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October news on the Canadian infrastructure market

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Creation of a Canadian infrastructure bank

On October 20, 2016, the Advisory Council on Economic Growth published its report entitled "Unleashing Productivity Through Infrastructure".

One of the report's recommendations is to create a Canadian Infrastructure Development Bank whose objective would be to deliver projects with an aggregate value of more than $200 billion over 10 years, while at the same time minimizing the use of government budgets. The new bank could grant financing in the form of subordinated debt or equity to supplement the financing provided by institutional investors in various projects.

The new entity would, in fact, promote the PPP delivery model or alternative financing models, although its role would not be to replace the existing provincial bodies, such as Infrastructure Ontario or the Société québécoise des infrastructures. Moreover, the federal government will also wish to ensure that the establishment of an infrastructure bank does not discourage investments by the private sector.

Finally, on November 1, 2016, the Finance Minister, Bill Morneau, confirmed the creation of the Canada Infrastructure Bank ("CIB") in 2017. The new institution will receive an initial capitalization of $35 billion.

It remains to be seen whether the CIB will be governed by the *Bank Act* or whether a new legislative scheme will be set up for this new institution.

Project to privatize eight Canadian airports

In the aforementioned report, "Unleashing Productivity through Infrastructure", the Advisory Council on Economic Growth proposes the privatization of the airports of Toronto, Vancouver, Montreal, Calgary, Edmonton, Ottawa, Winnipeg and Halifax.

The Council also recommends the use of private investment in other public infrastructures such as toll highways and bridges, high-speed railways, smart cities, broadband internet networks, power transmission lines and natural resources infrastructure.

This is not the first time the federal government has considered a project to privatize airports, but no decision seems yet to have been made at this stage, nor any agenda unveiled. However, the Canada Development Investment Corporation ("CDEV"), a federal Crown corporation reporting to the Finance Minister, Bill Morneau, has been mandated to hire consultants to advise the government.

On the other hand, during his speech to the Montreal Chamber of Commerce on November 2, 2016, the Minister of Transport, Marc Garneau, mentioned that privatization was only one of the options on the table.

Boralex closes a €100 million wind farm project financing in France

Boralex Inc. has announced the closing of financing for the Mont de Bagny (24 MW), Artois (23.1 MW) and Voie des Monts (10 MW) wind farms in France, for a total of approximately €100 million (Cdn$145 million). This financing is provided by Crédit Industriel et Commercial (Groupe Crédit Mutuel) and BPI France Financement. The construction of each of the projects is already underway and they should all be commissioned by the end of 2017.

This announcement was made shortly after Boralex acquired a wind farm portfolio of nearly 200 MW in France and Scotland, in September 2016. In June 2016, Boralex also closed another financing of €20.4 million for two wind farms in France.

These large transactions confirm Boralex's position as France's largest independent producer of onshore wind power, through its Boralex Europe subsidiary.

Possible refinancing of Montreal Gateway Terminals' debt

The Montreal Gateway Terminals project is currently studying the possibility of refinancing its bank debt.

This consortium, including Axium, Desjardins, Manulife, the FTQ and Industrial Alliance, acquired the company's assets from Morgan Stanley's first infrastructure fund in March 2015. The transaction was financed with mini-perm bank financing of $252 million over a five-year term. The banking syndicate currently consists of BMO, CIBC, MUFG & BTMU, RBC and Scotiabank.

DBRS downgrades Montreal hospital bonds

On October 20, 2016, the DBRS credit rating agency downgraded the rating of the senior secured bonds of the Centre hospitalier de l'Université de Montréal ("CHUM") from BBB (high) to BBB. This downgrade was due to the postponement of the substantial completion date of phase 1 from the second quarter of 2016 to the first quarter of 2017. This represents an additional delay of 20 weeks since the date of DBRS's last review and 48 weeks since the initial substantial completion date of April 22, 2016. The project will be in default if delays continue beyond July 2017.

HSBC implements a worldwide infrastructure financing platform

HSBC recently announced that it was setting up an infrastructure financing platform with a worldwide mandate, whose purpose will be to mobilize capital from institutional investors.

The team will be based in London and plans to sign its first mandate with the HSBC insurance company, which seeks to invest primarily in senior, investment grade infrastructure debt.

In doing so, HSBC is imitating other international institutions that are seeking to capitalize on the appetite for private capital for infrastructure debt. For example, the French bank, Natixis, has also established its own infrastructure debt platform, based on investments from insurance companies.

