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Leveraging Canada's Active P3 Market

By Paul Giovannoni and Paul Trombitas

A viable means to repair and upgrade infrastructure, particularly in a strained economy where public resources are limited and private capital needs strong, risk-adjusted investment opportunities, P3 maintains a strong presence in Canada.

A critical factor in facilitating a country's ability to support growth and generate prosperity, available public funding can either enhance or restrict construction on a national level. To combat the latter, various countries (e.g., Australia, Colombia) across the globe have leveraged private financial capacity to help move essential infrastructure projects forward.

In particular, Canada has been a leader in utilizing public-private partnerships (P3s) to address its infrastructure needs. A project delivery model that relies on the upfront collaboration of all parties in the design, construction and financing of infrastructure assets, P3s' success in the Canadian market has been a multifaceted effort that involves a broad range of organizations and agencies.

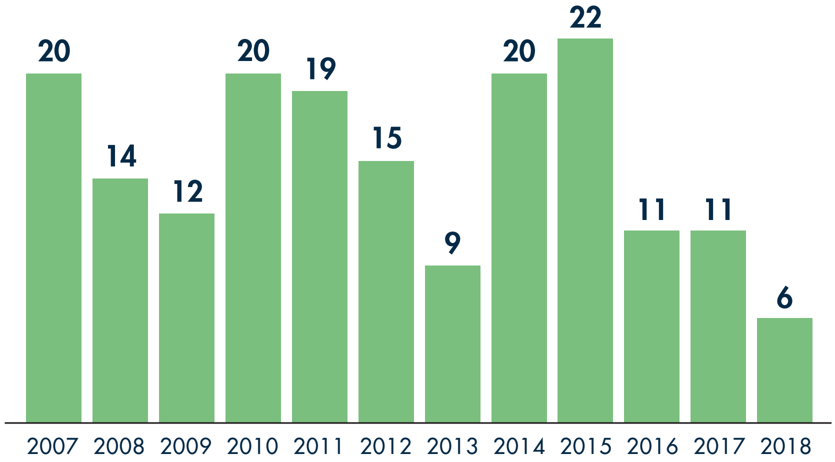
The Canadian government launched "PPP Canada" in 2009 to promote greater adoption of the P3 model nationwide. In addition, the "Canadian Council for Public-Private Partnerships" was established in 1993 to encourage and promote the P3 model across industry stakeholders. These two entities, along with other agencies and organizations, have made great strides in proliferating the Canadian P3 market.

By the Numbers

By definition, a P3 is a government service or private business venture that is funded and operated through a partnership of government and one or more private sector companies. Such partnerships play out particularly well on large infrastructure projects, where financing, ideas, risks and other input can be shared among the various parties—all of which have significant stakes at play. Although P3 infrastructure projects have had a fitful history in the U.S., other countries, including Canada, Australia and the United Kingdom, have fine-tuned such arrangements over the last few decades.

In looking at the numbers, the Canadian P3 market has successfully reached financial close on over 250 projects, accounting for more than $120 billion over the past 25 years. The majority (70%) of the country's P3 projects reached financial close after 2006 (see Exhibit 1 below), putting it at the helm of the Western Hemisphere's P3 market.

