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second coming: the re-emergence of the Canadian bond market for P3 projects

Over the past 5 years, broadly marketed bonds have emerged as one of the primary forms of debt financing for Canadian infrastructure projects procured through public-private partnerships ("**P3s**"). This paper explores the development of the Canadian market for P3 bonds; some of the key elements, benefits and challenges of bond financing for P3 projects, and potential application of the lessons learned in the Canadian market to the challenges currently faced by markets abroad - including Europe and Latin America – in developing a market for P3 or project bonds.

background - the global financial crisis

While infrastructure projects have been financed in the bond markets for decades in the United States and Asia, their prevalence in Canada has really only emerged in the past 4 or 5 years as the appetite for other options has shrunk. Despite the slow start, however, the growth of P3 bond financings in the Canadian market has been dramatic and today, the bond option is regularly considered as a primary financing structure for financing the procurement of public infrastructure by the private sector. It is also often the most cost-effective option – particularly for transactions involving large capital expenditures.

The growth of the bond market for infrastructure financing in Canada is rooted in the global financial crisis of 2008 and early 2009. This "credit drought" drastically reduced available credit and made those willing to risk any money very wary. It affected all asset classes and sectors, including infrastructure projects procured through P3s.[1] Prior to the crisis, debt financing in the P3 context typically involved a long term credit facility from banks or other

[1] The Canadian Council for Public-Private Partnerships ("**CCPPP**"), "The Impact of Global Credit Retraction and the Canadian P3 Market: Deliberations by the Industry Members of CCPPP", (Spring/Summer 2009) at iv, online: <http://www.pppcouncil.ca/pdf/credit_retraction_report_summer2009.pdf> .

institutional Canadian lenders such as insurance companies. While bond financings were used on several large transactions, these solutions were generally 'wrapped' by monoline insurers in order to enhance the credit rating and pricing on the issues. It is now well known that in the immediate aftermath of the credit crunch, the monoline insurance industry largely collapsed. As a result, project companies could only issue unwrapped bonds with a correspondingly lower credit rating and a result, these bonds became unattractive to long-term investors in the Canadian market such as pensions funds.[2]

With the existing infrastructure bond market effectively closed, private-sector debt financing for P3s in the wake of the credit crisis had to be sourced from more traditional sectors, including certain domestic and foreign banks as well as life insurance companies. However, during this period bank lending itself experienced substantial transformation due, in part, to the virtual elimination of the "underwrite and syndicate" lending approach and the disappearance of the monoline solution to manage long term risk.[3] Even on smaller projects, where banks and life insurance companies once played an important role, single-source solutions were rare as most lenders were not interested in large exposures to single projects.[4] As Canadian banks were generally unwilling or unable to lend to projects on a long term basis, the role of banks in the funding of Canadian P3 projects was, in the short term at least, significantly decreased. The exit of the majority of European banks from the Canadian market during this period caused the bank portion of the project financing market to shrink even further.

the rebirth of bonds

Significantly, at the same time that financing options for Canadian infrastructure projects were narrowing, government stimulus activity in Canada and abroad meant that the volume of long term financing required for government infrastructure projects actually increased. As a result, both sponsors and their financial advisors began looking for additional sources

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[2] See Matheson Ormsby Prentice *et al.*, "Pension Fund Investment in P3 Schemes", (Association of Corporate Counsel, 10 December 2009) online: <http://www.lexology.com/library/detail.aspx?g=70f1c4fb-530c-41f0-a041-1d7f84416703>.; Columbia Institute, "Public-Private Partnerships: Understanding the Challenge" (June 2009) at 32, online <http://www.civicgovernance.ca/files/uploads/columbiap3_eng_v8-webpdf.pdf> [Columbia Institute, "Understanding the Challenge"]; Graham D. Vinter, *Project Finance: A Legal Guide*, 3d ed., (London: Sweet & Maxwell, 2006) at 32 [Vinter, *Project Finance*]. As it turned out, the monoline insurers were an early victim of the credit crunch; European P3 Expertise Centre, "The Financial Crisis and the P3 Market: Potential Remedial Actions" (August 2009) at 5, online: <http://www.eib.org/epec/infocentre/documents/EPEC_Credit_crisis_paper-abridged.pdf> [EPEC Report]. The monoline insurers had a critical initial role in unlocking the bond market to project companies. As AAA-rated companies, monoline insurers would grant financial guarantees over project company bonds, enabling those bonds to receive AAA-rating as well. Although project companies had to pay a fee for such guarantees, there was a net benefit to purchasing them as they ensured greater demand and liquidity for the bonds, which in turn translated into higher bond prices.

