Project Finance
Recent Developments Of Importance

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Public-private partnerships (“P3s”) have been embraced by all levels of government in Canada and, notwithstanding some turbulence along the way, Canadian governments’ enthusiasm for P3s shows no sign of waning. In fact, only five or so years ago, a discussion of Canadian P3 deals would have been somewhat abstract with only a handful of projects having achieved financial close. This stands in marked contrast to the P3 market in Canada today where, at last count, approximately one 100 P3 projects have either been completed or are in various stages of procurement. These projects are being implemented across the country and cover the range of traditional infrastructure assets including hospitals, schools, highways, courthouses and recreational facilities.

Although Canadian financial institutions appear to be weathering the turmoil in credit markets better than their counterparts in other countries, the Canadian P3 market has not escaped unscathed. A combination of factors, including the withdrawal of foreign banks (traditionally major players in the Canadian P3 market), higher credit spreads and shorter loan tenors has resulted in some rough sailing in the relatively calm waters that have characterized the Canadian P3 market to date. The so-called “credit crisis” has resulted, directly or indirectly, in the cancelation of a handful of P3 projects and the restructuring of others, utilizing either traditional “Design-Build” (DB) models or interim financing structures such as “wide-equity” (some of which are discussed in greater detail later in this paper). Nevertheless, the Canadian P3 market is still robust and shows no sign of slowing down. Various governments, enjoying the benefit of increased stimulus funding for infrastructure projects, are injecting additional capital into projects, new financial players are stepping in to fill the void left by those that have withdrawn from the market and the Canadian approach to P3 projects is becoming more standardized — all positive signs.

In this paper, we will provide an overview of the P3 market in Canada, the deals being done across the country, some of the challenges faced and the approaches being employed to overcome same.

**British Columbia**

British Columbia was the first province in Canada to fully embrace the P3 model and at last count had 20 P3 projects in various stages with half of them already completed and operational. P3 projects underway in British Columbia include:

- the Surrey Outpatient Hospital Project, a Design-Build-Finance-Maintain (“DBFM”) hospital project with total project costs of approximately C$239.1 million (of which approximately C$172.4 million is to be delivered through the P3 model);
- the Kelowna and Vernon Hospitals Project, another DBFM hospital project with total project costs of approximately C$432.9 million (of which approximately C$382.8 million is to be delivered through the P3 model);
- the Royal Jubilee Hospital Project, another DBFM hospital project with total project costs of approximately C$348.6 million (of which approximately C$282.5 million is to be delivered through the P3 model);
- the Sea-to-Sky—Highway Project, a Design-Build-Finance-Operate (“DBFO”) highway project with total project costs of approximately C$600 million and which entailed two separate “DB” contracts for two portions of the highway and a DBFO agreement for the design and construction of another portion of the highway and the operation and maintenance of the entire highway corridor;
- the South Fraser Perimeter Road Project, a DBFO highway project which together with the Port Mann/Highway 1 Project and North Fraser Perimeter Road Project, form the major components of British Columbia’s Gateway Program — approximately 50 per cent of eligible project costs for this project are to be provided by the government of Canada as part of its “Canada–British Columbia Asia-Pacific Gateway Corridor Transportation Infrastructure Fund”. The federal funding is expected to be provided by way of construction milestone payments.

The 10 P3 projects already completed and operational in British Columbia include the C$1.9 billion Canada Line, the C$808 million Golden Ears Bridge, the C$355 million Abbotsford Regional Hospital and Cancer Centre and the C$144 million William R. Bennett Bridge.

Two other British Columbia P3 projects worthy of note and further analysis are the Port Mann/Highway 1 Project and the Port St. John Hospital Project. The Port Mann/Highway 1 Project was launched with the issuance of a Request for Qualification ("RFQ") in May 2007 and a preferred proponent was selected in August of 2008. Alas, the timing coincided with the turmoil in credit markets and the project was beset by rumours that the preferred proponent was having difficulty finalizing the financing for the C$2.46 billion project. In January 2009, the provincial government issued a press release announcing that it had reached an agreement-in-principle with the preferred proponent that would see the province provide approximately one-third of the financing required for the project with final terms and conditions expected to be announced in March 2009. At the same time, the preferred proponent was granted...
a one-month extension to finalize its financing arrangements. In late February 2009, Partnerships British Columbia issued a letter to the province announcing that it could not reach a mutually satisfactory agreement with the preferred proponent and recommending that the negotiations be concluded. A few days later the provincial government issued a further press release announcing its plans to proceed with the Port Mann/Highway 1 Project as a DB project using a fixed-priced contract with the construction joint venture that had formed part of the preferred proponent. Although the provincial government stated that the project’s financial arrangements were not the problem, it has been suggested that difficulties experienced by the lead lenders in syndicating the credit facility were a factor in the province’s initial decision to provide one-third of the financing and that difficulty raising the requisite equity was also a factor in the project’s fate.

