

**THE PRESENT & FUTURE
OF PUBLIC-PRIVATE
PARTNERSHIPS IN CANADA**

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Dr. Laurence B. Mussio
February 25, 2011

Foreword

THIS RESEARCH PAPER FROM NATIONAL BANK FINANCIAL MARKETS (NBFM)

appears at an important crossroads for public-private partnerships, or P3s as they are known, in Canada. Active participants are well established and can draw from a rich, complex experience in the field. The expertise of the participants in the sector has enabled Canada's P3 community of practice to master the complexities and solve the tough challenges that come with the delivery of first-class and cost-efficient public infrastructure in Canada. Those participants include public infrastructure agencies, leading developers, investors, financial services partners, contractors, legal firms and others.

Today, public-private partnerships rest on solid foundations: expertise, a track record of innovation and reliable execution. An important part of the public infrastructure of 21st century Canada will rest on those foundations. NBFM is passionate in its commitment to this sector and is positioned to play a leadership role. In addition to a robust advisory practice, over the past 12 months, we have invested in a proven team of professionals. NBFM has underwritten rated bond commitments in excess of \$1.5 billion. It has also arranged \$2.4 billion of bank lending and institutional private placement commitments to support firm P3 bids.

The recent success of P3s notwithstanding, I believe that the present and future of P3s in Canada merits closer attention and the attention of a much wider audience. That is why the National Bank of Canada's Financial Markets group commissioned "The Present and Future of Public-Private Partnerships in Canada". This paper provides a clear and comprehensive look at the development of P3s in Canada. It traces the Canadian experience with these partnerships and offers a very readable but analytical perspective on the state of play today across Canada. Moreover, it offers a view of the challenges and opportunities ahead, and a perspective on how to build an architecture of excellence in Canadian P3 practice.

This paper is not primarily directed at the specialist or the “insider” in the P3 community. Instead, it is intended for what I like to call the “knowledgeable skeptic” investors who want to take a closer look at a good risk-adjusted asset and who want a primer on the history and future of P3s in Canada. It is intended for those interested in public policy development, how public infrastructure is delivered, and how innovations in risk management have transformed traditional methods of procurement. It is also for those who are interested in how the Canadian public and private sectors collaborate to propose solutions to often-complex problems whose solutions cannot easily be found in past experience. In other words, this is also an account of how Canadian institutions, public and private together, can work together to create institutional innovation for the public good.

The story of P3s in Canada reflects in many ways the classic trajectory of innovation in products and services. When new markets are established, new business models can experience false starts and growing pains. So it was with public-private partnerships. The models had to be created, tried and tested. There was no “P3 Starter Kit” that guaranteed success every time, right out of the box. With every project, however, experience, expertise and capabilities grew exponentially - especially within provincial public sector infrastructure agencies that provide the leadership and direction for the P3 community. The judgement, the methodologies, the decisions taken and the ability to execute began to match the promise of P3s with the performance of P3s. The result has been the emergence of a model that provides first-class infrastructure that allocates risk rationally, achieves value for money, spends public dollars both carefully and efficiently, and provides an excellent risk-adjusted asset class.

I have been involved with public-private partnerships in one form or another for well over a decade. During that time, I have seen some of this country’s best public policy minds and market leaders overcome tough infrastructure challenges and suffer the occasional setback to get to the success and performance we enjoy today. That experience and expertise has led Canadian companies and individuals to develop an international specialization in the field.

The most significant conclusion that I draw from this paper is that P3s have in an important sense “arrived,” but at a moment where we face new and important challenges, including the legacy effects of the recent recession. Process and funding adjustments, including government self-financing (milestone and completion payments, etc.) are having the effect of limiting the formation of private capital. Persistent pricing “stickiness” creates a cost and “value-for-money” issue for government and, if not resolved through a broadened investor base and funding competition, may well constrain deal flow. These and other issues must be addressed in order for us to collectively continue to innovate and provide critical, growth-enabling infrastructure in a fiscally responsible manner.

I conclude on a personal note. I would like to extend my sincere thanks to Normand Bergeron, Président and Directeur Général of Infrastructure Québec and John McKendrick, Senior Vice-President of Infrastructure Ontario for offering their perspectives on public-private partnerships in their province. I would also like to thank Larry Blain, former CEO of Partnerships B.C. for offering his insights as well.

I hope you enjoy the paper.

Peter Hepburn
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February 25, 2011

Executive Summary

THE PRESENT AND FUTURE OF PUBLIC-PRIVATE PARTNERSHIPS IN CANADA provides an overview of relevant public-private partnership (abbreviated as P3) experience in Canada from the available literature. It reviews the development of P3s in Canada, where we are today, and how these partnerships have emerged as a strong, compelling alternative to traditional procurement of public infrastructure. It also focuses on how Canada can make our P3 practice better. The paper traces the origins and development of P3s in Canada, examines how they became an alternative to traditional procurement of infrastructure, and precisely what innovations rendered its value proposition a compelling one. The popularity of public-private partnerships was founded essentially on ten major benefits of this alternative financing, involving several elements: tougher rules and cost certainty, more advanced information and verification standards, public protection against failure, risk transfer, budget predictability for governments and, of course, value for money.

The paper then examines the early Canadian experience with the “first wave” of these partnerships, and how the “second wave” of P3 projects - essentially after 2004 - benefited from experience, better organization and a more developed and sophisticated market. The paper discusses how the second wave of these partnerships has delivered substantial gains in efficiency in the building and upgrading of public infrastructure in Canada. The paper identifies seven key factors in P3 success in Canada:

- 1) The emergence of specialized infrastructure agencies to handle infrastructure procurements at the provincial level;
- 2) The evolution of best practices over the last decade;
- 3) The success of the P3 community in developing “efficiency drivers” - strong, specific and highly pinpointed capabilities in the sector;
- 4) The evolution in the sophistication and relevance of value-for-money assessments;
- 5) A more effective risk allocation process and the emergence of performance-based contracts;
- 6) The importance of a clear and competitive procurement process; and
- 7) The legacy of the recent recession, which has had an impact, inevitably, on the financial environment for public-private partnerships.

The next section of the paper deals with tomorrow: specifically, with how next-generation public-private partnerships can build an architecture of excellence in P3s at a time when there is an unprecedented need for public infrastructure in Canada. The paper suggests several foundations on which successful P3 procurement will rest. Each partner has a part to play. Financial services partners will have to deliver a full range of expertise to improve P3 delivery - from infrastructure and capital arranging services, to translating experience, relationships and capabilities across various industry sectors into tangible, relevant benefits. For public sector infrastructure agencies, their continuing efforts to balance public and private participation, to maintain a consistency of rules, and to share information on a national basis are all essential. Next-generation P3s may also involve breaching the municipal frontier and considering new fields for P3 deployments. The paper suggests that federal leadership, the continuing development of a pan-Canadian evidence base for P3s and a focus on transparency challenges are also important elements of next-generation P3 success. Finally, the paper discusses how Canadian capital markets have an important role to play in the future success of public-private partnerships by expanding the available capital pool for these high-quality, long-term public projects.

