



P3s as an Expedient Financing Vehicle – Public and Private Sector Perspectives

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What are P3s?

Four key attributes:

- A public good or service delivered in partnership with the private sector
- Risk allocation consistent with party best able to manage it
- Whole of lifecycle costing (design and maintenance obligations are bound together)
- Private finance

Why Private Finance?

- Enforcing contractual compliance
- Innovation
- Efficiency
- Matching incentives to outcomes
- Value for money

What is “Expedient” about P3s?

- They are a useful tool for harnessing private sector efficiency, innovation and incentives to public policy purposes
- P3s are only expedient if they deliver value for money to the public sector and taxpayers
- That happens only if incentives are properly structured

When does a P3 make sense?

- Nature of the Asset/Service
 - Availability or usage risk models
 - Competitive market
 - Large enough to warrant extra costs
 - Clearly defined scope with measurable outcomes
 - Synergy between design and operation

When does a P3 make sense?

- A Proper Regulatory Framework
 - Public Support
 - Unions, public, sectoral, private sector
 - Depoliticized Procurement Process
 - Accountability, transparency, certainty
 - Government Side Expertise
 - Legal, financial, technical, project management
 - Centralized agency
 - Standardized process

When does a P3 make sense?

- A Clear Business Plan
 - A reliable needs assessment
 - Understanding the long-term commitment
 - Detailed output specifications
 - Focus on the ends not the means
 - Clear KPI's
 - Detailed value for money assessment

Value for Money

- Equation differs between an availability model and a full concession model
- Conducted at 2 points:
 - Before selecting the model and after bids received
- Public Sector Comparator vs. Adjusted Shadow Bid or actual bids

Value for Money

- 4 key cost components:
 - Base Costs
 - Financing Costs
 - Retained Risks
 - Ancillary Costs

Value for Money

- Base Costs:
 - Construction
 - Lifecycle Costs
 - Hard and soft facility management
 - Private sector premium (adjustments for taxes, insurance)

Value for Money

- Financing Costs:
 - Timing of payments
 - Discount rate to produce NPV
 - Private sector premium

Value for Money

- Ancillary Costs:
 - Procurement costs
 - Legal
 - Project management
 - Bid fees
 - Design costs
 - Technical advisors

Value for Money

- Retained Risks:
 - No value for money unless risks are transferred
 - Risk modeling:
 - Risk identification
 - Allocation (retained, transferred, shared)
 - Probability of Occurrence
 - Cost of occurrence
 - Assessment

A Mature Marketplace in Canada

- In the 1990's, England started the "PFI" initiative
- May 2002 saw the formation of Partnerships BC, Canada's first P3 Agency
- 2006 saw the formation of Infrastructure Ontario and Infrastructure Quebec

Federal Government Action

- Building the Proper Government Toolkit
- In 2009, PWGSC creates the Risk Register for Public-Private Partnerships, which outlines the importance of risk analysis and breaks it down into different categories.
- In 2010, PWGSC creates a Screening Tool to help parties decide if the P3 model is appropriate for their project.
- Budget 2011 requires federal departments to evaluate the potential for using a P3 for large federal capital projects – i.e. - a lifespan of at least 20 years, capital costs of \$100 million or more.

Federal Government Action

- 2007 – Federal Government creates P3 Canada
- In September 2009, the P3 Canada Fund is launched which contributes to municipal and provincial projects on a cost-sharing basis using a P3 model and template.
- So far, 13 projects have been identified as P3 Canada fund recipients

P3s in 2012 – Market Acceptance

- There are at least 178 P3s in Canada today. Broken up by sector:
 - Defense: 1
 - Education: 9
 - Energy: 5
 - Environmental: 20
 - Government Services: 5
 - Hospitals and Healthcare: 63
 - Justice / Corrections: 18
 - Real Estate: 3
 - Recreation and Culture: 16
 - Transportation: 38

P3s in 2012

- Broken up by jurisdiction:
 - Alberta: 15
 - British Columbia: 33
 - Federal: 1
 - Manitoba: 6
 - New Brunswick: 11
 - Newfoundland & Labrador: 1
 - Northwest Territories: 1
 - Nova Scotia: 3
 - Nunavut: 2
 - Ontario: 92
 - Prince Edward Island: 1
 - Quebec: 14

Municipalities

- FCM and other municipal organizations very skeptical
- New opportunities being created by P3 Canada Fund and regulatory changes
- July 2012 changes to federal *Wastewater Systems Effluent Regulations* require municipal governments across the country to adapt wastewater facilities to new standards
- Approximately 25% of existing wastewater facilities will require upgrades in order to comply with secondary wastewater treatment standards.

