however, has been far slower, whilst the provinces decide how far, and in what shape, they want to proceed with their own programmes. Much of the effort in Ontario goes through the province's SuperBuild Corporation. SuperBuild's much-repeated catchphrase is to assist in the ?strategic allocation of capital?.

One of the furthest advanced large ticket investments is the York Rapid Transit plan, and this has yet to produce any recognisable financing. The mandate for the municipality's ambitious light rail scheme is at stage one, which means that strategic partners are now looking at design and finance feasibility options, without a clear promise of an ultimate concession. Given this low-key mandate, the list of interested bidders produced documents of varying degrees of thoroughness, although a broad spectrum of PPP sponsors expressed an interest.

York has a healthy credit rating (Aaa from Moody's Investors Service), and the ability to take on more debt, so a private debt-financed solution is not inevitable. However, given that the total capital cost of the project will be between C$2.4 billion and C$4.2 billion, the municipality is looking to leverage its resources to the maximum. It may get as much as twothirds of the cost from federal and provincial governments.

The recent stage one winner was a loose consortium of Aecon (Canada's largest constructor), ATC National Express, IBI, Delcan, Siemens, EllisDon, Peter Kiewit, Irisbus and Nord/LB. Funding from the Ontario Government's $1.25 billion Golden Horseshoe Transit Investment Partnership (GTIP) programme is up for grabs. It beat out bids from SNC Lavalin, FastRide (including, among others, Aecon, Alstom, Borealis, Aeon, Connex and Hydro One), a Bombardier/Amec/Mott McDonald group, and TEC (led by Tyco subsidiary Earth Tech).

At the first stage the bid was decided by a mixture of available expertise and suggested fee (this should be in the region of C$10 million to C$20 million). Most of the members of the winning group have strong ties on an individual level and some experience in the management of large projects. RBC is informally on board as a funder, especially should a bond solution present itself, to complement Nord/LB's advisory and lending capabilities.

The main scope of the project is in the creation of two new north-south and east-west rail corridors, and a link with the commuter rail systems of Toronto, onto which the York Region abuts. The project must work within the masterplan (for road and rail) laid out by the municipality. Where the project looks set to create a precedent is with the open-minded attitude taken by all parties to potential financing structures.

One starting point is that it is very difficult to make serious money out of light rail schemes without a hefty subsidy. This is, in turn politically contentious, even where subsidy allocation can be isolated from politically accountable bodies. The prospect of explaining equity-like returns to the private sector on the back of subsidised services (pace Railtrack in the UK) could nudge the consortium in the direction of a trust structure or to offer ancillary opportunities to the private sector for high returns.

The most obvious examples would be the use of rights of way obtained for track to be given over to commercial development. Another solution would be for the eventual sponsors to put in place the trust structure so common in Canada to leverage infrastructure assets. In addition to the available tax advantages, including low cost leasing of rolling stock, it may be possible to reduce the equity commitment of the victorious sponsor group. This would work in favour of North American groups since, as one market observer put it, ?the Europeans are much more prepared to put in hefty equity?.

SuperBuild seems to be more prepared to keep its advisory expertise in-house ? or on long-term retainer. It will have final say on whether York receives the third funding that it is looking for from the government. It also intends to bid out a number of projects itself.

The two most important looming projects are the 407 extension and the Durham Courthouse deal. Both are still awaiting the submission of proposals. Durham involves the rationalising of the myriad local courthouses into one super-facility that will be easier to secure and access. This does not have a capital cost estimate, but could take the form of a real estate deal with little in the way of concession payments expected from Ontario. This depends on what value can be extracted from the old courthouse sites in the region.

The 407 East extension will be a more complex proposition, and again depends on whether the government is prepared to take on construction risk itself. What is clear is that the government will not give the existing 407 concessionaires a free run at the project, despite the obvious synergies between the two sets of work.

There are two assets ? the William Osler and Royal Ottawa hospitals ? where SuperBuild is currently evaluating bids. These will be offered as a design-build-finance-operate concessions, much as a hospital deal in the UK would. Visits to UK facilities have apparently impressed SuperBuild executives.

The final asset that comes within the SuperBuild remit is the sale of a strategic stake in Hydro One. This process has not been going smoothly. In June, the board of directors resigned after an argument over pay, and a new board was appointed 16 August. Public sector unions can point to polls showing that the sale of the asset is opposed by a majority of Ontarians, and the CEO, Charlotte Clitheroe, was fired after what the board of directors called a ?clear breach of fiduciary obligation?. However, BMO Nesbitt Burns and CIBC World Markets are now acting as financial advisors for the sale, with a fee represented as a percentage of the money gained (thought to be less than 0.1%).

Nevertheless, within the larger rail and transport schemes, especially in less well-served areas, trust structures could become very popular. And while few at SuperBuild or its peers have actively examined the options, it would represent one of the best opportunities both to redefine the structures used to finance PPP and for those stingy with equity to come into the game.

British-Columbia partners up

British Columbia is the latest province to begin the PPP process. With a new Liberal government in power, PPP, or P3 as the shorthand goes, has received far more active encouragement. Concrete plans or concessions have yet to emerge, but the UK example's influence is clear. The new advisory body, Partnerships British Columbia, will take on a similar role to PUK. BC's Minister of finance, Gary Collins, spoke to Project Finance about how his vision of PPP will pan out.

Project Finance: What's the main driver behind your PPP programme ? fiscal or political?

Gary Collins: It's about trying to get better value for the money we spend, both in services and in capital projects and we believe that as a government you can't assume that the public sector or the private sector for that matter ? can build capital or provide services more effectively. You've got to go out and look at all the options. We've come in with the policy that says, certainly on the capital side and then within ministries even on the service side, that says how do we get the best value. What is the option in this particular case, and for this particular project and on this particular service that provides the taxpayers with the best service for the least cost.