For 2011, the Canadian P3 community is well positioned to respond comprehensively to the continuing challenge of Canada's public infrastructure deficit. The first two decades provided the foundations for P3, as well as the lessons and vital experience. In the next phase of Canada's P3 deployment, success will depend not only on how well that architecture is reinforced and extended, but also on how well individual partners rise to the challenges that remain in unleashing the original promise of public-private partnerships in the public interest. Of course, one of the challenges is getting the P3 model itself just right. Those challenges can be significant, but the Canadian P3 community is more than equal to the task.

PART I: INTRODUCTION

An Overview of This Paper

THE PRESENT AND FUTURE OF PUBLIC-PRIVATE PARTNERSHIPS IN CANADA provides an overview of relevant public-private partnership (abbreviated as P3) experience in Canada from the available literature. It reviews the development of P3s in Canada, where we are today, and how we can make our P3 practice better. The paper can be considered a primer for those seeking to understand where the Canadian experience has led and will lead. It seeks above all to generate discussion about how the Canadian P3 community can make public-private partnerships a more efficient and effective vehicle for building and upgrading infrastructure in Canada.

In January 2010, the Conference Board of Canada published a comprehensive study on public-private partnerships in Canada called **DISPELLING THE MYTHS: A PAN-CANADIAN ASSESSMENT OF PUBLIC-PRIVATE PARTNERSHIPS FOR INFRASTRUCTURE INVESTMENTS**.¹ This study offers excellent points of reference and departure for the discussion in this paper.

This paper is divided into several parts. First, it offers an overview of public-private partnerships. Second, it lays out the case for P3s with reference to the Canadian and international experience. Finally, it analyzes and discusses the possible success factors and challenges for next-generation public-private partnerships in Canada.

Public-Private Partnerships in Canada - A Retrospective

Over the last twenty years, public-private partnerships, or P3s, in Canada have emerged as one of the answers to a very important public policy question: how do we come to terms with a very large and growing public infrastructure deficit? Much of Canada's publicly "built environment" - roads, bridges, highways, ports, hospitals, schools, libraries and a range of other public buildings - represent the heritage of the mid-20th century. Canada's remarkable expansion in the 1950s, 1960s and 1970s generated an impressive and lasting network of public infrastructure. By the 21st century, the ravages of time, wear and tear had taken their toll on that infrastructure. The changing patterns of Canadian life - new growth, changing demographics and environmental concerns - have added to the urgency of renewal. The increasing need to address the competitiveness, efficiency and productivity of urban, provincial and national economies has put further pressure on governments not only to act, but to act quickly, in spite of the constant pressures on public finance.

Public-private partnerships, or P3s, emerged as a key response to the challenges of Canada's infrastructure deficit. Pioneered in other countries of the North Atlantic world, especially in the United Kingdom, the P3 model offered a compelling new way to connect private capital and managerial expertise to a public purpose. Specifically, the private sector would be involved with designing, building, financing, operating and maintaining public infrastructure.

Of course, there has always been some degree of cooperation between the public sector and the private sector.² But public-private partnerships were something new: an innovative institutional mechanism to leverage the private sector's efficiency in public provision.³ They sought to create a unique and remarkable area of public-private collaboration. The model offered a way to overcome the limitations of traditional procurement. These partnerships promised powerful advantages. They opened up access to massive infusions of capital; they transferred risk to the private sector; they offered superior guarantees that projects would be done and done on time (with hefty penalties for not doing so); they provided value for public money; and they channeled resources, talents, knowledge and innovative power of the private sector to work with the soaring number and complexity of public projects.

Two Decades of Canadian P3s

Canada has now had twenty years of P3 experience. Those two decades have seen a steady evolution in the quality, efficiency and success of these partnerships. Complex transformations such as changes in public infrastructure procurement typically come with an “experience curve.” The Canadian P3 story began haltingly. In some cases, the value of the P3 model as applied in the early stages was questionable or non-existent. Inexperience handling these partnerships made P3s a subject of controversy and obscured public understanding of the model’s value proposition. These early initiatives taught the Canadian players in P3 procurement a number of lessons. The successes and challenges of Canadian P3s in the 1990s - the so-called “first wave” - also created vital experience, knowledge and insight into how to unlock the potential of public-private partnerships. In the last decade or so, we have seen a “second wave.” That second wave was as different as it could be from its predecessor - so much so, in fact, that the P3s of 1990 and the P3s of 2010 are similar virtually in name only. It has brought with it the development of expertise, markets and mechanisms, clear rules of the game, and the establishment of dedicated public agencies with top-flight talent, rigorous efficiencies and a deepening capability on the part of private sector partners. Those developments have dramatically changed the nature, quality and sophistication of the P3 model.

The effectiveness of the P3 model for infrastructure procurement comes at an important moment. The need for public infrastructure renewal, the pressure to deliver at a rapid pace and the constrained ability of public sector finances to fully answer the first two elements has brought the model into favour. The P3 model - its past, its present, and how its future can be strengthened - is the subject of this paper.

In many ways, Canada’s track record in public-private partnerships has made it an internationally-respected leader in the field. The Canadian P3 market has been called **“one of the more developed and admired ones in the world.”**⁴ The question is no longer if the P3 model should be used, it’s how: how Canada’s public private partnerships can collectively maximize their strengths and address areas of improvement. How should Canada’s P3 communities of practice define next-generation successes in the field? What are the next-generation success factors that will propel P3s into another wave of successful deployments? What will it take to make Canada a practice leader in P3s in the next generation? Canada’s experience and its future direction with P3s are, therefore, important. The future of public-private partnerships in Canada depends upon the delivery of consistent, measurable and long-term improvements in the way governments and markets continue to deliver the infrastructure of the 21st century.

PART II: THE EVOLUTION OF PUBLIC-PRIVATE PARTNERSHIPS

Origins

Public-private partnerships emerged in the last twenty years as an alternative to traditional public procurement. In that model, governments did everything: designed, built, financed, maintained, and took on all the risk. P3s provided new way both to provide and finance infrastructure by facilitating a number of innovations, opening up new channels of capital and financing, imposing market discipline on costs, transferring risk to the most capable and experienced parties, accelerating construction and providing value for money. Old public infrastructure demands enormous capital investment to restore, replace and expand. At the same time, governments are under constant pressure to contain spending as health care, education and other responsibilities expand. Governments confronted with large infrastructure investment needs, with restrictions placed on their ability to draw on borrowed money, turned to new forms of investment finance.⁵

Innovation: Faster Time and Lower Cost?

Government partnerships with the private sector to provide public goods and services emerged as the solution to the public sector's double-barreled challenge. For governments faced with large infrastructure deficits, public-private partnerships offered tangible, sustainable and long-term improvements in two fundamental areas: time and cost. The new P3s offered a way to accelerate infrastructure building and upgrading, and at a lower long-term net cost than traditional procurement. P3s also delivered a new form of taxpayer protection from cost overruns. The public sector pays, in other words, when the job is done or after the achievement of clearly defined milestones. This represents a powerful incentive to meet timelines, deadlines and conditions. As the Conference Board study aptly notes, **“the discipline of this market transaction ensures that the other innovations in the P3 model are working as they should.”**⁶ Value for money in fact represents the overwhelming value proposition of P3s. That's why P3s have been widely recognized as an innovative institutional mechanism to deliver successful outcomes in the delivery of public services.⁷

The United Kingdom has been a leader in the large-scale introduction of P3s. Between 1987 to the end of 2006 the UK government signed 590 P3s worth around £53 billion. There, the private sector played an important role in the dissemination of P3s, relying on a highly developed set of private institutions including funders, developers, project managers, operators as well as bank and legal firms. The popularity of the model spread to other countries. In Canada, the first wave of P3s began in the early 1990s.⁸

Premium Initial Cost for Premium Benefits

These benefits come with higher initial project costs. Those costs include the price of transferring selected risks to the private partner and the cost of private financing over public financing. The transaction costs associated with projects are also higher, for a reason: there is much greater due diligence and up-front risk assessment as well as several layers of due diligence undertaken by commercial and technical advisors on behalf of the equity investors and lenders.⁹ That more intensive process demands higher initial costs to unlock long-term benefits and take advantage of tighter pricing related to design and construction.