[3] CCPPP Report, supra note 1 at 2.

[4] Ibid.

of funding and the bond market – absent the monoline insurers – was once again evaluated as a viable option. While short term (generally 5 to 8 year) "mini-perm" or bridge loan bank-funded structures experienced a burst of popularity at the peak of the financial crisis, they were a less than ideal permanent solution in the minds of both equity and public sector entities due to their inherent refinancing risk.

As the financial crisis eased from "panic" mode, a number of factors contributed to the development of the bond market for P3 financings in Canada. First, by the late 2000's, the primary provinces involved in the procurement of P3 projects in Canada – namely Ontario, British Columbia, Alberta and Quebec - had largely standardized their documentation and risk allocation principles for tendered projects and had already closed a significant volume of transactions. This meant that there was a large stable of equity investors, financial advisors and legal teams who were familiar with the Canadian market for P3 projects. It also meant that when deals were ultimately presented to ratings agencies, they were based on established templates, some of which had been previously seen by the agencies in either the monoline-wrapped bond transactions or some rated private placements.

Even as the global financial crisis spread, the Canadian governments and capital markets remained among the strongest in the world. Canada's banks and government institutions, while stretched by the effects of international contraction, continued to enjoy strong credit ratings and the financial sector experienced very little of the dramatic change experienced in the United States and Europe. However, with the departure of the European banks from the Canadian market, the failures of the monolines, and the increased conservatism of the remaining banks and institutional investors, bond financings appeared by the end of 2009 to be one of the only credible alternative funding mechanisms for large scale infrastructure projects in the Canadian market.

Led by several large Canadian financial institutions, underwriter support for the bond option steadily gained momentum. Significantly, these underwriters also spent a substantial amount of time reviewing the stand-alone P3 project finance risk allocation model with the principal Canadian rating agencies – Standard & Poor's, Dominion Bond Rating Service and Moody's. While these agencies had previously been familiar with the P3 model from the monoline-wrapped transactions in prior years, evaluating and rating bonds without monoline credit support required significant up front work by rating agency analysts, and an open dialogue between the ratings agencies, financial advisors and equity sponsors was undertaken with a view to ensuring that appropriate structural changes were made to deal with rating agency concerns.

Political support for the bond financing option at the highest level of the Canadian procurement agencies also assisted in paving the way for the push to broadly marketed bonds. Where there were in fact some changes required to government template documents in order to accommodate bond financings, these were accommodated quite quickly where they did not change the overall risk allocation of the project or the financing. Furthermore, provincial procuring bodies also moved to include “completion” or “milestone” payments in their projects in order to assist in managing the quantum of capital needed, the average life of the financings and the magnitude of the construction risk piece outstanding at any one time.

As a point of comparison, P3 bond financings in each of the years 2007, 2008 and 2009 – the prime years of the credit crisis - failed to top a volume of C$500 million per year even with monoline participation. The turning point for the Canadian infrastructure bond market really occurred in 2010 when nearly C$1.5 billion in project debt was issued domestically in Canada to finance P3 projects. This was more than the sum total issued in the three previous years.[5]

One of the key transactions closing in 2010 was Quebec’s McGill University Health Centre PPP in Montreal, which featured a C$764 million public bond issuance and was rated A-/A(low). At the time, this was the biggest P3 bond deal in Canada and it significantly opened up the domestic investor market by attracting more than 50 buyers.