Does the programme enjoy a degree of political consensus?

It's no different here than anywhere else in the world. Certainly the public sector unions don't like it ? they view it as a loss of control. The general public has been interested and intrigued and is looking for better value. We have had no negative reaction from the general public in any way shape or form to us exploring these opportunities and pursuing the P3 structure. The anticipated components are there.

How long have you been working on the plans?

I spent ten years in opposition, and we had a change of government a little more than a year ago and this government has pursued this as one means of getting better value, so as minister of finance it's one of the things that I was charged with after I was sworn in last May.

Are there any particular areas of provision you're interested in?

What we've done as a government we spent all of the last quarter of last year developing three-year service plans based out of ministries and crown corporations that are intended to deliver upon the priorities of the government and the people of the province. There are capital projects, transportation projects, healthcare delivery services and other services that are part of these plans ? things that ministers have committed to deliver over time.

Was there an approach elsewhere that you found particularly useful when drawing up a programme?

We've tried to look at what everybody's done and put together a structure that works best for us. I'd say that we've probably sided with the structure that was successful in the UK, which they arrived at after both successes and failures.

But the most obvious difference with the UK is that it has very little in the way of regional government. You on the other hand, have three levels, all with debt-raising powers. How difficult will it be to get the interaction right? Who will be the driver for instance? At the moment it appears to be the provinces.

I think it will continue to be at the provincial level, although there's been good interest as we set this up at the municipal level. Their projects tend to be a lot smaller, although not always so, and as I've said to them, we're glad to help, but we've got to get this right first. So I don't think they should, and I've tried not to encourage them to take a lead on this. The federal government has become more tolerant of public private partnerships over time, and now they've allocated funds for their infrastructure programmes. We've seen those strings coming off and we're allowed to use these for PPPs such as the Vancouver Convention Center, which we expect that the Federal government will play a role in.

Do you think that the government will be mainly a source of funding, or also a provider of strategic advice?

The Federal government has been pretty flexible on infrastructure ? what it's used for and allow provinces to set individual priorities. I don't expect that we'll see large strings attached as to how they provide money.

Another plank of your province's programme is Partnerships British Columbia ? a conscious echo of the British Partnerships UK. How will it compare with its UK predecessor?

It will be on a smaller scale, obviously, but I do think there were lessons learned in the UK, successes and failures, some high-profile. We have drawn fairly heavily on the final PUK structure, which started to lead to some volume. We've got a structure in place which is not dissimilar, but it will evolve, according to the demands of this province and learn from any deals that we put through.

Will its role be to evaluate bids, or will it be advising successful bidders as well?

They would be the clearing house and contact point and would be able to draw on expertise from the private sector to evaluate bids and proposals and provide advice to the cabinet. At the end of the day it will be cabinet who will decide whether projects will go ahead and we'll have final sign-off through the Treasury Board on the contracts.

How important is transparency in the bidding process?

We have a real obligation in British Columbia, where there's a real deman for transparency and openness. Certainly people have questions about this, and have heard of the bad examples, so transparency will be key. The real challenge for government will be how to have transparency in bidding processes and at the same time assign a value to intellectual property if somebody comes up with an unsolicited bid, and that's a challenge. I've made comments clearly in public that we intend to provide value to intellectual property in unsolicited proposals provided that they're unique or that there's some technical expertise that others didn't have. But if somebody comes up to us, with say a proposal for the Cedar Sky Highway, which could be one of our first transport P3s, there's nothing unique about that, so we'd have to evaluate it.

How do you propose to deal with the high cost of preparing bids? It's a live issue elsewhere.

There has to be some evidence of originality or particular expertise or technology, maybe a unique process. There has to be some real value.

Another issue is the high financing costs associated with early projects. These tend to be refinanced, with the private sector taking a lot of these gains. Do you have an idea about how to deal with this?

We're looking at this and there are arguments around that. In the UK they operated under the assumption that that wasn't going to be a determining factor, that financing was going to be available to everybody. We're trying to see how that fits in and we'll be monitoring it.

What sort of discussions have you had with potential debt providers as to how much money is available? Do you think there'll be much difficulty finding it?

The premier and I in the last year, prior to our election, went out to the financial markets and talked about our plan and P3s were part of that. Since the election I've been back on tours and explained how the provision of services and capital through public private partnerships was part of our agenda. The response has been fine. British Columbia has never had any trouble accessing capital markets. We have a reputation as a pretty good credit and we've done well. Given the potential size of the projects relative to our borrowing it's pretty small, and I don't see that there will be any issue there.

Is there any intention on your part to stimulate new funds or new investors coming into the province, or will you let the capital providers work that out?

We're willing to do whatever we can as government to create opportunities for new methods of financing.

Do you anticipate there being the need for any new legislation, in the tax laws or elsewhere?

Not too much. We went to the legislature in January and made sure that contracting out of public services was an option for government, and cleared that up. We're still working and expect in the near future to complete legislation surrounding tolling policy, and the tollinpolicy review is being done by the minister of transportation right now, and at some point we'll have to have some sort of legislative structure around that. Other than that we see don't see that there's any big need for legislative changes to permit changes to happen.

What sort of size market over the next few years will there be?

Very difficult to gauge that at the moment. Looking through the service plans, you can find a large demand for transportation and infrastructure. We are currently evaluating a possible P3 for a hospital that we will be building ? in the Fraser Valley, just about an hour east of Vancouver. That's in the region of C$230 million. There will be the Cedar Sky Highway, part of the Olympic bid, the convention center, which will probably be in the region of half a billion. At this stage we're still seeing what's out there and what the interest is.