The Four Secrets to the Power of P3s

There are four mechanisms - four key innovations - that power the P3 value proposition:

1. **Performance-based contracts** - which ensure that private partners live up to their promises
2. **Optimal risk allocation** - which allocates risk to the partner who has the expertise, experience and ability to handle that risk best
3. **Integration** of design, construction, operation and maintenance to save cost and ensure execution certainty
4. **Private financing** - which provides ready access to capital and financing, and which imposes the discipline of the market on the project.¹⁰

The public sector retains the benefits of private participation while retaining public control and public ownerships of the infrastructure being built and the outcomes of the project being sought. It also allows the public sector to pursue an accelerated timetable for infrastructure building and upgrading. Infrastructure Ontario President and CEO J. David Livingston remarked in 2008 that it would simply not be possible for Ontario to project manage the numerous hospitals under construction in his province without the P3 model.¹¹

The Ten Major Benefits of Successful P3 Practice

What, exactly, is being imported into public infrastructure projects through the P3 model? Here are a few additional benefits of good P3 practice:

1. Tough Rules and Cost Certainty

Budget constraints are harder and more binding in commercial ventures. Overruns are typically not permitted. The cost you bid for is the cost you build for. That means much greater cost certainty for public projects.

2. Tough Information and Verification Standards

The P3 model involves more stringent information and verification activities for projects than in traditional procurement. In Canada, both the private partners and the infrastructure agencies of government take on this task.

3. Public Protection Against Failure

Failure cannot be transferred away from the private partners. They are on the hook for the risk they have undertaken and for the results they promised.

4. P3 Model Matches the Task to the Expert

P3s channel the complex, highly specialized tasks to the experts best able to handle them. Businesses that specialize in particular types of risky projects can take them on a scale that transcends the ability of government to do so - infrastructure groups within financial institutions, law firms, and especially construction companies with deep experience with infrastructure projects. Here, 'economies of learning by doing,' are a considerable advantage.¹² The beauty of this system is that it matches task to talent and challenge to capacity.

5. Private Managerial Expertise for Public Projects

P3s put the private sector managerial labour market at the disposal of public projects. The talent, experience and expertise of that market form a powerful adjunct to public sector expertise on the matter. The resulting collaboration leads to a strong mandate for the P3 model to deliver projects on time and with long-term cost savings. This added capacity can improve procurement outcomes by putting in place risk and consequence management techniques that were not typically available in the traditional procurement model.

6. Budget Predictability for Government

The P3 model introduces a strong element of budgetary certainty in asset maintenance. That avoids the temptation for governments to re-allocate maintenance budgets, for example, to cover other areas of budget deficit. It also promotes a “whole asset life” approach to both maintenance and the rehabilitation life cycle.

7. A Focus on Outcomes, Not Process

The focus is on desired outputs rather than inputs, and so private partners are compelled to choose cost-effective delivery practices. These projects are, moreover, delivered faster and more efficiently than under traditional public procurement methods.

8. A New Way to Manage Risk

The allocation of risk to the private sector means that once identified and valued, those risks are transferred to those with the deepest expertise to handle them. Risk is therefore minimized and costs controlled. One of the strongest elements of P3 public-private partnerships is the possibility for the public and private sectors to both share and allocate risk emerging from the investment.¹³ Canadian and international P3 practice has generally followed two main criteria: first, that the agent that should bear the risk is best able to influence the risk-related outcome; and second, that the risk should be borne by the agent able to bear the risk at the lowest cost.¹⁴ This type of risk allocation in infrastructure projects in particular is an undertaking fraught with complexity. If risk allocation is meant to establish financial equilibrium between the partners, bad or inaccurate risk allocation can raise costs and lead to protracted negotiations during which opportunistic behaviour is always a temptation. The complexity of risk allocation is especially challenging in areas of infrastructure such as transportation, for example. Technical risks in design and construction and completion dates are only the beginning. Commercial risks may also arise due to uncertainty, such as a change in traffic demand. Forecasts for certain types of traffic demand can differ from reality by 20% to 30%, for example.¹⁵ Political and regulatory risks are also possible - ones that emerge from actions terminating the concession, new taxes or regulations that severely reduce the value to investors or contract disputes. Finally, economic and financial risks involve uncertainties regarding economic growth, inflation rates and a number of other factors.

9. Investors Gain New Opportunities

Governments are not the only beneficiaries of P3s: investors are also important participants. Public-private partnership projects bring new partners to the table through the investments they generate. P3 investments are typically seen as attractive investments, especially for those investors seeking predictable, attractive returns on investment. The projects generate investment-grade, leveraged, and stable cash flows from government or quasi-government sponsors. Most projects also have strong contractual counterparties (in plain language, the parties to these P3 contracts and agreements) rated AA to AAA depending on the jurisdiction. Investors can also count on a long asset life - a 25 to 30 year life span of the main, underlying assets. That results in a long duration that is attractive to financial institutions and a host of other investors that hold long-term liabilities. In addition, the scale of these projects are typically large - in the ranges of \$250-\$500 million, which often requires a collaborative investment approach from investors. The risk of capital loss is considered to be low.

10. Public Well-Being Well Served

A well-functioning P3 system of procurement offers the public a number of important advantages. The enhanced ability of governments to deliver infrastructure - roads, hospitals, ports, bridges, and the like - on time and with long-term reduced costs is a substantial benefit. The easing of budgetary pressures on government accounts frees policy makers to focus on other priority areas such as health care, education and social and economic concerns.

The P3 model, then, provides an effective response to the challenge of infrastructure deficit. The speed and the scale of urban growth pose serious challenges for governments in both Canada and around the world. The challenges come in the form of building, maintaining and operating public infrastructures. That infrastructure is absolutely essential to maintain living standards and to create conditions for competitiveness and economic development.

In Canada as elsewhere, the most efficient use of public funds for public service provision in some sectors represents an additional motive to bring in private sector partners.

When P3s are successfully deployed they can also increase national efficiency by transferring activities from the public sector to the private sector, reducing the burden on public sector liabilities. The model also provides an opportunity to realize the value of public assets that could not normally be achieved.¹⁶

The P3 model, then, offers substantial benefits over traditional procurement in large and complex projects. In the next section, we review the Canadian experience with P3s. Did the reality live up to the promise?