Some may view British Columbia’s decision to proceed with the Port Mann/Highway 1 Project by way of a more traditional procurement model as a sign that P3s are falling out of favor in British Columbia. However, another view is that the province took a prudent and practical approach in the face of difficult credit conditions which would have made it difficult to support a P3 approach for such a large project on a “value for money” basis. The fact that British Columbia continues to introduce new P3 projects to the market is, in our view, evidence of the province’s ongoing commitment to P3s.

The Fort St. John Hospital project was launched with the issuance of an RFQ in May 2008 and the preferred proponent was announced in March of 2009. As with several earlier P3 projects in British Columbia, the bids received were in excess of the affordability caps the province imposes on such projects. However, unlike previous projects, the province was not prepared to exceed its affordability caps on Fort St. John. Negotiations ensued between Partnerships British Columbia and the successful proponent and in July 2009, Partnerships British Columbia announced that the project would be the first public-private partnership project in British Columbia to utilize a new interim financing model referred to as “wide-equity”. Essentially, the “wide-equity” financing model involves a larger private equity contribution than is typically required to satisfy lenders’ gearing requirements coupled with increased provincial funding for the balance of the project’s capital costs (several of the British Columbia regional P3 hospital projects already provided for funding from the applicable regional health authority on a “milestone” basis). The provincial funding is advanced as milestone payments with increased construction monitoring on behalf of the province (essentially replacing the monitoring that would otherwise have been performed by the project lender’s consultants) and the preservation of construction performance security typically required by project lenders. Partnerships British Columbia’s press release announcing the commencement of construction on the Fort St. John Project included a backgrounder on the financing which stated that the use of the “wide-equity” model is temporary and that Partnerships British Columbia expects to return to P3 structures utilizing bank financing “once bank borrowing becomes more affordable”. The writers understand that the BC Cancer Agency Centre for the North Project is also requiring proponents to include a “wide-equity” option with their bids.

Alberta

Alberta is another Canadian province that has utilized the P3 model to deliver infrastructure projects. The province has six P3 projects underway and one, the South East Edmonton Ring Road, already completed. P3 Projects currently underway in Alberta include:

- the Northwest Anthony Henday Drive Project, a DBFO project for a 21 kilometer section of the Edmonton Ring Road with a Net Present Value (“NPV”) cost of approximately C$1.42 billion;
- the Northeast Calgary Ring Road Project, a DBFO project for a 21 kilometer extension of the Stoney Trail with a NPV cost of approximately C$650 million;
- the Alberta Schools Alternative Procurement Project (Phase I), a DBFM project involving 18 schools in Calgary and Edmonton with a NPV cost of approximately C$634 million;
- the Alberta Schools Alternative Procurement Project (Phase II) which involves 14 schools, 10 of which will be procured through a DBFM model and four of which will be procured through a simpler DB model;
- the Southeast Calgary Ring Road project, a DBFO project for a further 25 kilometer portion of the Calgary Ring Road.

Faced with declining royalty revenues from oil and gas, Alberta remains committed to infrastructure spending, recently announcing plans to borrow C$3.3 billion to fund infrastructure projects and in September 2009 issuing C$600 million in provincial bonds as part of said program.

Saskatchewan

In January 2009, the province of Saskatchewan established a “P3 Secretariat” with a mandate to assess the use of P3s as a means for delivering infrastructure projects. Despite opposition to P3s from the usual suspects, the Saskatchewan government stated that it will look at P3s “slowly and deliberately”. Saskatchewan’s P3 Secretariat is currently assessing various aspects of P3s, including best practices from other jurisdictions, potential P3 projects in the province and market appetite for Saskatchewan P3 projects.
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Manitoba
Several P3 projects are underway in the province of Manitoba. These include:

- the Chief Peguis Trail Extension Project, a DBFM project for a 3.7 kilometer, four lane divided highway and multiple use bicycle path in the city of Winnipeg; and
- the Disraeli Bridges Project, a DBFM project involving the refurbishment of the Disraeli Bridges and the upgrading of approach roads and traffic interchanges.