Exhibit 1. Canadian P3 projects reaching financial close

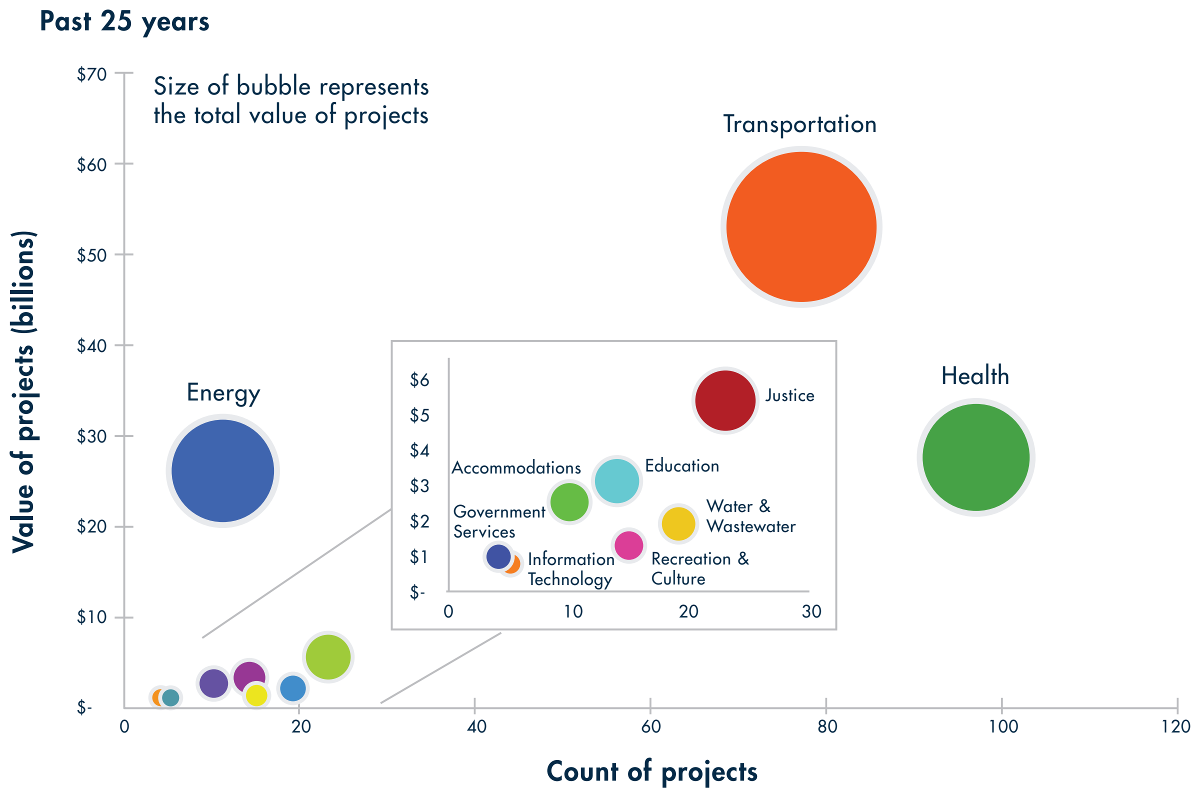


Source: P3 Spectrum and Canadian Council for Public-Private Partnerships

With the goal of leveraging private sector financial investment and market expertise to improve the country's overall infrastructure, the P3 model has been utilized successfully in transportation, health care, energy, education and various other project types. More specifically, transportation (43%), health care (23%) and energy (21%) have accounted for nearly 90% of the total value of P3 projects in Canada. Exhibit 2 depicts the count and value of the country's P3 projects carried out over the past 25 years.

In a recent interview with FMI, a utility owner indicated a growing interest in utilizing a P3 model to push its construction program forward. The utility owner wanted a contractor with "P3 know-how" to provide insight on effective strategies and best practices for structuring a successful P3 project. As owners continue adopting new methods to best deliver their E&C projects, firms that have proven experience and valuable insights on P3 best practices will have a competitive advantage.

Exhibit 2. Count and value of Canadian P3 projects by segment



Source: P3 Spectrum and Canadian Council for Public-Private Partnerships

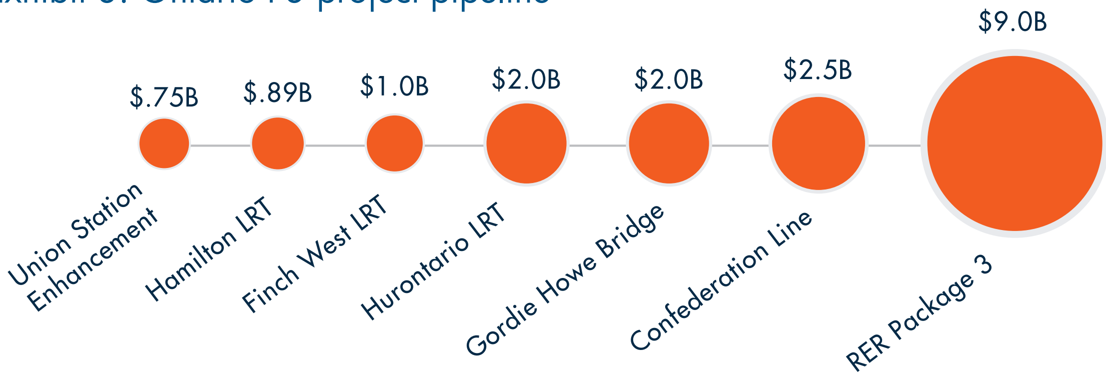
Today, P3 projects continue to proliferate nationwide, with Ontario representing nearly 50% of all Canadian P3 projects in the past 25 years. Outside of Ontario, British Columbia is next in line with 43 projects, followed by Alberta with 19 projects over the same 25-year time frame. Currently, Alberta is undertaking a significant LRT project in Edmonton with a total value over $2 billion. British Columbia is assessing a potential terminal project, Roberts Bank Terminal, valued at $2.5 billion. Needless to say, firms participating in the Canadian E&C market have experienced the continued growth of P3 projects in both number and size.