PART III: THE CANADIAN SCENE

The First Wave

The first wave of Canadian P3 projects rolled out in the 1990s experienced mixed success. The early projects underlined the challenges of transforming a good theoretical idea into practice. Projects such as the Confederation Bridge and Ontario's Highway 407ETR were early, sometimes halting, attempts at exploiting the advantages of these partnerships. There is no question that this highway has relieved congestion in one of Canada's most densely populated metropolitan areas - and that the highway continues to expand. But there is also no question that, in retrospect, Ontario did not get enough for the 99-year concession offered to the private consortium. Risk allocation and risk transfer, a vital but exceedingly complex part of the P3 equation, did not often work well for a variety of reasons.¹⁷ Here, the learning/experience curve proved costly. As a recent study on the subject notes, in the early days of P3s, governments had to confront highly sophisticated and complex decisions with administrative and organizational structures that were only just beginning to be put into place.¹⁸ The administrative and organizational capacity of governments took time to develop. Governments began to build a complex architecture of information, expertise, knowledge transfer and exchange, and standardization of processes that could handle complexity, and deliver value for money.

The challenges of the first wave of P3s in Canada generated some controversy, public skepticism and a certain amount of misunderstanding about the ultimate value of the model. This first-wave legacy has taken time to reverse in light of second-wave P3 improvements.

P3 2.0: The Second Wave

As this paper has suggested, the second wave of P3s is substantially different from its first-wave predecessor. The Conference Board study on the P3 experience in Canada makes several important points about the second wave of public-private partnerships in Canada - in other words, those projects that benefited from experience, better organization and a more developed and sophisticated market.¹⁹ In particular, the study concludes that:

- Public-private partnerships are an increasingly important vehicle for building or upgrading infrastructure in Canada, in spite of their controversial nature;
- In the last six years -from 2004 - Canadian P3s have delivered “important efficiency gains” for taxpayers ranging from a few million dollars to over \$750 million per project;
- The Canadian evidence on the performance of P3s shows a “high degree of cost and time certainty” between the financial closing of projects (the point at which the contracts are signed, sealed and delivered) to the end of the construction period; and
- “Optimal risk allocation” between public and private partners, upfront assessment of project costs, output-based contracts and private financing all contribute to Canadian P3 efficiency gains.²⁰

Recent studies point to powerful evidence of the success of the Canadian P3 model in the so-called second wave of P3 projects - that is, after 2004. Both value-for-money studies and performance evaluations point to a single conclusion: that the P3 model is better at delivering efficiency gains in design and operational efficiency than traditional procurement.²¹

Out of 55 P3 projects in Canada, 17 of them have been delivered on schedule or early, two were delivered only two months late, and the remaining 35 are works in progress.²²

Indeed, the evidence may well eventually reverse the onus of proof in judging the suitability of P3s versus traditional procurements in infrastructure projects. Instead of P3s continually attempting to prove themselves, it may fall to traditional procurement “stipulated sum” projects to prove that they deliver the same benefits as do public-private partnerships.

The following table offers some selected examples of the value-for-money savings Canadian P3 projects are producing.

TABLE I: VALUE-FOR-MONEY SAVINGS ON SELECTED CANADIAN P3 PROJECTS²³

PROVINCE	PROJECT NAME	EXPECTED VALUE FOR MONEY SAVINGS (\$ MILLIONS)	WAS IT DEVELOPED ON TIME ACCORDING TO THE PROJECT AGREEMENT?
QUEBEC	Autoroute 30	751	Expected (Dec 2012)
ALBERTA	Northeast Stoney Trail Ring Road, Calgary	350-450	Yes (Oct 2007)
ALBERTA	Anthony Henday Drive Northwest Leg Ring Road, Edmonton	240	Yes (Nov 2009)
QUEBEC	Autoroute 25	226.1	Expected (Oct 2011)
ALBERTA	Alberta Schools Alternative Procurement Phase I, Calgary & Edmonton	118	N/A
ONTARIO	Sault Area Hospital	102	Yes (Oct 2010)
ONTARIO	Niagara Health System	96	Expected (Nov 2012)
BRITISH COLUMBIA	Canada Line	92	Yes
ONTARIO	Woodstock General Hospital	71	Expected (June 2011)
ONTARIO	North Bay Regional Hospital	57	Yes (June 2010)
ONTARIO	Durham Consolidated Courthouse	49	Yes (Nov 2009)
BRITISH COLUMBIA	William R. Bennett Bridge	25	Yes (Delivered 108 days ahead of schedule in May 2008)

Canada’s P3 partnerships, then, are delivering clear, tangible benefits in procuring and delivering Canada’s infrastructure. As the Conference Board study notes, the benefits of cost certainty in delivering public infrastructure are not just about saving money, though that benefit is the main attraction. The certainty ushered in by the P3 model promotes predictability in public sector budgeting. In the traditional procurement model, governments were often compelled to allocate substantial supplementary funds midway through a project just to get it done - and whether or not there was any reference to value for money associated with the extra expenditures.

The success of the P3 model in Canada has not come without close attention to continuous improvement in the P3 community - especially in provincial governments. This public sector capacity-building in this area should be counted among the great unsung successes of public sector governance in the last decade. Since the 1990s, both private sector and public sector partners worked hard at developing the knowledge, mastering the increasing complexity, and putting in place the structures and the mechanisms to ensure the P3 model can live up to its potential and deliver good, sound value-for-money projects.

Travels Along the Experience Curve: Key Factors in P3 Success

The clear shift between the first wave of these partnerships and the second wave demonstrates that the Canadian P3 community of practice responded both as individual partners and collectively to unlock the potential of P3s. This has meant working out some of the legacy weaknesses of the model - for example, devoting greater attention to the balance of public and private participation, fine-tuning value-for-money assessments, addressing issues such as transparency and cost. In other words, the P3 community has had to adjust theory to Canadian practice. Today, public-private partnerships account for between 10 and 20 percent of total spending on public infrastructure.²⁴ The increasing organization and specialization of the sector will likely result in a greater focus on the P3 model in the future.

In this section, we outline the factors involved in translating lessons learned into transforming the promise of public-private partnerships into reality. What changed and what worked? We identify seven determining factors.

Factor #1: The Emergence of Specialized Infrastructure Agencies

The first and the most significant factor in the success of public-private partnerships is the emergence of specialized infrastructure agencies to handle infrastructure procurements. Alberta, British Columbia, New Brunswick, Ontario and Quebec have all established specialized infrastructure agencies to handle P3 procurements. At the federal level, PPP Canada was recently established to manage a \$1.2 billion fund to support innovative P3 projects.

Let us cite one example of the difference these agencies have made. In 2004, Ontario established a framework known as Alternative Financing and Procurement (AFP) for P3s.

The framework sets out five fundamental principles for infrastructure development:

- 1) The process must be fair, open and transparent;
- 2) The process must be tendered publicly, using competitive processes;
- 3) Procurement processes should ensure efficient and cost-effective participation of bidders;
- 4) Procurement decisions must be based on value-for-money assessments, with the protection of the public interest being paramount; and
- 5) Risks should be allocated to the party that is best able to manage them.²⁵

In 2005, the province established Infrastructure Ontario to oversee the delivery of all AFP projects in the province. This new agency added a fresh impetus to these principles by applying value-for-money tests by independent consultants to ensure that P3 projects offer potential cost savings when compared to a traditional procurement approach. Today, Ontario has become an active area of P3 innovation and expertise. Similar stories can be told of other jurisdictions as well - in Alberta, British Columbia and Quebec in particular.