CIBC Asset Management establishes an energy and infrastructure team

CIBC Asset Management has just set up an infrastructure and power projects financing team. The team's mandate will be to take out interests in the form of private placements or public bond issues in the Canadian infrastructure, PPP, and renewable or non-renewable power production markets.

This is therefore a new player from the banking industry positioning itself in the market for long-term public and private financing of infrastructure projects. Until now, TD Asset Management and Desjardins Asset Management were the two most well-known Canadian banking institutions active in fixed income infrastructure financing, in competition with the insurance companies that traditionally dominate this market.

Bond refinancing for Kingston solar park

On October 19, 2016, Connor, Clark & Lunn ("CC&L"), Samsung and a group of co-investors closed a $633 million bond issue for the refinancing of the Kingston Solar project in Ontario.

Kingston Solar is a 100 MW project, one of the largest in Canada, located near the city of Kingston, Ontario, which commenced operations in September 2015. The project benefits from a 20-year power purchase contract with IESO. The bond issue, which DBRS rated BBB, will mature on July 31, 2035 and bears interest at a fixed rate of 3.571%.

This is CC&L's second refinancing of a solar park through the issuance of bonds after the refinancing of Grand Renewable Solar — a project of the same size as Kingston Solar — completed in June 2016.

Public bond issues are an appealing option for the refinancing of Canadian renewable energy projects. However, the number of transactions completed to date has been relatively modest, in part because of the constraints imposed by the credit rating agencies, which, until now, had encouraged promoters to turn to more traditional types of financing, such as medium-term bank loans or private placements.

Overview of the Canadian Public-Private Partnerships market

BENJAMIN DAVID GROSS and GÉRARD MOUNIER

The Public-Private Partnership delivery model ("PPP" or "P3") is now well established in Canada, where more than 177 of such projects were closed between 1993 and 2015 (source: InfraAmericas). The great majority thereof (166) have been closed since 2004, and the current trend indicates the number of projects is on the rise. Thus, considering the projects already completed in 2016 as well as projects currently engaged in the tendering process, according to the Canadian Council for Public-Private Partnerships "CCPPP", the total number of completed and pending PPP projects in Canada currently stands at 247.

Canada is often described as the most active PPP market in the world, and is certainly one of the most mature. The life cycle of infrastructures, the Canadian geography and the current economic context are all convergent factors that favour this market. Also, the improvement of public infrastructures through the use of private capital is a concept which has always benefited from the support of the federal government.

The Liberal government elected in October 2015 made infrastructure a major pillar of its economic platform with the campaign promise to double the country's infrastructure investments. On November 1, 2016, Finance Minister Bill Morneau announced the creation of the Canada Infrastructure Bank ("CIB") in 2017, whose mandate will be to invest in large infrastructure projects by attracting capital from institutional investors. Taking into account existing infrastructure programs ($91 billion), the investments announced last March in the government's first budget ($14 billion), and additional investments included in the economic and financial update last November 1 ($81 billion), the federal government estimates that the country's total infrastructure investments will reach $180 billion between 2016 and 2028.

According to the CCPPP's data, the Canadian P3 industry is still dominated by social infrastructure (58%) and civil infrastructure projects (24%). The health sector remains the largest subsector within social infrastructure, with 37% of the completed transactions. However, we note an increase in transportation-related projects, particularly suburban highways and light-rail transit projects. Other types of projects are also being developed, such as wastewater treatment and waste management plants and power transmission lines, all of which are new asset classes offering alternative investment opportunities for investors.

Provincial bodies such as Infrastructure Ontario, Partnerships BC, SaskBuilds, Alberta Infrastructure, Partnerships New Brunswick and the Société québécoise des infrastructures are at the heart of the Canadian PPP programs and are directly responsible for the majority of infrastructure projects. Infrastructure Ontario remains the largest agency in terms of size and the number of completed transactions. It also serves as a reference for documentation and processes.

At the municipal level, about 15 municipalities have also undertaken to develop their own projects, although they are often implemented in partnership with the provincial agencies.

Federally, seven projects have been launched to date in PPP mode, notably the Confederation Bridge and the new Champlain Bridge. Another recent example is the Gordie Howe International Bridge connecting Windsor, Ontario to Detroit, Michigan, which is currently engaged in a call for tenders process.

The 177 PPP projects completed since 1993, as reported by InfraAmericas, represent an aggregate value of $79 billion, or an average project value of $482 million. If we consider the aggregate of projects identified by the CCPPP as completed and currently underway (247), this represents a total value of $118 billion. It is generally acknowledged in the industry that a project must have a minimum value of $50 to $75 million to be viable for the PPP delivery model.

