Waterloo LRT, Canada

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The C$621.2 million ($571.5 million) Waterloo light rail transit PPP in Canada is the latest transit deal to close using a mixture of short-term bank debt and long-term bond financing, after the C$2 billion Ottawa light rail deal, which closed last year.

The project is further evidence of Canada's growing light rail transit project pipeline and the comfort of developers and lenders with transit's risk profile. Canada's pipeline includes at least four other transit projects that are either already in procurement or set to be tendered this year.

Waterloo LRT's financing structure is similar to that of the Ottawa LRT, in that both deals included a bank debt portion, a bond issuance and a sizeable contribution from the provincial and regional governments in the form of milestone payments during construction and at substantial completion.

Financing structure

Waterloo LRT's C$171.2 million project financing comprised a equity, a short-term bank piece, and a long-term bond issue, all supported by a C$450 million contribution from the Province of Ontario and the Region of Waterloo, in the form of milestone payments. Such milestone payments in Canada lend themselves to a bank-bond combination, with the bank piece serving as a bridge to the receipt of those payments.

The high government contribution reduces the negative cost of carry that the procuring authority has to assume, according to Mario Angastiniotis, a director at Standard & Poor's in Toronto. He adds that provincial governments in Canada are still very liquid and thus able to provide a sizeable portion of the financial payments during the construction stage.

The C$103 million fully amortising, senior secured bond issued by project company Grandlinq matures on 31 March 2047, had a coupon of 4.771% and priced at 195bp over the Government of Canada benchmark long-term bond. The pricing, according to sources familiar with the deal, is fairly tight, considering debt was rated BBB+ instead of the single-A category, which is more common for Canadian projects. The Waterloo bond issue was broadly marketed and attracted a high level of interest from Canadian pension funds, life insurance companies and asset managers.

Complementing the bonds was a C$40.6 million short-term commercial debt piece that matures in August 2017, provided solely by Alberta Treasury Branches (ATB), a financial institution owned by the Province of Alberta. While ATB recently provided debt on the John Hart hydroelectric plant PPP in British Columbia, the Waterloo LRT transaction is ATB's first foray into light rail transit PPP. The lender is looking to participate in other deals in Canada, especially hospital PPPs, in the near future.

The project has a debt:equity ratio of 84:16, with sponsors Plenary Group and Meridiam contributing total equity of

C$27.6 million to the project. While most Canadian road or hospital PPP projects have a ratio of nearer 90:10, the slightly higher equity contributions on this project reflect its complex construction profile.

BBB+ category

Both the bank and bond facilities for Waterloo LRT received a BBB+ rating from S&P, in line with the project's complex construction profile. Canadian PPPs have usually reached for single-A ratings, because the country's life insurance companies, the bedrock of Canada's bond market, have historically preferred to buy debt with that rating.

The C$1.371 billion bond issue bond issue for the CHUM hospital PPP in Quebec, which closed in 2011, was the most prominent example until now of a triple-B Canadian PPP bond. That 38-year issue priced at a spread of 315bp over its equivalent Government of Canada bond.

"The rating category is being explored much more, to help deepen this part of the bond market in Canada and encourage more lenders to get comfortable with lending to projects with varied risk profiles," says S&P's Angastiniotis.

The BBB+ rating is also in line with the project's construction complexities and higher operational gearing, says Elisabeth Hivon, senior investment director at Meridiam. "Light rail transit projects are viewed quite a bit differently, compared to a road or hospital, owing to their operations and maintenance," she says. "The project's complexities do not lend it to an A category, but we see growing appetite in Canada for the BBB+ category," she adds.

Hivon says that Waterloo LRT is also unique in that the operation is part of the contract for the sponsors, which was not the case in Ottawa LRT, making the maintenance costs higher. The debt service coverage ratio (DSCR) will stand at at 1.36x (minimum) and 1.49x (average) during operations.

The concession

The GrandLinq consortium, comprising Plenary Group, Meridiam, Aecon, Kiewit and Keolis, won the contract for the project in March 2014. They will hold a 30-year design, build, finance, operate, and maintain concession for ION Stage 1, which will run between Kitchener and Waterloo. Under the concession, the Region of Waterloo will own the light-rail system, including hard infrastructure and vehicles, and will set the fares and frequency of the service.

Stage 1 of the rapid transit system consists of both LRT and adapted bus rapid transit (aBRT). GrandLinq will operate a section of the system from the Conestoga Mall in Waterloo to a terminal in Kitchener.

There are several more LRT projects that are being readied for tender by Canadian provinces like Ontario this year, such as the Sheppard LRT and Finch LRT. Another two projects will be out in the market to seek financing this year - the Edmonton LRT and Eglinton LRT - and they are also likely to use a mixture of long bond and short-term bank financing.

Advisers

Deloitte was financial adviser to the Region of Waterloo for the project, while Norton Rose was legal counsel. CIBC was underwriter on the bond issue.

Fasken Martineau provided legal counsel to lenders, while Blakes was legal counsel to the sponsors.