Factor #2: The Evolution of Best Practices

The evolution of best practices in P3s over the last decade has been won through application of lessons learned in the process. One early but prominent P3 project - the William Osler Health Centre (WOHC) in Brampton, Ontario - illustrates the successes and the challenges of the process. The plans for this hospital extended to the late 1990s, with approvals coming in November 2001. In August 2003, WOHC reached an agreement with The Healthcare Infrastructure Company of Canada (THICC), a consortium of two private-sector companies - Ellis Don (construction) and Carillion Canada Inc. (a non-clinical-service contractor) - and the Ontario Municipal Employees Retirement System (OMERS). In October 2007, the William Osler Hospital Centre opened its doors - a 608-bed hospital with 479 beds in service.²⁶

The Ontario Auditor General's 2008 assessment of this project analyzed many of the lessons learned about this prominent and well-publicized Canadian public-private partnership, citing several areas of improvement.

The lessons learned from the William Osler Hospital Centre project and others were in a sense put into practice three to four years before the Auditor General's report with the establishment of the dedicated infrastructure agencies. That meant no more "one-off" projects handled by departments or entities ill-equipped to handle the complexities of a large infrastructure project such as a hospital. With those agencies also came standardized agreement and procurement processes. Those new mechanisms have ensured that P3s can produce the outcomes that each partner is looking for.

Factor #3: Making Efficiency Drivers Work

Canada's positive P3 experience since 2004 has resulted from the emergence of strong, specific and highly pinpointed capabilities in the sector. Infrastructure agencies have been successful in working with their private sector partners in producing sound, effective performance-based contracts. They have also developed formal qualitative risk assessment processes which are based on both experience and changing commercial conditions. The rigor of the risk assessment and cost evaluation throughout the process - from the policy and planning state through to the design, procurement, construction, operation and maintenance - represents a major improvement in the execution of the P3 model.²⁷

The emergence of a disciplined, highly specific, expert-led procurement process has made a difference for the success of public-private partnerships in Canada. The detailed consideration of all costs up front, for example, provides a very clear picture of how the project will likely unfold. The ability to grapple with projected future costs was often postponed in the traditional procurement process. With P3s, those questions are tackled today, not tomorrow. As the Conference Board survey notes, the presence of private financing, and the risk that entails, **"forces both parties in a P3 procurement to take full account upfront of all the requirements and risks"** that a project may possess.²⁸ The ability of both the public agency and the private partner to deliver a detailed and sophisticated analysis on the subject reinforces the value of the partnership and increases its chances for success.

Factor #4: The Evolution of Value-for-Money Assessments

Value-for-money or “VfM” assessments represent another advancement in P3 practice. These assessments essentially document the time and cost savings expected before a project has begun - and whether it is worth it to proceed with a public-private partnership for the project. Gains in the complexity, accuracy and effectiveness of these evaluations have established a foundation of confidence in the P3 community. The VfM tests need to make sure that the risk transfer in any potential P3 is cost-effective and in the public interest. Here, the pricing of debt becomes especially important in any VfM equation.

What is the VfM track record? As the Conference Board notes in its study, 19 of the second-wave P3 projects have been delivered either early or on schedule, with only two projects delivered up to two months late. All 19 projects to date have had no construction cost overruns that were borne by the public sector.²⁹ Cost certainty is a tremendous advantage for governments, since they can channel funds to important projects without worrying about unpleasant surprises in the form of cost overruns in existing ones - a result that often occurred in traditional procurements. Those traditional procurements are not normally subject to any VfM test.

Factor #5: Risk Allocation Process and Performance Based Contracts

Another success of the second-wave P3s has been in the upfront assessment of risk allocation and the evolution of performance-based contract provisions. As P3 projects got more sophisticated, both the risk allocation process and the performance-based contracts were able to deliver substantial efficiencies by providing clear assessments and driving cost-effective delivery practices.

Factor #6: The Importance of Competitive Procurement and a Clear Procurement Process

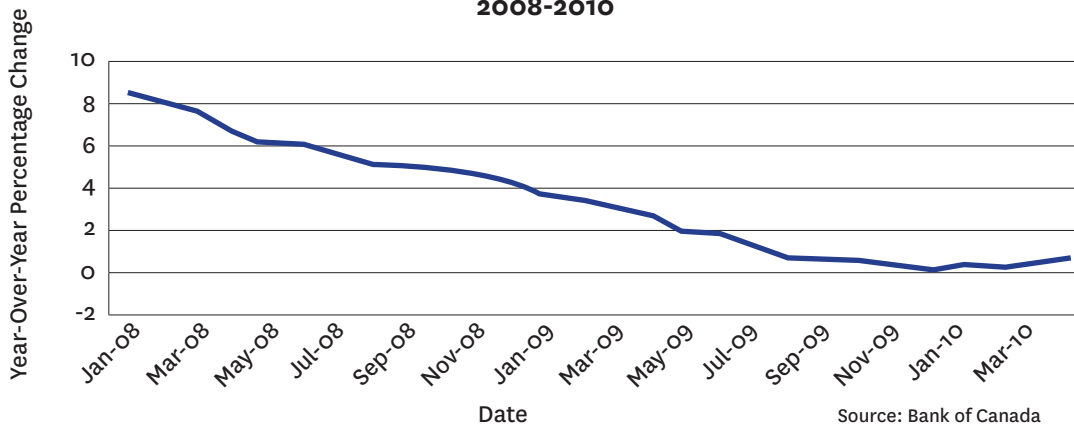
Two additional elements have powered the second-wave success of P3s in Canada. First, the development of the market for public-private partnerships has had an important and beneficial effect on the P3 track record. Several financial institutions and specialized advisory services compete for contracts. That allows the discipline of the market to serve the public interest.

Second, the transparency of the procurement process usually means that documentation, contracts, agreements, plans and the like are available for public viewing and discussion. A fairness advisor ensures that 'fair field and no favour' is guaranteed to the bidders to ensure a successful outcome. The strength and success of the procurement process is an important factor in the success of second-wave P3s in Canada.³⁰

Factor #7 The Legacy of The Recent Recession

Canada’s most recent P3 experience has also been marked by the recession of 2008. It is true that Canada fared better than all the G-7 countries during the downturn, experiencing an overall contraction of 3.4 percent in real GDP.³¹ The economic contraction and the general tightening of financial conditions, however, predictably created interruptions in the domestic and international credit markets. In Canada, total business credit experienced a steady contraction, as Chart 1 suggests:

Chart 1:
Total Business Credit, Canada
2008-2010



The credit contractions had an impact on the cost and availability of borrowing. Indeed, credit spreads shot up especially in US capital markets, but later reversed much of their original rise of 2008 and 2009, although this reversal has yet to be achieved for P3 financing. This “stickiness of pricing” reinforced the impression that P3s are expensive, perhaps overshadowing all the other longer-term beneficial effects of mounting public-private partnerships. The attitudes generated by the downturn - a greater concern for short-term fixes at the expense of long-term vision chief among them - had an inevitable impact on P3 perception.

In 2010, Canada led the way out of the recent difficulties with strong GDP growth, significant employment, one of the soundest banking systems in the world, strong balance sheets and generally the strongest fiscal position in the G-7.³² For the P3 community, the challenge is to once again re-emphasize the long-term benefits of these partnerships.

