CSE Canada: Federal bang

24/02/2011

Plenarys close on the C$1.13 billion ($1.14 billion) Long-Term Accommodations Project (LTAP) for the Communications Security Establishment of Canada (CSEC) demonstrates investors continuing strong appetite for Canadian infrastructure debt. In addition, its notably low pricing lays to rest, at least for the time being, scepticism from politicians about whether the private sector can raise cost-effective financing for infrastructure assets.

LTAP is a 33-year design-build-finance-maintain (DBFM) concession for a new 84,000 square-metre office building and 800-space car park for the CSEC in Ottawa. It also includes construction oversight and facilities management of the next-door medium-term accommodation project (MTAP), which was tendered separately and is being built by EllisDon. The new facility will consolidate CSECs operations into one building, from four. It is the federal governments second public-private partnership (PPP), after the C$195 million Royal Canadian Mounted Police E Division headquarters deal in 2010, for which HSBC Infrastructure III and Bouygues were sponsors. Defense Construction Canada is the grantor and government counterparty.

Royal Bank of Canada underwrote the C$1 billion debt, which broke down into a C$839.6 million 33-year tranche and a C$167.4 million five-year tranche. Amortisation of the long bond, which was originally C$838.2 million but increased on account of shifting interest rates during the road show, will not begin until six months after operations begin, which is currently scheduled for July 2014. The short bond will be repaid with the proceeds of a C$300 million substantial completion payment from the grantor. Pricing was 200bp for the long tranche and 113bp for the short; both were over the equivalent government of Canada bonds. Plenary is contributing C$124 million in equity.

The deal signals that Canadian infrastructure pricing is finally tightening. The spread on the debt for LTAP was the lowest for a Canadian PPP since Bilfinger Berger closed on the northern section of the Anthony Henday Drive concession in Alberta in 2008. Market participants say that the deal, as well as Plenarys C$413.8 million St. Josephs Healthcare Hamilton West 5th Campus, which closed at 225bp over CDOR in early December 2010, have helped sway opinions in the Ontario provincial legislature in favour of a large number of DBFM projects in the forthcoming 10-year infrastructure plan, instead of less attractive design-build-finance projects as was rumoured. The opinion of legislators was driven by stubbornly high private infrastructure spreads that did not begin to come in until last year.

The issue was oversubscribed, and its size allowed for larger ticket sizes for a greater number of institutional investors to participate. More than 30 investors came in on the deal, second only to SNC-Lavalins McGill University Health Centre (MUHC), which attracted more than 50 participants.

Security requirements were one of the most significant challenges facing the project. The grantor required that investors and bondholders had to be from so called Five Eyes nations Australia, Canada, New Zealand, the US or UK. This restriction effectively excluded the potential involvement by, for example, any Spanish or German firms. In addition, some project information was not authorised for release to interested parties.

Security and pricing are likely to have influenced the choice of bonds over bank debt. Currently, only European financial institutions, notably French, German and Spanish, are willing to make long-dated infrastructure loans; however, the grantors restrictions prevented many of these banks from participating. Despite this pressure on the competition, however, Canadian infrastructure bond spreads tightened considerably during 2010, making them price competitive with bank debt.

The grantor will begin making partial monthly payments to the concessionaire for oversight and management of MTAP from November 2011. Full payments will begin once construction is complete on LTAP, currently slated for December 2013. The financing has a minimum debt service coverage ratio (DSCR) of 1.15x and a lifetime DSCR of 1.23x according to DBRS. Standard & Poors estimates the minimum DSCR at 1.22x. Both agencies rated the bonds A.

CSEC started the bid process for the LTAP and MTAP projects in May 2008. A C$72.9 million design-build (DB) contract for the latter was awarded to EllisDon in August of that year. A request for qualifications for the 30-year plus construction LTAP PPP was issued in September 2009. Consortiums led by Carillion, Plenary/Innisfree and SNC-Lavalin were shortlisted for the concession in December 2009. The request for proposals was released the following January and Plenary/ Innisfree was selected in October 2010. Innisfree dropped out of the consortium on account of project-specific deal structuring requirements.

PCL Constructors holds a C$833 million fixed-price date-certain DB contract with the concessionaire, and construction was set to begin as Project Finance went to press. Honeywell is the facilities management service provider and Hewlett-Packard is the IT service provider. Throughout construction and during operations, all employees working at or in the facility will require a security clearance from the government of Canada.

Sponsors and financial institutions can expect fewer infrastructure concessions over the medium term in Canada. Three large hospital projects are expected to be procured this year Halton Healthcare Services and Humber River Regional Hospital in Ontario, and Centre Hospitalier de LUniversite de Montreal (CHUM) in Quebec and potentially the 407 East road project in Ontario. However, until Ontario releases its next 10-year infrastructure plan many market participants expect the pipeline to be thin going into 2012. One hope on the horizon is that LTAPs close, and its record low cost of financing, will prompt the federal government to tender more buildings as PPPs.

Plenary Properties LTAP
Status: Closed 31 January 2011
Size: C$1.13 billion ($1.14 billion)
Location: Ottawa, Ontario
Description: 33-year DBFM concession for a new 84,000 square metre Communications Security Establishment of Canada office building
Grantor: Defense Construction Canada
Sponsor: Plenary
Equity: C$124 million
Bond debt: C$839.6 million long tranche and C$167.4 million short tranche
Underwriter: Royal Bank of Canada
Legal counsel: Davies (sponsor), Torys (lender)
Financial adviser: Deloitte (grantor)
Design-build contractor: PCL
O&M provider: Honeywell
IT service provider: Hewlett-Packard