Hitting Record Highs

The number of multibillion dollar P3 projects is hitting a new record high, particularly with the growing expansion of mega-transit projects. As one transportation agency official stated, "It is slightly challenging for us when we come out with a billion-dollar project because so many companies are competing on all the other major P3 projects. This is unique from anywhere else in the world. What happens is that expertise is pulled from all around the world because the Canadian market cannot keep up with this mass of major projects."

Right now, Ontario is experiencing an unprecedented level of mega-P3 projects. Exhibit 3 represents the province's current P3 project pipeline, which totals over $21 billion. These megaprojects require significant labor resources—a requirement that has caught the eye and piqued the interest of many major multinational E&C firms that have the manpower and resources to complete such complex projects.

Exhibit 3. Ontario P3 project pipeline



Source: PW Finance and P3 Bulletin

The continuing success and ongoing growth of the Canadian P3 market has also attracted a unique consortium of E&C power players, drawing the likes of the country's homegrown giants and the "who's who" of multinational E&C firms and financiers. This band of industry giants is unified by a single purpose: the pursuit of a consistent stream of megaprojects across Canada.

Models That Work

Traditionally, there have been two distinct models for delivering P3 projects. The first is typically used by North American firms and is organized according to the firm's distinct role (i.e., financing, construction, operations and maintenance, etc.). The second model, which is typically used by European firms, includes greater vertical integration with a single construction firm participating across multiple roles—both on the front end (financial component) and back end (operations and maintenance) of the project life cycle.

The large multinational market entrants are structured to leverage the second model, which has gained traction and proven successful on large P3 projects across Canada. Vertical integration enables these firms to price more effectively and avoid duplication of risk. With those benefits, vertically integrated firms have been known to outprice their competition by double digits. Firms that have participated on multiple P3 projects have become even more aggressive on their P3 project pursuits, particularly as it relates to their pricing strategy.

"It is hard to compete against the big players on a multibillion-dollar P3 project, because they have it down to an art," stated one market participant. As the market continues to evolve, large Canadian construction firms are migrating toward the vertical integration model. These construction firms are becoming more involved in the equity component and expanding their services to operations and maintenance. The successful expansion of service offerings was indicated to be time-intensive and costly, requiring dedicated company resources at all times.

In addition to the large, vertically integrated P3 firms, smaller, midsized firms with P3 knowledge and experience are also becoming highly sought after. Local market experience and knowledge are another critical component for teams participating in the Canadian P3 market. Midsized firms with local experience are in demand and well-positioned to participate in a non-shareholder role.

As project size continues to increase, firms of all types and sizes will be needed to successfully deliver these megaprojects. Through in-depth interviews with more than a dozen P3 industry leaders as well as FMI experts, we uncovered several tactical strengths that help contractors get started with P3s, from both a business and operational standpoint.[1] Here are five key areas to consider:

1. **Build your expertise through strategic joint ventures. Pick your partners carefully.** Most interviewees described P3s as a completely "different animal." What you learned in previous construction jobs does not necessarily apply to P3s. Therefore, it is important to start cautiously, educate yourself as you move along, and work with experienced project partners—ideally, trusted partners with whom you've had successful prior experience. When selecting the right partners, the lowest bid is not always the best choice when you are hoping to form a long-term relationship in which both your futures are invested.