Second-Wave Success: Conclusion

Both Canadian and international experience suggests that the P3 model outperforms traditional procurements. Here, the foundations of success rest on the ability of key players to master highly complex factors: debt financing, changing market conditions, risk allocation, performance issues, innovation and effectiveness, lifecycle maintenance, public-private relationships and more. That hard work that is done up front — the detailed considerations, analyses, and risk allocations — are translated into both clear agreements and well-defined responsibilities that are reflected in the projects. The Canadian and international evidence persuasively shows that a clear, detailed and sophisticated P3 procurement process will result in substantial savings in terms of time and money over traditional procurements.

PART IV: TOWARD NEXT GENERATION PUBLIC-PRIVATE PARTNERSHIPS

In the last two decades, Canada's public-private partnerships have emerged as a strong, compelling alternative to traditional procurement of public infrastructure. The first wave of P3s validated the potential of this new procurement model. From its beginnings in the early 1990s, Canadian public policy-makers and private partners understood the potential for cross-sector collaboration to the delivery of goods and services. The benefits in terms of time and cost, managing complexity and new levels of discipline became possible. The first wave of P3s generated a progressive and cumulative understanding among the key players as a young Canadian P3 community of practice adjusted P3 theory to P3 practice. One of the principal lessons learned was that for all the strengths and advantages of the P3 model, it is also very demanding one. P3 projects can fail to deliver if players do not have the experience, expertise and capabilities available to unlock the potential of these innovative partnerships.

As an Australian commentator bluntly editorialized about a recent infrastructure project in New South Wales, **“if you don't do it properly, people will get burned.”**³³ It must also be said that the first wave of P3s in Canada created an impressive base of experience that led P3 players to learn, implement new approaches and unlock the potential of the model. The result is that the second, contemporary wave of P3s bears little resemblance to that first wave of P3s in Canada.

Building An Architecture of Excellence in P3s

The success of public-private partnerships in Canada has depended on the ability of governments and private sector partners to identify the success factors in improvement. Between the first and second waves of P3 procurement, governments, policy-makers and private sector partners laid the foundations for successful P3 deployments. They did so in the light of their early experience to improve the way the public sector handles projects. Canada's second wave partnerships were therefore based on the establishment of clear principles, effective processes and a strong public sector network of people with the expertise and professional experience to ensure P3 success. The developing sophistication of Canada's private sector partners also developed expertise and capabilities that became an essential pillar of P3 success. The result is that there is now a world of difference between the P3s of, say, 2000 and those of 2010. Governments get good value for public investment, innovation is encouraged, and they have wide access to private capital.

Other international jurisdictions have followed the same path. In Australia, the former Rudd government created a statutory body, Infrastructure Australia, to improve the way their government handles public-private projects - especially since it intends to spend \$1 trillion in super funds to bankroll a national infrastructure renewal program targeted at new roads, ports and other projects.³⁴ The European Union created the European PPP Expertise Centre (EPEC) in September 2008 to help the public sector overcome shortfalls in expertise, share experience, pool and synthesize information from across the EU about requirements for effective transactions and the skill-sets required to handle them.³⁵

Canada's public-private partnerships are strong and successful. Indeed, Canada is often seen as an international leader in the field because of that success. Of course, areas of improvement remain. If P3s are here to stay, how will Canada's P3 community of practice improve on the model? If the "third wave" of P3 partnerships began today, how could the Canadian P3 community use its successes in the area as a launching pad to deliver more effective and more successful partnerships? In other words, how can Canadian P3s make the transition from good to great?

The Canadian P3 community brings together an impressive set of capabilities from across the Canadian financial system. Those capabilities also contribute to Canada's competitive advantage - in terms of its ability to build infrastructure, develop its capital market, and deliver public services. Each of the players brings its talents to the table. The next-stage generation P3 market in Canada will demand more from all of its key players. In the case of financial services providers, the measures of success will come in the depth of their financial expertise, long-standing infrastructure finance industry relationships, and the ability to advise and arrange capital with relevant financial products. In the case of governments and agencies, success will come with meeting the demand for high-quality infrastructure which takes full advantage of all the benefits of public-private partnerships: on-time completion, certainty of cost, value for money, transfer of risk, the application of innovative financial instruments and construction processes, and more.

A Timely Partnership: Canada's Need for Infrastructure in Uncertain Times

The strengths of Canada's P3 community of practice are available at a time when the country's infrastructure is in urgent need of attention. Approximately 60% of infrastructure in Canada is between 40 and 100 years old. The cost of new infrastructure has been pegged at between \$115 and \$125 billion. This need comes at a time when Canada's combined federal and provincial deficit stands at over \$80 billion in 2010. Significant unfunded future liabilities and debt obligations make the public sector's fiscal challenge an important determinant in how it chooses to tackle its infrastructure deficit.

Of course, aging infrastructure and the limitations of public finance are not solely Canadian challenges. According to the American Society of Civil Engineer's 2009 Report Card for America's Infrastructure, the cost for needed improvements is estimated at \$2.2 trillion over five years. This comes at a time when government budgets are strapped as tax revenues decline and social program costs increase.³⁶

Here, Canada has a double edge over the United States. First, while the P3 model is gaining support and interest in the USA, it is far from a mainstream form of procuring and financing public infrastructure.³⁷ Canadian and provincial governments have established highly professional agencies that are able to take maximum advantage of the P3 model. Second, Canada's overall situation in mid-2010 is remarkably robust. Canadian financial institutions not only survived the turmoil, they have also become the object of admiration from other countries whose banks fared less well.

One estimate puts Canada on track to achieve a 3.6 percent increase in GDP in 2010, a 2.9 percent increase in 2011, and a slightly better performance in 2012.³⁸ Moreover, in contrast to past crises, when governments and the private sector retreated in tandem, this crisis seems to have aligned the interests of investors and governments in favour of infrastructure.³⁹ Capitalizing on this opportunity will not only depend on Canadian financial institutions and governments, however. International capital, bond buyers, and developers — their participation, interest and commitment — constitute a key element of success in delivering a renewed and upgraded infrastructure.

The successful future of public-private partnerships in Canada depends on two factors: How well the Canadian P3 community targets remaining/outstanding challenges; and how well the partners take what they do well and do it better.

Remaining Challenges

What challenges remain for P3 procurement in Canada? The reputation of public-private partnerships in Canada has sometimes suffered because of the mixed successes of first-wave P3s. In that first wave, P3 projects came under criticism for not providing value for money or for featuring high contracting costs. The complexity of projects, problems with risk transfer and contract management effectiveness were all cited as challenges to the P3 model.⁴⁰ Goal conflict, lack of knowledge, unfamiliarity with particular use-risks associated with government projects and lack of effective knowledge transfer reduced the ability of partners to offer real cost savings in the first wave of P3 projects in Canada. As the Conference Board study shows, however, the second-wave P3 procurements have benefited immensely from the deepening experience and expertise of public and private sector partners in delivering infrastructure. The time to move to the next level in the evolution of P3s has arrived.

I. The Importance of Communications

The sometimes-controversial nature of P3 projects in Canada should also remind public and private sector partners in P3 projects that they must not only achieve value for money, but they must also demonstrate and communicate that value to the public. If P3s bring an “overwhelming value-for-money proposition” to the Canadian market,⁴¹ then the Canadian P3 community must be more willing to proclaim the advantages of the model and firmly focused on the outcomes. To the public, outcomes matter most. Provincial infrastructure agencies are well down that road. They are increasingly taking the time to explain the process and the benefits to the public without falling into mere promotionalism.

