2021

# Infrastructure Opportunities in Canada:

## Alternative Financing and Procurement and Public-Private Partnerships

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Over the last 25 years, Canada has become one of the leading markets globally for delivering much-needed public infrastructure by way of public-private partnerships (“**PPPs**” or “**P3s**”) and alternative finance and procurement (“**AFP**”), the name given to PPPs in Ontario.

Within Canada, Ontario has been, and based on current project pipelines, will continue to be, the most active jurisdiction in terms of number and value of projects completed and under procurement. Ontario Infrastructure and Lands Corporation, or Infrastructure Ontario (“**IO**”), is an agency of the Government of Ontario that was created in 2005 to procure and deliver AFP projects. Since then, more than 75 projects have reached financial close. There are also currently 16 civil projects and 24 social projects in procurement or pre-procurement valued at over $60 billion. Key projects in active procurement include the Ontario Line Subway, the Scarborough Subway Extension, the Yonge Street North Subway Extension, six rail expansion projects, several highway projects, six health care projects and two justice complex projects. There are also 24 projects under construction, mainly in healthcare, justice, transit and transportation. The extent of the projects being delivered through IO provides affirmation of the Government of Ontario’s commitment to P3s.

IO has recently embraced a broader set of procurement and contracting approaches. For instance, IO has added a new category of projects using a Rapid Procurement and Delivery methodology. As a result of COVID-19, IO has worked with ministries and broader sector partners to help deliver vital infrastructure smarter, better and faster than traditional methods. IO has been working with the Ministry of Long-Term Care to successfully procure the rapid delivery of four new Long-Term Care facilities using a Modified Construction Management model. IO has also used the Alliance delivery model for the Union Station Enhancement Project (see below for a discussion on the use of Alliance and Integrated Project Delivery models).

In Ontario, the provincial government completed a comprehensive overhaul of *Ontario’s Construction Lien Act*. The new *Construction Act* came into effect on October 1, 2019. The amendments are meant to achieve three objectives: (a) modernize the language to address commercial realities in today’s construction industry – notably PPP procurement models; (b) accelerate payment by introducing a mandatory prompt-payment regime; and (c) expedite the resolution of construction disputes by introducing a mandatory adjudication regime.

In many respects, the changes to this legislation have been welcomed by the PPP sector. This legislation explicitly addresses distinctive characteristics of PPP projects through certain exemptions to the prompt-payment and adjudication regimes. For example, public bodies (for instance, Crown entities) and the operation and maintenance portion of PPP projects are exempt from prompt-payment requirements, and project milestone phases are accommodated by exempting PPP projects from mandatory adjudication of substantial completion. Many of the impacts on the PPP sector resulting from the changes to the *Construction Act* remain to be seen as projects are only now entering into construction with the application of the new regime. Other Canadian provinces and territories, as well as the federal government, are reviewing these legislative changes and considering whether to adopt similar regimes in their own jurisdictions.

British Columbia has also been at the forefront of P3 procurement in Canada. Infrastructure BC (previously Partnerships BC), established in 2002 by the British Columbia provincial government, has overseen the delivery of more than 52 projects. There are currently ten projects under construction, including the Pattullo Bridge Replacement Project and the Broadway Subway Project, with another eight projects in procurement, including seven hospitals and a secondary school replacement project. The Sea-to-Sky Highway, connecting Vancouver to Whistler and used by many during the 2010 Winter Olympics and Paralympics, was one of the earliest signature PPP projects in Canada. Additionally, Canada Line, a rapid transit line connecting the Vancouver International Airport to downtown Vancouver, is considered a benchmark for successful rapid transit P3s in Canada. British Columbia has recently brought the P3 model of project procurement and delivery to new asset classes not previously seen in Canada, including a biofuel waste-to-energy facility and a worker accommodation facility.

The British Columbia government has confirmed its commitment to seeing the Surrey Skytrain Expansion Project proceed. The Surrey Skytrain Expansion Project was originally intended to be British Columbia’s first LRT project. However, following local civic elections in the City of Surrey, direction was shifted in favour of expanding the existing Skytrain line deeper into Surrey.

Overall, British Columbia has confirmed its support of large infrastructure projects with a three-year commitment of $22.9 billion to be spent on projects such as transportation, post-secondary facilities, health facilities and low- and middle-income housing.

In the summer of 2018, the British Columbia government announced that major infrastructure projects in British Columbia will be built using a new Community Benefits Agreement, which, according to the government, will include a targeted approach to maximizing apprenticeship opportunities and a focus on priority hiring and training of Indigenous people and women. Importantly, under the Community Benefits Agreement, within 30 days of employment on the job site, any non-worker or worker from another affiliation will be required to join the union for work specific to the project. The first horizontal infrastructure projects to be delivered using this framework will be the Pattullo Bridge Replacement Project, the four-laning projects on the Trans-Canada Highway between Kamloops and Alberta and the Broadway Subway Project, while the first vertical infrastructure project to use the Community Benefits Agreement will be the Cowichan District Hospital Replacement Project.