2. **Plan comprehensively for project complexities. Be smart about your business decisions.** P3s are typically very complex, large-scale projects. It is therefore ever-more important to know what to expect of the partnership beforehand and to outline expectations and responsibilities at the outset in an extensive, detailed contract. On top of that, a conflict-resolution contingency should be on hand to deal with inevitable disputes, whether large or small. Always keep an open mind and be ready to resolve issues at every step of the way.

3. **Understand the cost and risk barriers to entry. You need deep pockets and a thick skin.** Due to the magnitude of P3 projects, contractors are often required to provide proof of strong balance sheets and solid bonding capacity. Often, the concessionaire will require a large (i.e., financial) parent company to back the performance of the design-build and request very large Letters of Credit (LOCs) as additional performance guarantees of the design-build to meet the lender's requirements for backing the deal with debt. While the amount of equity a firm looks at fronting is one obvious consideration, the issue with greater potential impact on a firm's balance sheet is the financing risk it is taking on.

4. **Be very strategic about the projects (and owners) you go after.** Preparing bids for P3 projects can take years and millions of dollars of investment. Therefore, it is paramount to have a deep understanding of the owner's "ecosystem" (What are his/her budgeting process, timetable and constraints? What does his/her decision-making process look like? How is the public agency run?) and the viability of the project, which is often dependent on the public and political context. As part of this reconnaissance phase, it is also important to identify public agencies that understand what types of public policy goals they are trying to achieve and promote.

5. **Get in the door early.** Start building relationships with public officials and finance representatives now. P3s require commitment and support from very senior public officials, who must be actively involved in supporting the concept of P3s and taking a leadership role in the development of each given partnership if they are to succeed. Start conversations with public officials and finance representatives long before projects have been announced. Understanding both their project needs as well as the P3 process is key to building trust with a given stakeholder—crucial if they are to personally invest themselves in a P3. Long-term relationships with key influencers will help you shape and develop P3 projects from the onset.

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[1] "Public-Private Partnerships: What You Need to Know." Sabine Hoover. FMI. 2013.

The P3 Opportunity Is Vast

The potential opportunity this presents for midsized firms is tremendous, but only if those firms can position themselves to take full advantage of the market. The winning midmarket firms that will be the most successful are those that have a well-defined and focused strategy that combines the external market conditions and opportunities as well as the internal context the organization operates in and its aspirations.

Firms that are within five to 10 years of a potential ownership transfer and that have well-structured processes and loyal, experienced leadership could be prime candidates for an acquisition by a large multinational firm seeking to vertically integrate and penetrate the Canadian P3 market. Conversely, the firms that have growth aspirations, higher risk profiles and a strong balance sheet may enter the P3 market through the smaller-scale projects (i.e., those that fly under the radar of the larger firms chasing megaprojects).

The Canadian P3 market has not shown any signs of slowing down in the future, and while it may appear to have the greatest potential for billion-dollar contractors and multinational consortiums, it also presents a significant opportunity for middle-market firms, should they choose to venture out into this evolving marketplace.

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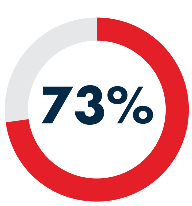
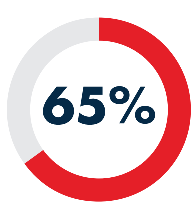
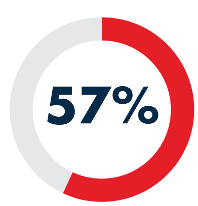
FMI Client Highlights



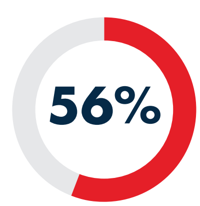
of the ENR **Top-400** **LARGEST CONTRACTORS**



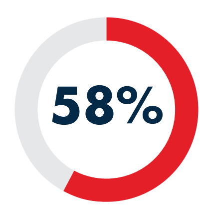
of the ENR **Top-200** **SPECIALTY CONTRACTORS**



of the ENR **Top-100** **DESIGN FIRMS**



of the ENR **Top-200** **ENVIRONMENTAL FIRMS**



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