Property Development Aspects of Infrastructure and Other Public Projects

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It is widely recognized that there is a critical need for construction of new infrastructure and the repair and maintenance of existing infrastructure. Infrastructure includes a very wide range of projects: highways and toll roads, rapid transit, hospitals, airports, bridges, ports, water and wastewater, energy and power, schools, courthouses, sports, cultural and recreation facilities, and downtown revitalization. There are also many other types of "public projects" which involve municipal government, senior government or government agencies.

There is a significant commercial real estate component to many infrastructure and public projects. Almost all such projects have a construction element which involves development of real estate or improvements to real estate. Many projects also have related commercial and residential real estate development opportunities. Because there is such a significant development aspect to most infrastructure and other public projects and because there can also be commercial and residential real estate opportunities associated with infrastructure and other projects, these projects are a key component in Canadian property development. Transit-oriented development (commercial and residential real estate development above and around rapid transit stations or along rapid transit corridors), commercial development around ports and at airports and train stations, brownfields redevelopment, and commercial and residential real estate opportunities associated with downtown revitalization are all examples of significant property development opportunities for both the public sector and the private sector.

Spectrum of Project Models

There is a wide spectrum of project models for the delivery of infrastructure or other public projects. On one end of the spectrum would be the "traditional model", under which the public sector maintains ownership of the project asset (including real property) and prescribes the specifications for what is to be constructed and operated. Most project risk in this model stays with the public sector. One of the criticisms of the traditional model has been that a project is often delivered over budget or later than the agreed upon time for delivery.

At the other end of the spectrum of project models is a "privatization". In a privatization, the public sector transfers ownership of the public assets (including the real property) to the private sector. As the owner of the project asset, the private sector will have control of the asset, subject only to any agreement that may be entered into between the public sector and the private sector respecting the construction, operation and ownership of the asset. The privatization model has not been widely used in North America.

In the middle of this spectrum are public-private partnerships. There is a wide array of public-private partnership structures in and of themselves. The differentiating characteristic of the various types of public-private partnerships will be the degree of control that the private sector has over the assets. Another important differentiating characteristic of the various types of public-private partnerships is whether "private financing" is obtained.

Public-Private Partnerships

The very use of the term “partnerships” in the term “public-private partnerships” is misleading. There is no legal partnership between the public sector and the private sector in a public-private partnership. The public sector certainly would not want to be in a situation where there is a legal partnership because that would mean that the public sector could very well be responsible for liabilities incurred by the private sector in the ordinary course of the development or operation of the asset. Instead, the use of the word “partnerships” is more akin to the word “collaboration” and simply refers to the fact that the private sector and the public sector are collaborating on a project and allocating project risks between them. Oftentimes, the term “public-private partnership” is short formed to “P3”. The Province of Ontario uses the term “Alternative Finance and Procurement” (or “AFP”) to describe such projects.

It is important to distinguish between the various types of delivery models and the various types of public-private partnership arrangements. Sometimes, proposed projects are described as “privatizations” when they are actually “P3s”. Since a privatization involves the private sector’s ownership of the asset and this may not necessarily be the case (and in fact, usually is not) in a public-private partnership, this misunderstanding of the nature of the project can result in opposition to a proposed project simply on the basis of a misdescription of what is taking place.

When a P3 is utilized as a project structure, there is usually an agreement entered into between the public sector and the private sector and which may be called a “Project Agreement”, a “Concession Agreement”, or perhaps a “Ground Lease”. This agreement will set out what the powers, responsibilities and duties are of the private sector in the delivery and operation of the project asset. In addition, such an agreement will deal with insurance issues, indemnification, termination (for default or, possibly, “for convenience”), and dispute resolution provisions, as well as many other detailed provisions. There may very well be project financing agreements entered into between the private sector and the lender providing project financing. In many cases, the private sector utilizes a “special purpose company” that contracts with the public sector and also contracts with the lender.

In most cases, the public-private partnership arrangement will also include a Design-Build Agreement between the special purpose company and a contractor and an Operations and Management Agreement between the special purpose company and the operator. These two additional project agreements are very detailed documents and the public sector will, in almost all cases, require that it approve the form and content of these documents before the agreements are entered into.

One of the important issues to be negotiated between the public sector and the private sector when a P3 is entered into is the term of the agreement under which the private sector has the rights and responsibilities set out in the agreement between the public sector and the private sector. Depending on the type of project and how it is structured, the term can range from 15 years to 99 years. To the extent that ownership of the asset is transferred to the private sector during the term of this arrangement, the agreement between the parties will need to address repair and maintenance responsibilities, so that the asset is returned to the public sector in a state of maintenance and repair that the public sector expects. Even if ownership of the project asset stays with the public sector, repair and maintenance are important issues.

Property Development Opportunities

Infrastructure and other public projects present tremendous opportunities for commercial real estate investors, builders, contractors, and others involved in the development of infrastructure and other public projects. Many infrastructure and public projects have a very significant property development component. The following are just some of the property development aspects of infrastructure and other public projects:

(a) The land on which infrastructure and other public projects are developed is often owned by the public sector. Where the public sector does not own all of the necessary land, for example, in highway development or public transit projects, the public sector needs to acquire the property from an owner, either by way of a voluntary agreement (such as an agreement of purchase and sale) or by

expropriation.

(b) In some infrastructure and other public projects, the land upon which the development or project takes place is leased by the public sector to the private sector, often under a long term ground lease. The actual asset constructed on the lands may be owned by the public sector or, if constructed and owned by the private sector, it can be transferred by the private sector to the public sector at the expiry of the ground lease. The ground leases in such projects are complex and sophisticated.

