

P3 projects reduce risk, forum told (May 1, 2002)

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VICTORIA - David Santangeli, an investment banker with Scotia Capital, has spent the last 10 years finding capital to make public-private partnerships projects go and it's all about risk: risk transfer, risk allocation, and minimizing the pain.

Transferring the risk from the public sector to the private is what differentiates a P3 project from a standard government contract, Santangeli told Canadian Design-Build Institute members Friday.

He pointed out many risks-operational, construction, and financial-can be difficult to quantify and that can make assessing a P3 project problematic for government. Guessing wrong can hit public safety or finances hard.

The private sector, on the other hand, usually knows how to measure and manage risks so it is in a better position to assume those risks than government is. Going private, Santangeli said, can actually increase public safety because it's easier for government to regulate someone else. It also often makes more financial sense for a project to be done by the private sector, he said, even taking into account different financing rates.

The cost of government funding represents the power to tax and not the true value of the project.

Santangeli warned against falling into the trap of comparing private financing rates with the government's cost. On paper, the value of a hypothetical utility owned by the public sector with six-per-cent financing is almost \$432 million, while the same project owned by the private sector and financed at 7.6 per cent is less than \$290 million.

In reality, the project is not worth more when owned by the public sector and the cost of private-sector funding more accurately reflects the risks and eventual benefits of the project. The players willing to take those financial risks with a P3 project are banks, public bond buyers, and debt private placement investors.

The handful of banks available to most Canadian projects will do large, complex arrangements but they like deals that run five to seven years and that's a difficult timeframe for infrastructure projects to meet. There are more public bond buyers (about 150), making for a large deep market, Santangeli said, and they only like a rated credit risk of A or better. They also only like simple deals.

Of the 20 or so debt private placement investors, only a handful will bother to analyze complex structures. P3 organizers should structure the deal to fit the wallets that exist, Santangeli advised. Public market equity investors "won't answer the phone" for P3 and subordinated debt funds have very limited interest in P3.

Public pension funds, on the other hand, are very likely targets. They've got big appetites for the right deals and they're patient. They'll go into a long-term project-30 to 40 years-if the returns look stable.

Specifically, there are large strategic investors like Australia's Macquarie, which is limited to transportation and regulated utilities, or Borealis, with a wider mandate that includes schools and hospitals. They are experienced and aggressive and willing to take equity and capital markets risks.

Sponsors may take on similar roles to strategic investors, especially where spin-off benefits exist, like engineering work in the case of SNC-Lavalin.

Viable P3 projects take more than just financing, Santangeli said, and he had some advice for both sides of the partnership.

"In dealing with the private sector," he advised government, "push as much risk on them as they will take, make them compete in an open, fair process, but accept that they should get a fair return."

He warned private sector partners not to promise to take on more risk than they're really willing to accept, to always expect a project to be tendered no matter who created the concept, and to structure the financing away from market holes and toward deeper pockets of capital.

Both sides should hire qualified, experienced advisers.