Roundtable

Canada

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If you build it

Canada's Liberal government is in the midst of creating an infrastructure bank. But announcements and execution are two different things. How will the bank move Canadian infrastructure investing forward? **Joel Kranc** and four key industry participants find out

For anyone not paying attention recently, much lip service has been paid to job creation and economic stimulation through infrastructure spending. In 2015, China established the Asian Infrastructure Investment Bank, aiming to support the building of infrastructure in the Asia-Pacific region. There are 52 member states currently. In the last US election (and in current discourse), then candidate and now President Donald Trump talked about a $1 trillion stimulus to boost job growth and fix an ailing and crumbling infrastructure. The most recent discussion coming from the Trump White House is that the $1 trillion contemplated may be insufficient to handle current projects and could face more bipartisan obstacles in Congress.

In Canada, under the auspices of Justin Trudeau's Liberal government, two budgets have come and gone, both of which introduced and later reiterated infrastructure spending. Initially, in 2016, the government pledged C$180 billion ($136 billion; €128 billion) in infrastructure spending over 12 years. This year, the announcement of a Canada Infrastructure Bank, aimed at

spending C$35 billion in the coming decade, was made as part of the most recent budget,with legislation to make the bank a reality introduced just before we went to press. The government said it hopes to structure the bank to attract private sector capital into larger infrastructure projects. And in a speech made last year by Finance Minister Bill Morneau, he said he wants to work with all levels of government to achieve the administration's plans. "It is very important that all levels of government and the private sector work together to bring our best ideas forward when planning and implementing infrastructure policy."

Which leads us to the current state of play in Canada. A lot of infrastructure talk has been going around, budgets have been tabled in Parliament, and announcements have been made. But has this really amounted to more opportunities for the private sector and enough large-scale or scalable projects to make investors want to participate in the Canadian infrastructure story?

AN ELUSIVE OPPORTUNITY

Canada has traditionally been a relatively small market in terms of investable opportunities, and according to Greystone Managed Investments' Jeff Mouland, "while there is an abundance of infrastructure capital in the market, the number of opportunities to deploy capital domestically are fairly limited". Investors, he points out, are looking to deploy capital quickly after a commitment, but historically, large multi-billion dollar Canadian infrastructure projects have been few and far between. "The mid-market transaction space will most likely offer a more sustainable and scalable infrastructure opportunity set, providing a larger degree of execution certainty and value proposition for private capital." He adds that core services such as transit and energy supply and efficiency – areas that are essential rather than discretionary – will see more interest from private capital.

However, beyond the size and scope of the Canadian market are the government's recently stated commitments. Expectations have been created, and it is here that our participants express mixed views regarding the government's progress.

"I was disappointed that the government's latest budget made no reference to airports," admits the Ontario Teachers' Pension Plan's Andrew Claerhout. "This would have been the right timing, in terms of the length of time the government has been in power, and how much time is remaining, to come out with some more concrete plans." The government had announced that it was exploring the idea of converting Canada's eight-largest airports, and possibly its port authorities, into 'for-profit entities' that would be sold to private investors. Claerhout, who invests in ports, airports and seaports around the globe, was hopeful for more details around this, which never materialised.

Similar to Mouland, Claerhout says that leaves the Canadian market mostly reliant on the public-private partnership model of procurement, which does not necessarily attract big investors. "It's

AROUND THE TABLE

Jeff Mouland, executive director & head of infrastructure, Greystone Managed Investments

Mouland joined Greystone in 2012. He leads the infrastructure team and is responsible for investment strategy, asset sourcing and execution, and portfolio construction and management. Before Greystone, Mouland was part of the infrastructure investment team at the Public Sector Pension Investment Board, where he sourced and executed deals across sectors and helped develop an emerging market direct investment and strategic fund investment strategy.

Gregory Smith, president & chief executive, InstarAGF Asset Management

InstarAGF founder Gregory Smith has over 20 years of investment experience in public and private infrastructure, real estate, power and utility businesses. Prior to InstarAGF, Smith was managing partner and head of Brookfield Financial's Global Infrastructure Advisory Group. He also served as the president of Macquarie Capital Funds Canada, where he was responsible for the establishment, growth and operations of Macquarie's unlisted and listed funds business in Canada.