By 2011, more than half of the P3 projects in Canada that reached financial close in that year used long-term publicly rated bonds as a financing tool. This was a significant increase over 2010, when only a third of projects were financed in this fashion.[6] Overall, 2011 saw an aggregate issuance volume of over C$4 billion in P3 bonds. It also featured two bond issuances of over $1 billion as Plenary Properties LTAP LP raised both long and short term ‘A’ rated bonds to fund construction of the federal Communications Security Establishment Canada Long-Term Accommodation Project (LTAP) project in Ottawa, Ontario, and Health Montreal Collective Limited Partnership issued $1.4 billion in long term bonds rated only ‘BBB(high)’ to finance the Centre Hospitalier de L’Universite de Montreal provincial healthcare P3 in Quebec.[7]

The Canadian bond market for P3 projects had returned.

key structural elements of a bond financing

As a general matter, project bonds issued in P3 financings are private debt obligations issued by the sponsor(s) of a particular government infrastructure project, generally

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[5] “Canadian PPP bond issuance explodes in 2010” by Cezary Podkul, Infrastructure Investor, November 17, 2010, online: http://www.infrastructureinvestor.com/Article.aspx?article=57487.

[6] “How bonds took over Canada’s PPP market”, Project Finance Magazine, November 28, 2011, online: http://www.projectfinancemagazine.com/Article/2941293/How-bonds-took-over-Canadas-PPP-market.html.

[7] “P3 bonds find their market”, National Post, January 26, 2011, online: http://www.canada.com/story.html?id=3af01c40-dcf8-4191-80d5-2338e3177760.

through a special purpose vehicle ("**SPV**"). Repayment of the bonds typically rests upon receipt of payments made to the SPV by a public sector authority. These payments can take several forms, from milestone or progress payments during construction to regularly scheduled payments after substantial completion. In most project, post-substantial completion payments generally take the form of availability-based payments, although in some cases revenue or market-based payments such as tolls are featured. The need to achieve certainty that these payments will be made on time – and the requirement for liquid security if they are not – drive the key financing concerns and structuring elements of bond transactions.

While complex, project bonds issued in connection with P3 transactions are attractive to investors for several key reasons. First and most importantly, they offer an often-generous yield premium when compared to traditional government or quasi-government debt issuances. Accordingly, for institutional investors focusing on lower-risk portfolios, they can enhance overall return. In addition, these bonds are designed as low risk and stable long term investments, backed by cash flows generated from core government infrastructure assets and are often seen as defensive plays in times of economic uncertainty.

To achieve these benefits, structure is key. When evaluating a transaction as a potential bond financing, underwriters and rating agencies will focus on a wide selection of transactional elements, including the quality of the key players (the contracting government entity, the equity sponsors, the construction contractor and the operations/facilities maintenance provider(s)), the principal contractual arrangements, the proposed gearing and debt-service coverage ratios for the project, lifecycle risk and attendant management techniques, the overall security package, and any unique features such as revenue risk that may differ from established market precedent. Often, specialized advisors are retained to assist with these matters are they relate to technical construction and operational items, insurance and proposed revenue or traffic levels.[8]

Although each transaction will be evaluated from both an underwriting and credit rating standpoint on its own, Canadian P3 transactions funded in the domestic bond market will generally share many common attributes. Perhaps the most common of these is an investment-grade rating from at least two nationally recognized rating agencies. While transactions have closed in the 'BBB+' range, most project bonds in Canada's P3 market have achieved a rating of 'A-' or better.[9] Most often, ratings from two primary agencies rating projects in the Canadian market are required at financial close, with a requirement for a continuing rating by a specified number of agencies.

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[8] A discussion of revenue risk in P3 financings – bonds or otherwise – is outside of the scope of this paper as such projects will have inherently different risk allocations and financing considerations.

[9] DBRS PPP Fact Sheet , December 16, 2011.

To support such a rating, project equity of approximately 7 to 20% (depending on project structure) is generally required. Where the equity investment is to be deferred to a point in time when construction is complete, equity support in the form of a letter of credit is generally required. It is noteworthy that in all Canadian projects financed by project bonds, where any credit support is provided in the form of a letter of credit it will also generally be subject to replacement or draw on downgrade of the issuing bank below a pre-established ratings threshold. In the Canadian market, letters of credit issued Canadian banks are generally preferred over those issued by foreign lending institutions. This is a legacy of the credit crisis and a reflection of the fact that many international lending institutions are still rebuilding their balance sheets and have retreated from the Canadian market in any event.