In the RFQ for the Disraeli Bridge Project, the City of Winnipeg notes that it was one of the first municipalities in Canada to utilize the P3 model in connection with the Charleswood Bridge Project in 1995. Winnipeg is also using a P3 model for the East District Police Station and the City’s mayor has announced that P3s will be considered for other infrastructure projects.

Ontario
In May 2005 Ontario released its “ReNew Ontario” program, a C$30 billion, five-year strategic plan to invest in the province’s infrastructure. Infrastructure Ontario, a Crown corporation, was established to manage the province’s major infrastructure projects. Infrastructure Ontario launched its Alternative Financing and Procurement (“AFP”) program in 2005 and now has 48 projects in various stages. These P3 projects involve hospitals (a number of which are being constructed under Infrastructure Ontario’s build-finance model), courthouses, detention centres and roads and include the following:

- the Ministry of Government and Consumer Services New Data Centre, a DBFM project with a NPV cost of approximately C$352 million which achieved financial close in April 2008;
- the Bridgepoint Hospital Project, a DBFM project for a 680,000 square foot, 472 bed hospital and rehabilitation facility with a NPV cost of approximately C$622 million which achieved financial close in August 2009;
- the Woodstock General Hospital Project, a DBFM project for a 350,000 square foot hospital with a NPV cost of approximately C$270 million which achieved financial close in October 2008;
- the Toronto South Detention Centre, a DBFM project for a 1,650 male offender-bed facility expected to achieve financial close in the third quarter of 2009;
- the Waterloo Region Consolidated Courthouse Project, a DBFM project for a 30 courthouse facility for which the RFP closed on August 4, 2009;
- the Windsor-Essex Parkway project, a DBFM project for a six lane, 11 kilometer highway, service roads and recreational trails for which an RFQ was issued in June 2009.

Two other Ontario P3 projects worthy of note are Infrastructure Ontario’s Nuclear Procurement Project and the Niagara Health System Project. The Nuclear Procurement Project was launched as part of the Ontario government’s 20 year Energy Plan. The five objectives of this plan are the elimination of coal-fired generation in the province by 2014, maintaining the level of Ontario’s nuclear generator capacity at 14,000 megawatts, doubling the use of renewable energy to 15,700 megawatts, reducing electricity demand by 6,300 megawatts through conservation and increasing the use of gas powered generators to handle peak demand.

In March 2008, Ontario launched a two stage procurement process to select a vendor for a new two-unit 2,000-3,000 megawatts nuclear generation facility. Four parties were invited to participate in the first phase of the procurement process with the list of invitees being based on a prior independent review of current nuclear reactor designs commenced by the province. The RFP described the project as “to develop, construct and provide licensing, commissioning and engineering, operations and maintenance support and fuel supply and possibly financing” for the nuclear power plant. Three proponents submitted Phase I submissions and in June 2008 Infrastructure Ontario announced that all three would be invited to proceed to the second phase of the procurement process. At the same time, Infrastructure Ontario also indicated that it expected to select a preferred vendor in November 2008 and enter into a project agreement in December 2008. These deadlines were subsequently extended to “Spring 2009”.

In February 2009, Infrastructure Ontario announced that it had received bid submissions from all three proponents bidding on the Nuclear Procurement Project - Areva NP, Atomic Energy of Canada Limited (“AECL”) and Westinghouse Electric Company. Approximately four months later, in late June 2009, Ontario’s Ministry of Energy and Infrastructure issued a news release announcing the suspension of the Nuclear Procurement RFP. According to the news release, of the three proposals received only the submission from AECL was considered to be compliant with the terms of the RFP and the province’s objectives. The news release also stated that concerns about pricing and uncertainty surrounding AECL’s future (the government of Canada which owns AECL had announced a restructuring of the corporation in May 2009) led to the decision to suspend the project. Various media reports cited “sticker shock” at the bid prices as a factor in the government’s decision and the minister responsible for the project was quoted as saying the cost was “billions” more than expected. To date, there have been no further developments on the Nuclear Procurement Project.