While Ontario and British Columbia have been the most active jurisdictions in using a PPP approach, several PPP projects have been procured in other provinces, as well as federally and municipally. The province of Quebec has executed major road, hospital and prison projects using a PPP model. The province of Alberta has also employed the PPP approach and has completed a number of PPP roads and schools projects and an expansion of a water and wastewater treatment facility. In addition, the City of Edmonton has reached financial close with respect to its Valley Line Southeast LRT Project and its Valley Line West LRT Extension, with the latter procured as a design-build-finance. Also active in the PPP market is the City of Calgary, which is currently procuring the Green Line LRT Project. New Brunswick, Nova Scotia, Manitoba, the Northwest Territories and Nunavut have also been active in the PPP market, with the City of Moncton's DBF Downtown Centre project having reached financial close in New Brunswick, and the Northwest Territories' closing of the Stanton Hospital P3. Nova Scotia has also recently reached financial close on its project to twin Highway 104, which will be delivered as a design-build-finance-operate-maintain project, and has embarked on the redevelopment of the QEII Health Sciences Centre.

After disbanding its P3 Secretariat in 2009, the province of Saskatchewan reinvigorated its PPP program with the establishment of SaskBuilds Corporation, a Treasury Board Crown Corporation, in October 2012. SaskBuilds' first project, a long-term care facility, reached financial close in 2014. SaskBuilds has now closed two major projects: the Regina Bypass project and the two joint-use schools projects (consisting cumulatively of 18 elementary schools), and the Saskatchewan Hospital North Battleford project is currently under construction. Saskatoon and Regina, the two largest municipalities in the province, have also completed other projects, including a civic operations centre, a stadium and a wastewater treatment plant.

COVID-19 has had an impact on the administration and drafting of P3 agreements. Contractors have been claiming delays due to COVID-19 and have framed these claims as either *force majeure* events or as changes in law. Government sponsors have been responding to market concerns about COVID-19 and have altered their template P3 agreements to better address and more fairly allocate the risks associated with COVID-19. It is expected that the dialogue between government sponsors and market participants related to COVID-19, and pandemics in general, will continue throughout 2021.

Apart from the innovative PPP approach to contracting, government authorities have begun to investigate and use other innovative approaches to project delivery. Currently, Integrated Project Delivery ("**IPD**") and Alliancing ("**Alliance**") procurement models and forms of contracts are under significant review and are beginning to be used by owners in an attempt to further create greater cost and schedule certainty, reduce disputes, increase collaboration and better manage risks. The IPD model has its origin in the United States, while Alliance is a model used in the United Kingdom and Australia. These models are used to deliver projects from several million dollars to over a billion dollars and which vary in complexity, although the model is often used to deliver projects that must balance many competing interests and deal with complex issues and risks. Both models are similar in their approach and goals for project delivery. Five years ago, only one IPD or Alliance project was under way in Canada, while today Ontario, Alberta and Saskatchewan have completed or have underway at least 10 IPD projects and one Alliance project. The models are now in use by federal, provincial and municipal authorities. British Columbia has recently announced that the new Cowichan District Hospital Redevelopment Project will be procured and delivered using the Alliance model.

IPD and Alliance processes and contracts are different from traditional project delivery models as the focus is on shared responsibility. All project parties set goals together, share information and accept all parties as equals. They also share the financial risk and the reward. The intent is that the entire team succeeds or fails together, so one party does not win while another party loses. In its implementation, the parties include at a minimum the owner, the designer and the construction contractor who are involved in forming the project, setting goals and identifying risks. Decision making is by a governance committee of the parties and payment is driven by a risk and reward regime with actual costs paid, but profits earned through success of project goals. As well, under the IPD and Alliance model, the parties agree to limit or waive claims against the other parties for most events.

The IPD model is a different way of thinking to complete a project and the Canadian Construction Documents Committee ("**CCDC**") has released its own IPD form of contract, the CCDC-30. IPDs are not expected to remove the use of traditional forms of contracts, but it is a market that is going to continue to grow and to represent a portion of the market. An ongoing review of the uses and success of the IPD and Alliance models will inform owners what projects are best able to capitalize on their use.

As a final point regarding infrastructure projects, it is noted that the CCDC has committed to release for 2021 revisions to its construction contract templates. The revisions are meant, amongst other things, to capture changes resulting from Ontario's *Construction Act*. The first template that has been released is the CCDC 2 - 2020, Stipulated Price Contract form. CCDC will eventually roll out an upgrade to its other forms, which will include the CCDC 5B - Construction Management for Services and Construction form, which IO has used as part of its Rapid Procurement and Delivery.