Next, given that the trigger for public sector payments in P3 transactions is a completed infrastructure asset, Canadian P3 projects funded with bonds will generally feature a strong security package coupled with a turnkey construction contract designed to satisfy all elements of the facility required to be completed by the government contracting authority. The construction security package generally includes some combination of parental performance guarantees, letters of credit, performance and/or labour and materials bonding and subcontractor default insurance. While different construction contractors have their own preference as to which of these will be on offer and in what proportions for a given transaction, Canadian projects financed through bonds will as a rule feature a strong construction package in order to deal with concerns raised by both rating agencies and investors as to completion risk.

In many cases, the financial covenant package for a bond financing will focus on incurrence-based rather than maintenance-based items coupled with fairly long equity cure periods for defaults as compared to bank financings. Accordingly, some issuers view bond financings as involving less day to day oversight and greater latitude on the part of equity to deal with issues as they arise. On the other hand, bank financings and private placements will generally include some types of maintenance-based financial or other covenants and in such transactions default thresholds (particularly during construction) may also be tighter. It is important to keep in mind that where bonds form only part of an overall financing package - the remainder of which is shorter bank piece or a private placement – a “hybrid” transaction will generally incorporate both either contractually (through a common terms agreement) or effectively (through cross-default mechanisms) and both equity and the SPV will need to comply with the stricter of the two standards..

Pricing, of course, remains of paramount importance and a key driver in the popularity of bond financings in Canada. Observers have noted that despite a late start, the Canadian P3 bond market has gained steadily in strength since 2010, and credit spreads continue to compress. Canadian bond yields today are at historic lows and average credit spreads for new issues continue to tighten – from approximately 200 bps over interpolated treasury bonds approximately one year ago to approximately 187 bps for an issue rated A(low) in

May 2012. Tighter pricing is in large part due to the fact that the investor base for Canadian bond financings has grown dramatically over the past 4 years. While the appetite for new issues was driven almost entirely by life insurance companies during the early days of the market, the market for Canadian P3 bond financings now comprises pension plans and a wide variety of asset managers. Books are regularly oversubscribed as investor demand presently exceeds supply of Canadian P3 bond issuances.

In terms of tenor, early Canadian P3 bond issues were structured to have a long term amortization profile in order to match the tenor of the underlying P3 concession – generally 20 to 30 years – with a small buffer or "tail" in order to ensure debt repayment before the end of the government payment stream. However, in the recent past short term bond issuances have also begun to form part of overall Canadian P3 financing structures in order to account for short term funding required in advance of government completion or milestone payments. "Bullet" bond tranches have also been included in some new issues in order to attract interest from buyers that cannot invest in amortizing bonds due to portfolio constraints. Generally though, the appetite for long term properly structured bonds remains high.

challenges of the bond solution

While the benefits of the bond solution for P3 infrastructure financings are numerous, the Canadian experience is clear that the bond alternative is not without its challenges.

Perhaps the most significant obstacle to those considering bond financing for the first time is the cost and complexity of this financing alternative when compared to other options. Although at the present time the all-in costs of bond financings are attractive when compared to other alternatives, all things being equal a bond financing will generally cost more to implement and involve more complex documentation than a bank or private placement financing alternative. This is in part due to the additional requirements imposed by local securities legislation involving due diligence, coupled with increased disclosure documentation such as offering memoranda and in certain cases, prospectus requirements. The increased cost and complexity is also driven by the costs involved in obtaining rating agency review, generally by two separate agencies. Furthermore, where two or more tranches of bonds are used, or where bonds are layered with other sources of financing such as a short term bank solution, resulting intercreditor and structural priority issues will generally drive up negotiation and documentation costs.