The Niagara Health System project
was watched closely by players in the Canadian P3 market particularly when it looked like the project could become a victim of the credit crisis. The preferred proponent for the project, Plenary Health Niagara (“PHN”) was announced in August 2008 and commercial close (i.e., the signing of the project agreement) was achieved on September 24, 2008. Financial close was anticipated to occur approximately 30 days thereafter. Unfortunately, lending support for the project fell away just prior to financial close leaving PHN having to raise replacement financing in the midst of very difficult credit market conditions. After a number of delays, the Niagara Health System project reached financial close in late March 2009. Financing was provided through a combination of construction loans, a long-term private placement of debt and increased equity. As part of the financing, the province agreed to provide a construction progress payment prior to substantial completion of the project but after full drawdown of the construction financing and project equity. Under the terms of the provincial funding arrangement, the province has the option to require that its progress payments be replaced with private-sector financing if the credit markets improve.

The Niagara Health System project provides an excellent example of the “partnership” between the public and private sectors that is a key component of P3s and critical to their success. PHN and Infrastructure Ontario worked together closely to secure replacement funding for the project and achieved financial close in very difficult market conditions.

Québec

Québec is another Canadian province that has embraced P3s. Following in the footsteps of British Columbia’s Partnerships British Columbia and Ontario’s Infrastructure Ontario, Québec established PPP Québec in 2005 to advise the government of Québec on all P3 matters. The Chair of Québec’s Treasury Board has stated that the province plans to use the P3 model for a number of major projects calling P3s a “globally recognized method” and a “critical tool for Québec”. To date, Québec has nine P3 projects in various stages including the A-30 Highway project which achieved financial close in September, 2008 and is notable as it involved the raising of approximately C$1.2 billion of debt financing in the midst of difficult credit conditions. Other P3 Projects in Québec include:

• Autoroute 25, a C$554 million highway project that achieved financial close in December 2007 and is notable as Québec’s first P3 project and first toll road;
• the Montréal University Hospital Centre, a 772 bed hospital in Montréal, which launched a call for proposals in May 2008 and is now expecting proposals to be submitted in the first quarter of 2010;
• the McGill University Health Centre, which launched its RFP in October, 2008 and expects to announce a successful proponent in December 2009;
• the Montréal Symphony Concert Hall, a 30-year DBFM project with an approximate value of C$267 million which announced the winning bidder in March 2009.

Other Provinces

Other Canadian provinces have also launched P3 projects or are presently exploring the use of P3s in various sectors. New Brunswick is using a P3 DBFMO model for the Moncton Courthouse Project, a 133,000 square foot justice center scheduled for completion in 2010. Unlike most P3 projects in Canada, the private-sector partner involved in the Moncton Courts Project will own the land and building and lease the facility back to the province for a 30-year term. New Brunswick is also employing a P3 structure for the 150,000 square foot Saint John Courthouse Project and for the construction of schools in Rexton and Moncton. New Brunswick utilized a P3 model for construction of various section of the Trans-Canada Highway, including the Fredericton-Moncton Highway, originally designated as a toll road and subsequently converted into Canada’s first shadow-toll highway, and the Grand Falls – Woodstock section of the highway.

In December 2008 the province of Nova Scotia issued an RFP for advisors to support the development of infrastructure projects involving highways, corrections and mobile radio. The province’s press release announcing the RFP quoted Nova Scotia’s Minister of Transportation and Infrastructure Renewal as saying, “We want to ensure we have access to people with experience and knowledge in planning and implementing projects using a public–private partnership procurement”.

A study commissioned for the province of Newfoundland and Labrador in 2004 identified a public–private partnership as the “most applicable” structure for completing a fixed link across the Strait of Belle Isle and the C$160 million Deh Cho Bridge Project in the Northwest Territories was structured as a P3.

Federal

At the federal level, Public Works and Government Services Canada has undertaken to construct the new headquarters for the RCMP’s E Division in Surrey, British Columbia using a P3 model. The government of Canada also established PPP Canada Inc. in 2007 with a mandate to assess and advise on P3 projects at the federal level. In September 2009 PPP Canada Inc. announced the launch of the C$1.2 billion P3 Canada Fund designed to support the development of P3s in Canada. Provincial and territorial governments in Canada have been invited to submit funding requests for infrastructure projects to be procured using a P3 model.
Challenges

As noted at the outset of this article, Canadian P3s have not been immune to the financial uncertainty that has prevailed for much of the past year.