When P3s do not work

- One-off P3s can be risky for the public sector
 - Insufficient experience on both sides to transfer risk or price it properly
 - Higher transaction costs
 - Insufficient public sector expertise
 - Insufficient focus on output specifications
 - Experienced P3 markets will deal better with P3s than markets that do fewer P3s.
- Insufficient long term capital
- Counterparty risk
- Inefficient and lengthy process

P3 Financing: Why Private Finance Matters

- Public ownership of the core assets and limited ability to undertake balance sheet finance means a limited recourse finance structure
- As a result, the ability of equity and lenders to get a return or to be repaid rests on the performance of the contract between the project entity and the government authority
- That means that private capital is enlisted to serve the public good – the building of the asset and the delivery of services consistent with the contractual requirements of the project agreement

Lender Security for Performance – the benefit

- Lenders will look to the following to secure repayment:
 - Project risks backstopped through a ‘pass-through’ to contractors of financial substance and technical ability
 - Equity contribution sized to cover the risk
 - Contractor coverage of “on-time” and “on-budget” risk
 - Extended warranty protections, lower liability limits
 - Reserves for major risks
 - Liquid security of the contractors
 - Rights to step-in and cure

Lender Security for Performance – the price

- Higher costs due to lender-imposed requirements
- Restrictions on public sector rights to variations
- Bankability as a limit to risk transfer
- Innovation vs. certainty

Innovation vs. certainty

- Equity sponsors and lenders will find that lenders' tendency towards project control and monitoring can be the source of conflict between them.
- While equity sponsors will favour risks that might lead to efficiencies down the road, lenders are more likely to favour pursuing paths with certain outcomes.
- Lenders receive a fixed rate of return on their investments, while equity sponsors stand to benefit financially from project improvements.

Constraints on P3 Capital Markets

- Variable risk profile of P3s (construction vs. operations) may deter long-term investors who seek low risk throughout tenor (bank vs. bond)
- Minimum credit requirements for investors vary globally: it's not one P3 market
- Lack of standardization and inherent complexity requires specialized knowledge which investors may not develop without large deal flow

Usage Risk Projects under IO

- IO has been slow to move to revenue risk or usage model
- Early projects were build-finance: P3s with training wheels
- Then availability-based design build finance maintain (not operations)
- Highway Service Centres project
 - Bankability as a restriction on revenue risk
 - Separation of construction and operations risk
- Pearson to Union rail link
 - Inherited from Federal government
 - Project foundered on revenue certainty

Usage Risk Projects under IO

- Pan Am Athletes Village
 - Condominium project
 - Backstop for lenders
 - (Minimum revenue guarantee vs. default payout)
- Drivers' Examinations Centres
 - Brownfield project
 - Still in market
- Waiting in the wings:
 - Water projects:
 - Water rate increase risk

Factors in Funding Usage Risk Projects

- Predictability and reliability of revenue
 - Brownfield vs. Greenfield
 - Traffic risk assessment
- Project vs. balance sheet finance
 - Size of Project
- Government willingness to accommodate lenders
 - Minimum revenue guarantees
 - Minimum payouts on project default
- Market experience and competition

Build-Finance

- Private entity responsible for financing and construction
- Public entity pays and takes ownership after construction certified as complete
- Design may or may not be undertaken by the private sector
- No operational requirements

Design-Build-Maintain

- Private entity responsible for design and construction
- Public entity pays for construction on a progress basis and takes ownership after construction complete
- Private entity maintains the facility
- Usually separate contracts

Design-Build-Finance-Maintain

- In addition to obligations under DBM, private sector also responsible for financing
- Allows design, construction and operations synergies

Design-Build-Finance-Operate (Maintain)

- Same as DBFM but adds significant soft operational requirements (which may include some revenue risk)
- Ownership
 - May remain with the public
 - Private entity may own with ownership reverting to the public after the agreement expires

Concession

- In addition to obligations under the DBFO model, private entity also takes on usage risk



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