Partly due to their increased complexity, bond financings also carry different - and sometimes more significant - execution challenges. In most Canadian jurisdictions the cost of financing a project must be fixed at bid submission and local governmental authorities wish to bear little or no risk with respect to the movement of underlying credit spreads or, in some cases, even cost of funds benchmarks. Accordingly, for those equity sponsors looking for underwritten transactions in order to fix financial model debt costs, both the nature of the underwriting commitments from capital markets firms and the prices at which they are offered will bear close scrutiny. Furthermore, where underwriting commitments are based on conditions precedent that are out of the control of equity sponsors, these will need to be managed during the period between bid submission and financial close. A key challenge in many bond financings, for example, is ensuring that rating agency requirements are met so that ratings pre-sale reports can be obtained in a timely manner for marketing purposes and so that final ratings confirmations (which are generally based on the receipt and review by the rating agencies of final documentation) are available for both pricing and settlement.

From an underwriter's standpoint, even a tightly-structured transaction can still present underwriting challenges in a time of volatile financial markets or one in which there are several transactions looking to price or close. The timing of when a transaction is brought to market, coupled with the length of time to close, are key areas of underwriter concern that need to be managed in conjunction with rating agency review, securities laws, investor due diligence and contract finalization.

While as noted above, bond financings are generally less expensive on an all-in basis when compared to other financing structures for transactions in the range of a hundred million dollars and larger, there are some elements of financial 'drag' even with bonds. This is because the almost universal preference of bond investors is for single fundings. When contrasted with the usual cash flow of a project - which involves periodic needs for progress payments over a construction period of 1 to 3 years - it is clear that a single up-front funding will generally result in at least some negative carry to equity because it is unlikely that bond proceeds could be reinvested at a rate equal to their coupon over the construction term. This negative carry needs to be taken into consideration in any bidder's financial model and in certain circumstances, particularly on smaller projects, it could result in the bond option being less attractive from a pricing standpoint.

Equity sponsors also need to be aware that the post-closing situation of an issuer in a bond financing is quite different from that of a borrower in a syndicated bank loan or private placement. In those facilities, ongoing monitoring and requests for amendments and waivers are processed through an administrative agent who is generally able to function as the interface between the obligor and a relatively small group of lenders. In a transaction financed solely by bonds, the indenture trustee who represents the bondholders will generally be a large trust company who is several degrees removed from the actual bondholders (of which there may be hundreds) many of them holding their bonds through clearing agents or additional levels of trust arrangements. In the absence of bondholder votes (which are expensive, time consuming and at times even impossible to hold) corporate trustees generally have very little appetite to exercise discretion on matters such as amendments and waivers.

Accordingly, the way in which any change in circumstances after financial close will be dealt with (and in particular any amendments requested by the borrower to accommodate project variations requested by the applicable public sector authority) must to the greatest extent possible be contemplated in the documents and a decision-making path must clearly laid out. Often, these concerns can be managed by appointing third party consultants such as technical advisors to act as a "proxy" for bondholder review, and indentures customarily provide for a threshold value of acceptable changes provided that the technical advisor can opine that the requested change will not adversely affect the project. In addition, where bonds are rated by one or more rating agencies, a requirement that rating agencies confirm the bond ratings when certain changes are made to the project in lieu of bondholder consent can offer additional comfort and flexibility to both trustees and issuers.

a bright future for bonds

Despite a slow start and the need for issuers and advisors to manage an increase in transaction complexity, the outlook for bonds as a low cost long term financing tool in the Canadian P3 market is strong. There remains a steady demand for high quality assets in the domestic Canadian bond market, contrasted with limited capacity available from US or European banks. While Canadian bank and institutional investor interest has recovered in part, in many cases these same players have now simply shifted resources to bond marketing and investment efforts and while bank and institutional credit facilities are still a regular feature of Canadian P3 bids, they are now often featured alongside bond offerings or as stand-alone options for smaller transactions. Furthermore, the pricing and underwriting constraints imposed upon both Canadian and foreign banks by the implementation of Basel III has in some cases made both bank loans and swaps (which are generally required in order to achieve a fixed rate of financing when bank facilities are used) more difficult to structure and price on a competitive basis. With yields on new bond issues remaining low and a steady although not overflowing pipeline of government projects, the future of the P3 bond market in Canada looks strong.

lessons learned

Other jurisdictions around the world are also seeking to build a project bond market for P3 and other large infrastructure projects. In particular, the European Union's ("**EU**") Project Bond 2020 initiative has recently been launched by the EU and the European Investment Bank ("**EIB**") with the stated goals of reinvigorating broad-based capital market financing for infrastructure projects throughout the EU and assisting individual infrastructure project equity investors to attract long-term private sector debt financing.[10] It is now in the final stages of launch for a pilot phase for the financing of between five and seven projects as

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[10] "The pilot phase of Europe 2020 Project Bond Initiative (reissue), Memo/11/370, Brussels, 23 May, 2012.

broadly marketed bonds over the next few years. Early candidates in the EU's trial pipeline are said to include UK OFTOs, Belgium's A11 Motorway and Germany's A7 roadway.