One challenge P3 projects have faced is the inability or reluctance of lenders to hold credit spreads during proposal validity periods which can sometimes stretch to six months and the requirement for “market-flex” type provision which were not seen on P3 deals prior to the credit crunch. To address this issue, public sector parties in British Columbia and Ontario have separated technical and financial submissions and have introduced the concept of financial re-submissions. Proponents are required to obtain shorter commitments from their lenders at the bid submission stage (typically 30 days) and are then permitted to renew, replace or revise certain aspects of their financing at prescribed intervals and prior to financial close. Although the exact mechanics differ from province to province, proponents must be able to demonstrate that any increase in margins proposed as part of a financial re-submission is attributable to general market contributions and not factors unique to the proponent or the project.

However, the additional “flexibility” to revisit financing terms after bid submission comes with a caveat. During the RFP stage it is accompanied by an ability on the part of the applicable public sector party to introduce alternative funding. In British Columbia, for example, if the public sector party determines that the cost of a proposal exceeds its affordability threshold or that the proposed credit spreads are higher than market, it may require that the preferred proponent seek alternate funding (either alone or in conjunction with the public sector entity) or obtain additional funding itself. Similarly, in Ontario, current RFPs allow Infrastructure Ontario, in certain circumstances where a proponent revised financial submission exceeds Infrastructure Ontario’s budget for a project, to inter alia, require that the proponent terminate its relationship with its existing lenders and, in conjunction with Infrastructure Ontario, conduct a competition among other prospective lenders to provide financing for the project. The Infrastructure Ontario RFP also requires that proponents not enter into exclusivity arrangements with lenders or prospective lenders thereby ensuring there are lenders able to participate in any funding competition that may become necessary.

Needless to say, whilst the introduction of financial re-submission provisions have addressed, at least in part, the issue of commitment hold periods and market flex, the ability to require proponents to seek alternate financing has been a source of considerable concern for lenders who are now faced with the possibility that, after expending a considerable amount of time working on a bid, they could find themselves excluded from a deal.

Another challenge P3 projects have faced is the general unavailability of long term bank debt. In the past, a number of Canadian P3 projects were financed by lenders who were prepared to extend credit for terms of 20 years or more (essentially matching the tenors of the underlying project agreements). However, most banks are no longer prepared to offer such long-term credit facilities. Consequently, “mini-perms” (with typical tenors of seven years) are becoming the most common type of bank debt on Canadian P3 deals. Soft mini-perms appear to be the most prevalent with the sponsors facing the possibility of cash sweeps and margin increases if they are unable to refinance. The short tenors mean that sponsors face potential refinancing risk on their projects. To date, public sector parties have not demonstrated a willingness to share in any refinancing risk although proponents are allowed to include refinancing assumptions in their initial bid submissions.

Hybrid deals have also become more popular with project financing comprised of a combination of shorter term bank debt and longer term bond financing. Provincial governments have increased substantial completion payments to facilitate such structures and Infrastructure Ontario also introduced a fixed payment due two years after service commencement on several of its projects (although this year two payment is not a feature of more recent projects). The increase in public-sector funding has facilitated the completion of P3 projects by reducing the amount of private-sector financing proponents need to raise. However, financing terms for P3 deals continue to be more restrictive than in previous years with higher gearing ratios (i.e., more project equity), higher margins, greater performance security and market-flex provisions being the current norm.

Club deals have also become more prevalent in the Canadian P3 market as there are few lenders willing to underwrite large financings and take syndication risk. As a result, bid costs are often higher as proponents find themselves negotiating with a larger group of lenders during the RFP stage.

Conclusion

Despite challenges, the Canadian P3 market continues to thrive. Deals are closing and new ones are being introduced regularly. P3 documentation is becoming more standardized and governments are adopting more uniform approaches to risk-sharing, thereby creating a more attractive market for domestic and international participants. P3 deals are still proceeding as public and private sector participants demonstrate a practical, flexible and collaborative approach to closing projects.
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