(c) Where there is private financing for these projects, as opposed to senior government funding, there can be leasehold financing based on the ground lease. Often, pension funds and life insurance companies finance these projects because of the nature of the project and the underlying long term ground lease. Pension funds and life insurance companies are attracted to 25- or 30-year mortgage loans that often accompany such projects.

(d) The project documentation can also include a concession agreement, a design-build agreement, and an operation and management agreement. These documents need to reflect the project risk, as allocated between the public sector and the private sector. “Optimal risk allocation” occurs when project risks are allocated to the party best able to handle and mitigate the risk. If all project risks are assumed by the private sector, this is not “optimal risk allocation” and the inevitable result is a more costly project.

(e) A significant and emerging property development component of such projects is highrise residential, retail, and commercial development above or adjacent to infrastructure. For example, Metrolinx and others are examining ways to encourage “transit oriented development”, which is property development above or adjacent to subways and other rapid transit stations. This type of development affords municipalities the opportunity to share in the development potential above and adjacent to such stations. Additionally, there are residential, commercial and retail development opportunities associated with train stations, airports, and port and waterfront development.

Transit-Oriented Development

Municipalities and developers have become very interested in planning for transit-oriented development in Canada and the United States. “Transit villages” and “mobility hubs” are being considered and planned by municipalities and provincial agencies in Canada. Metrolinx, in particular, is taking an active lead in mobility hubs. Development around rapid transit stations can include commercial, retail and residential development. Such transit-oriented development is consistent with sustainable development initiatives being undertaken by Canadian municipalities and provinces. It is also consistent with efforts by municipalities to achieve intensification in large urban centres.

Transit-oriented development is one way in which municipalities may be able to participate with real estate developers in joint developments around subway, BRT, or LRT stations. This could provide a great opportunity for municipalities to participate in these kinds of developments and for innovative real estate developers to develop commercial or residential real estate in prime urban locations.

Rapid transit projects are not the only infrastructure projects that afford such commercial real estate opportunities. Municipalities in Canada are looking at ways to encourage commercial and residential real estate development around ports and harbours, and above and adjacent to railway stations. Prime real estate around ports and harbours and railway stations can be utilized for commercial and residential real estate development when port, harbour and railway infrastructure is renewed and developed. This, too, can result in sustainable development and intensification.

Other Infrastructure and Public Projects

Many municipalities in Canada have arranged for development of sports, cultural and entertainment centres in their downtown cores.

In many cases, this is part of an overall plan by municipalities to revitalize downtown areas. A successful sports, cultural and entertainment centre in a downtown core can then result in spin-off development nearby, such as highrise condominiums, restaurants, retail, and other commercial uses. Other types of projects, such as courthouses and brownfields developments, have been part of downtown revitalization plans that Canadian municipalities have implemented.

One of the more important infrastructure sectors at the present time and for the foreseeable future, is delivery of safe drinking water and wastewater management. Some municipalities maintain full control over delivery of safe drinking water and the management of wastewater. Other municipalities have entered into arrangements with the private sector, under which the private sector operates and manages safe drinking water systems and wastewater systems. It is important to differentiate between the operation and management of such systems and the ownership and oversight of such systems. The operation and management of safe drinking water systems and wastewater management systems does not necessarily mean that the private sector party operating and managing those systems owns those systems. Many Canadian municipalities have entered into arrangements with the private sector under which the municipality still retains ownership of the underlying land and safe drinking water facilities and the wastewater management facilities, as well as oversight and control over the private sector's operations, and the private sector is retained under a contract to operate and manage those systems. Many municipalities are assessing whether to continue the traditional approach whereby the municipality operates and manages those systems or contracts with the private sector for the private sector to operate and manage those systems. In Ontario, legislation has been introduced to impose obligations and duties on the owner of safe drinking water facilities and the party that operates and manages those facilities. Penalties are imposed for a breach of those duties and obligations.

Another infrastructure sector where there has been much debate recently is highways and toll roads. Many people have advocated there should be more toll roads in Canada, in order to reduce traffic congestion and encourage the use of rapid transit. There are some toll roads in Canada and some are planned for the future. In a toll road project, the land upon which the highway is situate is often ground leased to the private sector. In Ontario, Metrolinx has been established as a Crown agency to develop and implement a regional transportation plan and system for the Greater Toronto and Hamilton Area. This co-ordinated regional planning for highways, roads and rapid transit is a welcome approach to resolving traffic congestion problems and establishing a single unified integrated transportation system.

Energy and power projects have always been an important infrastructure sector in Canada. There are many types of energy and power projects (for example, nuclear energy, solar energy, and water or wind power) and it is expected that energy and power projects will continue to be a very significant infrastructure sector in Canada. These projects also have significant property development aspects. For instance, land interests may need to be purchased, leased or expropriated for transmission lines, solar panels, wind farms or other energy or power facilities.

One of the early infrastructure sectors to be emphasized by provincial governments in Canada over the past five years was hospital development. In particular, a tremendous number of hospitals have been developed or are being planned in Ontario through the efforts of Infrastructure Ontario, using its AFP approach.

Conclusion

Clearly, property development forms a significant component of infrastructure and other public projects. The need for infrastructure renewal and development and other public projects across Canada will remain critical for many years to come and, as a result, the property development aspects and opportunities associated with these projects will continue to be important.

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