As the EU initiative launches, some insight from the Canadian experience may be applicable. First and foremost, the relatively speedy and broad-based development of the Canadian bond market for P3 transactions in the wake of the financial crisis demonstrated that credit – both in terms of the public sector's ability to pay and the private sector's ability to perform over the long term – is key. Throughout the credit crunch, the Canadian federal government retained its 'AAA' debt rating and the corresponding ratings of the principal procuring Provinces also remained strong. Canada's overall economy – including the strength of its banks - also remained robust. Canada's P3 sector has never experienced a financing default on a project. Its' stable of project equity sponsors stayed robust through the late 2000's and remains so today.

While the recent experience of the EU is admittedly different in this regard with many of the member countries holding a debt rating less than 'AAA' (even though the EU itself does benefit from such a rating), a key element of the EU Project Bond initiative is to provide credit enhancement in order to raise the overall credit profile of particular projects. The assumption here is that this will make it easier for their sponsors to attract private financing in the bond market. The pilot phase of the initiative, for example, is expected to see the injection of €230 million of seed funding or "risk capital" by the EIB which is expected to stimulate projects worth up to €4.5 billion. The EIB will provide its credit support either as a subordinated/mezzanine loan or as a subordinated debt guarantee. In both cases the facility provided by the EIB is designed to be interposed between the equity and broadly marketed bonds debt provided to a project. The subordinated pieces will cover up to 20 per cent of project costs and are intended to credit enhance projects to allow bonds to be issued with a target 'A' rating that could be bought by institutional investors.

Achieving ratings at such a level is significant because the Canadian market has demonstrated that project bonds rated below 'A-' can pose marketing challenges, particularly to institutional investors who have firmly established long term portfolio thresholds mandating credit ratings in excess of 'BBB+' or its equivalent. As the holder of a 'AAA' credit rating itself, the EIB's support may certainly assist in raising the overall credit profile of a particular issue. However, in situations where both the procuring body and the sponsors themselves are not highly rated entities, the 20 per cent "cushion" offered by the EIB's program may not necessarily achieve the overall target ratings goal. While each of Fitch, Standard & Poor's and Moody's have noted in their comments on the EU project bond initiative that the EIB's proposed mechanisms would be likely to, on an overall basis improve a transaction's credit risk, they have also been careful to note that whether or not such benefits will justify a credit rating in the 'A' category is more difficult to assess without project specifics, including other qualitative aspects that may constrain the rating, regardless of financial support. [11]

It is possible, and in fact likely, that as a complement to the EIB's credit enhancement program further structural changes to EU P3 project bonds may be required to achieve the desired ratings and in turn, the target financing volume as bonds. Indeed, rather than a substitution for a strong credit rating driven primarily by financial credit support, the Canadian market has shown that as a general rule robust construction security packages are core to achieving higher investment grade ratings. In the EU, where debt guarantees from equity sponsors and sponsor completion guarantees have been generally preferred over more fulsome construction security options such as bonding, letters of credit and reserve accounts, a reluctance to structure and price for a more vigorous construction security package may result in projects that are not financeable and cost-effective over the long run even with EIB support.