It cannot, however, fall to just infrastructure agencies to promote the benefits of public-private partnerships. Financial services teams must also go the extra mile in making the case to policy-makers, investors, taxpayers, infrastructure users and the broader public about the benefits of P3s. In other words, it’s not enough to have a good financial model and a decent credit spread: Financial services teams have to engage in the art of persuasion, dissemination of knowledge and educational awareness.

II. The Challenge for Financial Services Teams: Delivering A Full Range of Expertise

Now that the system, the structure, the rules and the professional processes are in place, the success of public-private partnerships will increasingly depend on how well the partners carry out their obligations and deliver what they are supposed to deliver.

What can financial services partners in public-private partnerships do to improve P3 delivery? Canada's financial services sector has developed strong capabilities and expertise in handling public-private partnerships. A number of firms now provide a highly specialized range of services that provide vital elements of P3 project provision and infrastructure financing. National Bank, Scotiabank, RBC, CIBC, TD, BMO, Investec, Macquarie and Brookfield all provide varying levels of services, though different levels of focus, experience and strategy.

From a financial services perspective, the complexity, demands and sophistication of next-wave public-private partnerships in Canada will require infrastructure and capital arranging services providers to have a full range of experience, relationships and capabilities across various industry sectors. In this area, Canadian firms - construction companies and law firms in particular - are beginning to use their expertise and specialization in P3s to compete in foreign market such as the Caribbean and Australasia.

Infrastructure financing firms will have to go beyond the development and implementation of financing strategies for projects. Those activities usually embrace every major phase of a P3 project, from Request for Quote (RFQ) to financial close. Those activities also involve development of the financing structure and strategy, building and managing the financial model and the comparative financing evaluation process. The financial partners must also be able to adroitly manage the rating agency process and communication with lenders.

Next-generation P3 partnerships will demand a higher level of service that not only "add value" to service provision, but also deliver capabilities that can ensure the success of public-private partnerships. Firms must be able to deliver the full range of emergent capabilities for these projects to ensure their success. That includes the ability to deliver the following:

- Independent advisory services with demonstrated ability to source and develop financial solutions
- Strong analytical and financial modeling capabilities
- Effective project management
- In-depth knowledge of Project Agreement and related contracts
- Intuitive understanding of key project issues
- Ability to develop innovative, creative and deliverable financing solutions to the evolving Canadian market
- Transaction support to help lenders and bondholders with the technical aspects of the process
- Impeccable, strong and deep reciprocal relationships with
 - Legal firms that have project finance expertise
 - Industry consultants - P3 technical advisors and insurance consultants
 - Government agencies
 - Sponsors, technical advisors
 - The global and Canadian lending community to advise on and arrange capital, traditional infrastructure debt buyers, and debt capital markets to create additional debt placement opportunities
- Multiple product offerings across the range of instruments of financial services (bank debt, bond underwriting, private placement arranging, derivatives, etc.) and able to understand the subtleties, dynamics and requirements of debt market investors
- Conduct “heavy lifting” (in terms of analysis, insight, recommendations, paperwork) on due diligence for prospective lenders
- Adapt to changing circumstances in bond markets, sponsor preferences, and changes in government and public policy, etc.
- Deliver execution certainty - track record of success
- Provide leading market knowledge and trusted advisory services to proactively address the changing Canadian infrastructure market with client-first advice and objectivity

The competitive landscape in Canada for P3s amasses an impressive capacity across the Canadian financial system. Each of the players brings its talents to the table. The next-generation P3 market in Canada will demand more from all of its key players. In the case of financial services providers, the measures of success will come in the depth of their financial expertise, long-standing infrastructure finance industry relationships, and the ability to advise and arrange capital with relevant financial products.

III. The Challenge for Public Sector Infrastructure Agencies

Canadian provincial and federal governments have been at the centre of second-wave P3 success. The establishment of strong provincial infrastructure agencies, especially in Alberta, British Columbia, Ontario and Québec, has resulted in impressive improvements in the way public-private partnerships have been handled. The result has been the development of successful, well-defined mechanisms and processes. The commitment to fairness, transparency, innovation and their stout defence of the public interest has been demonstrated. Canada's infrastructure agencies are also constantly sounding the market and adjusting the process as they manage large-scale civil infrastructure projects.

These increased capabilities changes reflect the ways that the public sector has restructured itself for the new governance and administrative requirements involved as managers of contractual relationships.⁴² The process is strong and the mechanisms are strong. There are several areas of possible improvement infrastructure agencies and public sector partners may wish to consider.

- 1. Balance of Public and Private:** A major efficiency driver in the P3 model is private capital participation. Deploying private capital imposes market discipline on the project. The balance between public and private funds in a P3 project, therefore, should be considered carefully, and based on such vital reference points as value for money, the need for risk transfer and third party discipline, the kind of project being undertaken, and time considerations. Here, the cost of private capital and reducing credit spreads comes into play. Credit spreads (the cost of private capital over government's typically favourable rate) particularly need to be both sensible and provide value for money. In every case, of course, the model chosen must best fit the needs of the population.
- 2. Consistency of Rules:** Canada's federal structure and division of power means that provincial agencies have naturally taken the lead in providing the key infrastructure in transportation, education, healthcare and in a variety of other sectors where provinces retain primary responsibility. Infrastructure agencies therefore set the rules that best fit their provincial situation. Provincial approaches to infrastructure projects vary according to the civic and political culture of individual provinces, of course. Where possible, however, a greater consistency of rules across Canada would further streamline the P3 process in Canada and deliver potentially greater benefits. That means working toward having similar processes, conditions, data, and methodologies across Canada. This consistency would not affect the needs of individual provincial agencies to request different types of information. What consistency may do, however, is to create a flexible but predictable framework participants can work with and become familiar with across Canada.

Consistency of rules may also extend to consistency of treatment. This is especially true when it comes to barriers to entry, or in the treatment of potential non-provincial or non-Canadian partners. The rules need to offer an assurance that potential participants will be treated with equity, no matter where they come from.

It is important to stress here that that “consistency” does not equal “standardization.” In a regionally decentralized federation, each jurisdiction must be able to respond to its own particular needs and requirements. In this case, provincial infrastructure agencies have been extremely collaborative in sharing best practices and strategies and striving for consistency while recognizing the often-unique demands of their respective provincial contexts.

- 3. Information Sharing:** Best practices point to formal information sharing as an important principle of the process. Informal networks and back channel information, however, provide an imperfect market for information sharing.
- 4. Breaching the Municipal Frontier:** The P3 model should be expanded to the next level of government - municipalities. The municipal market in Canada is undeveloped, and represents the next-level government frontier in the advancement of P3s in Canada. As Patrick Boocock notes, “Municipalities often lack the resources and budgets to effectively procure major pieces of infrastructure, such as a wastewater treatment plants, although their relatively small size means that these projects can become overburdened by a full blown P3 process and standard P3 documentation.” The answer may come in a less complicated, easier to follow procurement process that will enable municipalities to minimize procurement budgets and provide them with the necessary expertise to move projects forward.⁴³ Yet, municipalities are often resilient to taking advice from senior levels of government. The issue in procurements at the municipal level is often one of asserting and protecting local control.

