Mutually beneficial

Public sector deals offer investor stability while bringing private sector management skills to the table. BY JENNIFER BROWN

It could be said the perfect storm has created the ideal climate for private-public sector partnerships and joint ventures to take shape in the last few years. The state of the economy being what it is means two factors are at play: pension and other investment funds are looking for solid entities to funnel money into in an attempt to deliver decent returns. At the same time, there are government bodies interested in partnering with the private sector to help them better manage increasingly costly infrastructure projects.

Pension funds are the logical buyers for these types of public-sector projects, says David Brown, a partner at WeirFoulds LLP who co-chairs a private equity conference each fall. "They get up and talk about how they love these assets and the reason is that to keep generating seven- to 10-per-cent return it's tough, so they love these assets that can throw off stable, and in some cases government-guaranteed, cash flows. They love toll roads, for example, like [407] ETR and the secondary trading of assets like that. They have built-in collection mechanisms often administered or assisted by government. These types of assets are incredibly lucrative."

Brookfield Asset Management Inc. announced in September that it was purchasing a substantial stake in two Chilean toll roads from a Spanish firm for US$291 million. A consortium led by Brookfield acquired ACS Group's 46-per-cent stake in the Vespucio Norte toll road and a 50-per-cent stake in the San Cristóbal Tunnel. Brookfield is focused primarily on property, power, and infrastructure assets. At the time there was concern the investment might be in an earthquake zone, but Brown says moving into riskier areas can be part of the play. "You understand why these funds are moving up the food chain in terms of risk when you realize they need to meet the returns needed to fund the pension fund contributors when they retire."

Some Canadian pension funds are looking for opportunities outside of Canada to own infrastructure assets as opposed to the P3 model where you have a lender. "They are looking to simply have a revenue stream at a rate of return that meets their portfolio needs," says Osler Hoskin & Harcourt LLP partner Rocco Sebastiano. Whether it's energy projects, toll roads, or parking lots, investment funds are simply drawn to the stable cash flow public infrastructure projects deliver. There is some operational risk but very little compared to other market ventures these days. The problem is they are few in number compared to the other prospective deals out there.

With all the talk of tough times at the municipal level, the sense is there may be more movement at that level in the years to come than in the past. "One of the challenges we have in getting municipal projects to be attractive is deal size and project size and the promise of deal flow," says Sebastiano. "These things are resource intensive — they want to know there is going to be regular deal flow."

In June of last year, Osler acted for Atomic Energy of Canada Ltd. on the sale of its Candu Energy division by Natural Resources Canada. The Crown corporation's reactor business was sold to SNC-Lavalin Group of Montreal for $15 million, ending a process that began in 2009. The government has the opportunity to get royalties down the road because it retained the intellectual property rights. The government will also provide SNC up to $75 million to complete a new reactor. "What would have probably taken a private-sector entity much less time in terms of getting that deal done it took a lot longer," says Sebastiano. "I expected a further announcement of other things but that deal closed three months ago and there doesn't seem to be activity on other assets."

Getting government to make decisions on a timeline the private sector would normally demand can be a challenge on M&A deals of that kind. "They've got so many levels of approvals they need to obtain it makes those deals much more time consuming and you need a lot of patience," says Sebastiano. It also helps if there is someone to champion the transaction. "In the Candu sale the deputy minister was very much behind it and he believed it was something the government should do. When you lack someone like that to run with it like he did, it does make it difficult to get those M&A deals done," he adds.

Projects like the Candu sale also need a champion who is well regarded — whether it's a senior bureaucrat or deputy minister, it's important to have someone who has the ear of the government or cabinet who can help facilitate the discussions and make sure things stay on the front burner and move forward.

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The flipside of that is P3 school projects in B.C., Ontario, and Alberta. "I don't think you'd come upon a more streamlined and efficient process anywhere in the world," says Tobor Emakpor, a partner in Osler's construction and infrastructure group. "They have been fantastic in getting a large number of projects done in an incredibly short period of time." In the U.K., the last school deal he closed took just under two years from the initial selection of the proponent.

Canadian assets are in fact in high demand from investors outside our borders. "We were working with a group out of New York looking to do an acquisition of a Crown corporation and that's where there is revenue to be derived," WeirFoulds' Brown says.

"There are a number of entities with a lot of capital looking to deploy it smartly, and governments around the world have some very highly desirable assets that those financial institutions or pension funds with capital are looking at," says Patrice Walch-Watson, a partner with Torys LLP in Toronto who believes 2012 will be a year in which governments will be key players in driving M&A in Canada, the United States, and around the world.

There has been discussion by the City of Toronto of selling a portion of Toronto Hydro but it is mired in political debate. "There's always concern about undertaking a fire sale to make up a shortfall in your budget and that's in part some of the reason councillors are against the sale of Toronto Hydro," says Sebastiano. While provincial and federal governments have been on a path of divestiture of services and infrastructure for some time, the lingering economic climate of austerity is forcing many to dig deeper and think more creatively.

While public-private partnerships have been around for a long time, they continue to draw interest from the private sector and the public in delivering infrastructure in the way of schools and hospitals. "I think we continue to expect it to be an active area. What we're really seeing is a re-drawing of relationships in the private sector," says Torys' Mark Bain. "P3s are ways of investing in infrastructure and we don't think government is going to leave the field of providing infrastructure and providing services but they're going to do it in a different way."

In addition to continued investment in P3s, Bain says the secondary trading of those contracts will also draw attention when it happens. "When we look at areas that have more mature P3 markets than we do — in Australia, the U.K., and continental Europe — they are five to 10 years ahead of us," says Bain. These P3 contracts have restrictions on secondary-market trades until the asset is operational for a couple of years. "They're just starting to hit that stage here and we will see some trading of these contracts for the first time."

Public outcry over the sale of public assets has diminished over the years as taxpayers see proof of the benefits; it's still critical as to how projects are positioned. "I think that often a big part of the transaction is being able to anticipate public concern and address it upfront from a legal perspective," says Walch-Watson. CL