The success of the Canadian market for project bonds clearly articulates that in a market where both government and equity sponsor counterparties are operating in a credit-challenged environment, a strong construction security package can result in less overall project risk which can in turn translate into a more desirable credit rating and a more marketable bond offering. Recent experience in Latin America shows that equity sponsors there are also facing the challenge of how to mitigate construction risk for bondholders in a world with no monoline insurers to look to and the same analysis is likely to apply there. [12]

While enhanced credit support and stronger security packages will likely be of significant value in achieving the target investment-grade ratings on European project bonds, it is noteworthy that in Canada these structural changes occurred concurrently with a strong effort on the part of equity sponsors and financial advisors to educate both local and international institutional investors about the P3 market. Canadian underwriters spent considerable time with life insurance companies, pension funds and third party fund managers to improve their aggregate understanding of construction risk and operating risk in P3 and other infrastructure projects. At the same time, they were in close contact with finance officials in the principal jurisdictions who were in the process of procuring large projects (Ontario, Quebec and British Columbia, as well as at the federal level) to discuss changes to the tendering process to accommodate the bonds as a financing option. Where such changes could be made to ensure successful execution on a bond financing without

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[11] *"Global Infrastructure & Project Finance EMEA Special Report Fitch Comments on EU Project Bonds Initiative",* Fitch Ratings, 27 April 27, 2011, online: http://www.fitchratings.com; *"Special Comment: Europe 2020 Project Bond Initiative"*; Moody's Investors Service, June 28, 2011; and *"Credit FAQ: How Europe's Initiative To Stimulate Infrastructure Project Bond Financing Could Affect Ratings",* Standard & Poor's, May 16, 2011.

[12] *"Why Project Bonds? Why Now?",* by Cathleen McLaughlin and Dorina Yessios, Latin Lawyer Magazine, April 2011 (Vol. 10, Issue 3).

changing the risk allocation between the parties, they were readily accommodated by the public sector.

Finally, the financial community worked in tandem with Canada's principal ratings agencies during this period to come to an understanding of how the agencies would evaluate a publicly issued bond without a monoline guarantee. In response, the agencies were prepared to provide useful feedback in a public forum. DBRS for example, has published its own *"Guide to Rating Public Private Partnerships"* as a companion piece to its long standing publication *"Rating Project Finance"* in order to assist in providing public and private sector market participants with insight on the level of various indicators that would, in DBRS's view, be sufficient to achieve an A-range rating.[13]

In part, the Canadian financial advisory and underwriting community was heavily incented to assist in the development of a robust Canadian P3 bond market by certain core elements common to most of Canada's P3 procurement processes. First, Canadian P3 transactions generally require committed financing when financial proposals are submitted. As a result, bidders in the Canadian market have generally engaged financial arrangers or underwriters very early in the tendering process and have worked closely with them throughout the bid open periods – which can span over a year. Furthermore, financing packages are heavily negotiated and often quite thoroughly documented even before technical prices are submitted as part of the bid package. Finally, Canadian procurements generally provide bidders with a high degree of control over the financing options that they are permitted to bid and are generally not prescriptive in this regard. This meant that although public sector procuring bodies evaluate all aspects of a financing, including execution risk when selecting a winning bid, bidding teams had the flexibility as the credit crisis waned to select the option (or options) that made the most sense in the context of a given project. Many European procuring bodies do not currently run their bid processes in this fashion, and where financial innovation is a goal they may wish to consider changes to their own tendering processes in order to accommodate capital market financing, such as allowing more bidders flexibility to choose financing options and the engagement of a bond arranger early on in the process.[14]

While there may be much to learn globally from the Canadian experience in developing a deep and flourishing project bond market, perhaps the most important lesson Canada can

[13] "Methodology: Rating Canadian Public-Private Partnerships", Dominion Bond Rating Service, December, 2011; online: www.dbrs.com.

[14] *"News - EU's project bond pilot phase to kick-off"*, Infrastructure Journal, November 6, 2012, online: www.ijonline.com/Articles/80709.

offer to Europe and Latin America is that there is no “one size fits all” model of either a P3 transaction or a project bond. Key to the Canadian experience is the message that each transaction needs to be assessed by government, equity sponsors, financial advisors, investors and ratings agencies on its own merits. Once a financial market of willing investors is established - and the Canadian experience shows that it need not take very long to do so - there is room for transactions that stretch the limits of size, ratings, asset classes or other structural elements. With nations around the world experiencing infrastructure deficits of historical proportions, this is only good news.

by Catherine Doyle and Tim Murphy

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a cautionary note