To date, Ontario and British Columbia have been the most active Canadian provinces in terms of PPP, together contributing 121 out of a total of 177 projects (68%) by the end of 2015. Ontario has completed 90 projects to date, or 51% of the Canadian market. This is followed by Quebec with 10%, New Brunswick with 6%, Alberta with 6% and Saskatchewan with 5%.

Canada remains a market open to international competition and foreign capital, and continues to attract numerous players from Europe and the United States. In terms of risk, this is a relatively conservative market that is not so open to projects exposed to volume (or traffic) risk. However, this has the advantage of attracting the interest of institutional investors for Canadian infrastructure debt, which actually benefits from high-quality risk ratings.

In terms of financing, the Canadian pension funds and life insurance companies are the main actors involved in investments in the form of private placements. Their interest in this class of assets has made private placements the primary financing solution for the Canadian P3 market. Most of the projects resort to bank credit during the construction phase, which is then refinanced on the bond market once the project has been completed. However, some projects have been financed solely through bond issues.

Thus, according to InfraAmericas, of the 177 projects that were financed by the end of 2015, 125 (71%) were financed solely with bank debt, 37 (21%) were financed solely in the capital markets, and 15 (8%) were financed with hybrid forms, i.e., through a combination of bank debt and long-term bond financing.

More recently, a secondary market for PPP projects has developed which has some potential throughout Canada. While most institutional investors such as pension funds and insurance companies view PPPs as long-term investments, there are also some promoters who potentially wish to assign their interests in certain projects after a relatively short time, in order to redeploy their capital in other projects or sectors.

Renewable energies: the trend is toward hybrid financing

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For about two years now, most renewable energy projects, particularly wind farm projects, have been financed using a so-called "hybrid" model, i.e., a combination of medium-term bank debt and long-term financing or private placements.

The term "hybrid" is derived from the vocabulary of the Public-Private Partnerships industry, particularly projects involving an operational and maintenance component as part of a long-term concession. Indeed, during the construction phase, these projects generally involve a bank construction loan with a term of 2 to 5 years, combined with a long-term bond issue. In most cases, the bank financing is to be repaid upon project completion by payments from the Public Authority, while the bond financing is amortized over the duration of the project's operational phase.

Until not so long ago, renewable energy projects were financed through one of two different models: medium-term bank financing of 5 to 7 years, or more rarely 10 years (i.e. "mini-perm financing"), or long-term financing (or a private placement) whose term was as close as possible to the term of the power purchase agreement — generally 18 to 20 years.

Bank type loans were primarily granted by the large Canadian banks, while long-term financings were generally the hallmark of the insurance companies and foreign banks.

More recently, particularly for the wind farm projects stemming from the latest call for tenders for community projects in Quebec, we have witnessed the emergence of hybrid financings which allow for the optimization of the project's financial cost and benefit from a lower interest rate on the mini-perm tranche, while still enabling the financing to be secured over the full duration of the project.

One of the features of this type of financing is that the long-term lenders must agree to grant a capital repayment holiday for the duration of the amortization of the bank's tranche. Indeed, if the two tranches were required to be amortized at the same time, the burden of repayment would have an excessive impact on the project's cash flows. Also, the long-term lenders generally prefer the bank's tranche to be fully amortized over its initial term to avoid any risk of refinancing at maturity.

It is technically possible using modeling to work up a plan to simultaneously amortize the two financing tranches that could be absorbed economically by the project. However, this would require a substantial reduction in the amount of the bank's tranche, and therefore minimize the financial benefits of the hybrid structure.

Other technical issues must also be addressed, such as, for example, how disbursements are to be made during the construction phase. The simplest way is to proceed in a similar fashion to PPPs, i.e., by fully disbursing the long-term financing at the start of the construction and starting the progressive payouts on the bank's tranche once the funds of the long-term tranche have been fully spent. Another way of proceeding is to pay out the two tranches at the same time with progressive payouts made pro rata to each other. This method is sometimes less suitable for institutional lenders for administrative and cash management reasons.

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Lavery Infrastructure

The Lavery Infrastructure team is recognized for its expertise in public and private infrastructure and for its skills in all areas of practice relevant to infrastructure projects. The team is experienced in setting up infrastructure funds, tax law, equity and debt financing, construction and suretyship law, municipal law, real estate law, environmental law, government affairs, transportation law, and mining and energy law. Major players choose our firm to advise them at all stages, from the conception to the construction and operation of projects that have marked their environments for decades.

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