Here are a few quick and sensible recommendations that new municipal entrants may consider:

- **Project Agreements:** These need to be standardized to guarantee an efficient process.
- **Commitments:** Municipalities need to commit themselves to P3 projects once advisors have been involved.
- **Methodology:** As this paper shows, the P3 is state of the art and well advanced. Using a proven methodology is both possible and highly recommended.
- **Advisors:** The need to hire an experienced, knowledgeable advisor seems obvious, but is often overlooked.
- **Don't Transfer Risk That Others Don't Transfer:** There is always a temptation for municipalities to transfer types of risk that other jurisdictions don't dare transfer. The experience of other cities, states and provinces should be well understood: there is usually a reason why they have not transferred the risk.
- **Don't Reinvent The Wheel:** Municipalities can look to provincial agencies for guidance and advice. Those agencies have the experience, the capabilities and an impressive command of the field that should be harnessed and exploited.

5. Consider New Fields: The P3 model is appropriate only in certain circumstances on certain projects where such a partnership will deliver value for money. Governments may wish to consider other areas of public sector activity where leveraging public-private partnerships may not be normally considered. Energy generation and wastewater treatment are obvious possible candidates. Schools are another possibility where P3s can contribute to the public interest. One recent article suggested that public-private partnerships may work well in improving the managerial quality of the response and recovery phases of disaster management.⁴⁴ Others examine whether the P3 model may work in areas as diverse as tourism and education.⁴⁵

- 6. Asserting Federal Leadership:** Federal leadership in public-private partnerships could provide greater momentum in the sector. The P3 Canada Fund (P3CF) recently launched by PPP Canada represents the beginning of a greater federal role in accelerating infrastructure development through these partnerships. The emerging model in this area is co-operatively federalist. The government of Canada is harnessing the expertise and capacity of the well-established provincial agencies in certain cases. This permits federal policy-makers to focus on policy development and the facilitation of a sound, national market where the cost of bidding is the same or similar across the country.
- 7. Development of a Pan-Canadian Evidence Base:** The Conference Board of Canada study “Dispelling the Myths” suggests that procurement authorities consider developing a “pan-Canadian evidence base of conventional infrastructure projects” that would cover outcomes, value-for-money studies and other details.⁴⁶
- 8. Focusing on Transparency Challenges:** One of the challenges of the first wave of P3s and of conventional procurement was the transparency of the process. As the Conference Board recalls, the second wave of P3s in Canada became considerably more transparent in several ways. Key procurement documentation, the establishment of a fairness commissioner and the unblinking eye of auditors-general means that the fairness and transparency of the process is on much more solid ground. It is also interesting to note that with the exception of the scrutiny of the Auditor General, this additional scrutiny is not possible with traditional public procurement contracts. One visit to the website of Infrastructure Ontario or that of Partnerships BC, for example, will show the range and substantive nature of the information available to the public about P3 projects.⁴⁷

Still, transparency is sometimes cited as a continuing challenge to public-private partnership arrangements. The reality as much as the perception has an impact on public opinion and the legitimacy of the process. Here, some thought may be given to using a clear, narrow standard for what information should be kept confidential and ensuring that the documentation and the process is as open as possible.⁴⁸ The balance between transparency and protection of, for example, trade secrets, private balance sheets and the like must be continually negotiated.

III. The Challenge of Markets: Improving the Pricing of P3s

Finally, a third challenge to improving public-private partnerships in Canada involves the country's capital markets — and fund managers. The markets that provide the capital for P3 projects in Canada also have an important role to play in the future success of this model. Here, a few subtle changes may make a substantial difference. A major challenge to deepening the P3 financial market in Canada is the amount of capital available to funnel to these projects. Here, the answer seems to be broadening the investor base — perhaps through syndication and attendant broader distribution. By deepening the investor base, demand will be increased which will tighten credit spreads. Canada's large pools of pension funds also need to be convinced to invest in Canada — and not just in equity, but also in debt. P3 projects represent reliable, safe investments that contribute directly to national productivity. They are also long-term assets that produce on average above market return. Yet, the Canadian institutional investor base for public-private partnership projects is slender. In 2010, that base seems to be growing as pension funds and capital fund managers begin to understand the long-term benefits of investing in P3s.

Canadian banks also have their part to play in facilitating the P3 market as well by considering a greater collaboration to facilitate European bank financing in the Canadian market, or considering lending for longer terms. P3 investments — infrastructure investments — typically represent long-term, high quality investments in the Canadian context. In other words, if Canadian capital markets can build a liquid capital pool in Canada to meet the demand for P3 projects, Canada's P3 partnerships can only stand to benefit.

Conclusion

In the last twenty years, public-private partnerships in Canada have emerged as an innovative and powerful way to deliver public infrastructure. The success of that model has been hard-won. The partners in Canada's P3 community of practice have laid the foundations for delivering on the potential these public-private partnerships can offer. Governments developed strong, effective institutions of governance that put in place the right set of rules and conditions for P3s to thrive. Enterprise harnessed the markets, the capital and the managerial talent to successfully take on the complexities of risk and return. The collaboration between the two has worked well in the broader public interest. The benefits are tangible and measurable. When it comes to public infrastructure, Canadians are more focused than ever on outcomes and value for money. Public-private partnerships deliver on both counts.

One of the key elements in maximizing the potential of public-private partnerships is our ability to exchange and transfer knowledge and best practices — to stimulate the P3 community of interest in sharing successes, solutions and challenges. Two key concepts related to P3s merit particular future attention. The first concept is the philosophy, methodology and realities of “value-for-money” in the Canadian P3 context. As this paper has shown, the concept of value-for-money constitutes the fundamental basis for P3s.

The second concept is focused on transitory but recurring phenomenon: the “stickiness of pricing.” That term is an insider's way of referring to the reluctance of a price (or a credit spread, for example) to change, in spite of changes in either input costs or demand. The global financial crisis that emerged in 2008 has had multiple impacts on financial institutions and the credit market. When it comes to credit spreads, P3 projects have historically come at a premium to those achieved for similarly rated public, corporate or infrastructure issuers. There are several premiums that come into play: liquidity premiums, amortizing premiums and structural premiums. Those premiums drive the P3 cost of credit — an understandably central issue for infrastructure agencies. As a result, in some cases P3 financings have been characterized by stubbornly high credit spreads, though the situation has improved markedly in the second half of 2010. Both concepts — value for money and the so-called “stickiness” of pricing and credit spreads — represent life-or-death issues for P3 projects. How we frame these challenges and propose initiatives as a P3 community of practice is both timely and relevant.

In 2011, the Canadian P3 community is well positioned to answer the continuing challenge of Canada's public infrastructure deficit, in spite of the challenges that have been outlined in this paper. The first two decades provided the architecture. They also provided the lessons and the experience. In the next phase of Canada's P3 deployment, success will depend not only on how well that architecture is reinforced and extended, but also on how well individual partners rise to the challenges that remain in unleashing the original promise of public-private partnerships in the public interest.

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- 17 As the Conference Board study notes, many of the early P3 transactions were also characterized by their attempts at transferring all the revenue risk to the private consortia. In other words, private sector partners would be responsible for all the risk associated with any variation in revenues arising from the use of the facility - road tolls, for example. For a variety of reasons, these transfers of risk did not work well, mainly because other features of the transactions were usually adjusted to compensate. *Dispelling the Myths.*, p. 7.
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