## FINANCING TO INFRASTRUCTURE PROJECTS

While the term "public-private partnership" or "PPP" has been used to describe a wide variety of transactions involving public and private participants – including the contracting out of services, the creation of non-share capital corporations (such as NavCan) and monetization of public assets through concession agreements – the present use of the term "PPP" typically refers to long-term arrangements entered into between public authorities and private sector entities pursuant to detailed contractual arrangements under which the private sector entity is required to design, build, finance and maintain and/or operate public infrastructure for a fixed period. These arrangements are effected through an agreement (typically referred to as a "project agreement" or "concession agreement") entered into between the public authority and the private sector entity which sets out the respective obligations and responsibilities of each party and allocates risks between them. In Canada, a wide range of PPP structures has been used, including traditional Design-Build, Build-Finance (which many consider to be outside the spectrum of PPPs), Design-Build-Finance, DBFO (Design-Build-Finance-Operate) and DBFM or DBFOM (Design-Build-Finance-Maintain or Design-Build-Finance-Operate-Maintain), based on the UK Private Finance Initiative model, providing for a long-term concession and including significant financing and risk assumption by the private sector. In the Canadian context, PPPs are not thought to include privatizations of public assets, as in the case of full or substantial divestiture of assets by the public sector.

PPPs are often used as an alternative means of procuring and financing infrastructure where there is insufficient public sector capital to meet immediate infrastructure investment needs. PPPs allow the public sector to access new sources of financing and achieve the benefits that private sector skills and management can bring, thereby creating efficiencies and value-for-money.

The fundamental principle underlying all PPPs is that risk should be allocated to the party best able to manage that risk. The risks typically allocated to the private sector include design, timely construction, operation and/or maintenance (where those are part of the project agreement) and financing. Milestones for project delivery, a fixed price contract and specified service standards are key components of the risk allocated to the private sector. The principal risks that are retained by the public sector, or shared with the private sector, will depend on the project type and the jurisdiction, but will typically include certain changes in law, insurance costs, uninsurable events, certain supervening events outside the control of the concession company (such as force majeure and catastrophic climate events, public sector strikes, protest actions and the like) and risks related to pre-existing but undiscoverable environmental conditions. Risks relating to adequacy of design, construction, maintenance and life cycle repairs typically reside with the private sector.

In Canada (as in the UK), PPPs typically are structured using a project finance approach under which a special purpose vehicle ("**SPV**") is established for the sole purpose of delivering a project and its related services. The SPV will enter into the project agreement with the public sector authority and will then "drop down" most of the design, construction and operational risks to subcontractors. The SPV will enter into financing arrangements with private sector debt providers, the debt coming from one or more of several sources (e.g., domestic and international banks, pension funds, insurance companies or bond investors) on a limited recourse basis. The lenders' principal recourse will be to the payment stream available to the SPV under the project agreement over the term of the concession. Canadian PPP projects are usually highly leveraged (with approximately 90% of the project costs being financed by way of senior debt, while the SPV's owners will typically contribute about 10% of the project costs by way of equity).

While PPPs were initially implemented in the face of considerable criticism (particularly from labour unions concerned about possible public sector job losses), as new roads, hospitals, schools and other public infrastructure are commissioned and built using a PPP model, the criticism has become much more muted. The PPP approach has become increasingly popular in Canada as many governments face significant budgetary deficits and conclude that P3s provide an innovative means of addressing Canada's significant infrastructure deficit without imperiling public finances.

With respect to performance security, the Ontario *Construction Act* introduces standardized bonding requirements which may not conform with the 'standard' requirements of PPP lenders. Accordingly, the *Construction Act* acknowledges the special financing structures of the PPP sector by exempting these projects from certain bonding requirements. For example, the project agreement between the public body and the private sector entity does not have to conform with the bonding requirements if the aggregate coverage value in the project agreement exceeds the amounts prescribed by regulation.

Of note is the increasing attention given to the Canada Infrastructure Bank. The Bank was created to co-invest with private sector and institutional investors in new, revenue-generating infrastructure **projects**. The federal government has authorized the Bank to invest $35 billion in such projects, and it is currently participating in thirteen projects, including in the transit and green energy generation sectors. The Bank will act as a centre of expertise on infrastructure projects and will offer this expertise to provincial, territorial and municipal governments wishing to undertake revenue-generating projects.

The federal government is also providing infrastructure funding through the Investing in Canada Plan. This Plan will fund more than $180 billion over twelve years to support projects across Canada in the areas of public transit, green infrastructure, social housing and the movement of goods. The flow of funds for infrastructure projects is expected to remain strong as governments seek to stimulate economic growth and to rebound from COVID-19. Within the federal government, Infrastructure Canada is responsible for investing $30 billion in COVID-19 Resilience infrastructure projects, while Ontario has set aside $1 billion to be invested in COVID-19 Resilience infrastructure projects. Ontario is planning to direct these funds towards long-term care, education and municipal projects.

As a final point on funding, governments involved in transit projects, such as subways or rail, are attempting to leverage government-owned land around such projects to attract investment by developers. Governments are working to have developers build residential and commercial space around major transit nodes to create a transit-oriented development ("**TOD**"). In return for the land provided by the government, the government will obtain a commitment from a developer to build certain density and contribute funds or construction services to upgrade a current transit station or create a new transit project, such as a subway. Within Ontario, the government has passed two pieces of legislation, the *Transit-Oriented Communities Act, 2020* and the *Building Transit Faster Act, 2020* to facilitate TOD projects which, in turn, help support its transit projects.

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