Richard Lee, managing director, project finance & infrastructure group, Manulife Financial

Lee is responsible for both infrastructure equity investments and project debt financings, having joined Manulife in 2005. Prior to Manulife, Lee worked at Veolia Water, Sithe Asia, CH2M Hill, Probyn & Company and Royal Bank of Canada. Lee has over 26 years' experience in advising, investing, developing and lending in power generation, transportation and water and wastewater infrastructure sectors. He obtained an MBA from York University in Toronto and a BASc in Mechanical Engineering from the University of Toronto.

Andrew Claerhout, senior vice-president, infrastructure & natural resources, Ontario Teachers' Pension Plan

Claerhout leads OTPP's infrastructure & natural resources group and is responsible for delivering long-term, predictable value and hedges against inflation by making direct investments in infrastructure on a global basis. Additionally, he is responsible for physical investments in natural resources, such as timberlands, oil and gas assets and farmland. He joined OTPP in 2005 and previously headed the pension's London office from its opening in 2007 until returning to Toronto in 2009.

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>
> Claerhout

great for lenders and construction companies, but not particularly great for people looking to write large equity cheques," he says. He also notes that because energy and power are largely deregulated and not government-controlled in Canada, these areas provide more investable opportunities.

Although Canada's long-term infrastructure plan is to spend C$180 billion over 12 years – compared with the US's proposed $1 trillion in spending – InstarAGF's Gregory Smith says it is, in fact, a more aggressive plan than the US's, when considering the relative size of the US economy, which is nine times larger than Canada's. He sees the first two years of the Liberal plan, which focuses initially on smaller municipal projects, as an appropriate first step and meaningful progress towards meeting Canada's infrastructure needs.

"The next phase of Canada's infrastructure plan will focus on larger and more complex projects, which take time to plan and execute properly," he points out. "We see strong demand for infrastructure investment, but also a large supply of investment dollars. I would argue [that demand and supply] are equally large and I don't believe there is an oversupply of capital in the market. What we are missing is the procurement process to match the supply of capital to the demand for infrastructure." He stresses that at this phase, it is worthwhile for the government to slow down and "get it right" in terms of what the next trends will be.

Investors, though, need to be aware that trends and pockets of opportunity can change quickly. "We operate a lot in the renewable energy sector," notes Manulife's Richard Lee. "A lot of capital – debt, equity – has gone into it and we still continue to deploy it. But having said that, I think there is a lot of political pushback in terms of the rates you have to pay to these generators over the long-term and it has tempered [investment] dramatically in Canada."

WHAT ABOUT THE BANK?

Many around the table believe more could have been said or done by the Liberal government on the Canada Infrastructure Bank. At this point, all that is really known is that Jim Leech, former OTPP chief executive, will act as special advisor to help create the bank. Smith says he believes the strategy will be (or at least should be) to take

"economically viable or nearly economically viable projects and create a process to bring them to market where you can use private sector capital to enhance value and growth".

Claerhout points out that even though the bank will be used to make projects economically viable – and hopefully attract larger investors – it remains unclear how independent of government it will be. "One of the pieces of advice I have consistently given [the government] is to make this independent; hire a high-powered chair and chief executive and pay them well so that it is an attractive career option and not a form of philanthropy. The government should set broad policy objectives, but let the implementation of how the bank works, what projects it identifies and invests in [and] what security it uses to provide that bridging capital be in the hands of management."

No one wants the bank to become a tool of the government to promote pet projects, or be influenced by lobbyists or other pressures.

Lee argues there is a danger once the mandate is set that there may be pressure to deploy capital. "That may suck away the opportunities from others that are already in the market, because there are relatively few opportunities and then the management of such an institution starts expanding the horizon of what they can or cannot do. This could then lead to cannibalising the market at the expense of the taxpayer."

He adds that it would be natural for project developers to call up the bank for cheaper capital and that may crowd out private investors. He also notes that some greenfield projects that cannot get off the ground with private sector money may be too high a risk, but are still needed from an infrastructure point-of-view. The government could then provide credit enhancement or equity support to enable a marginal project that is in the public good to proceed.

Smith, however, takes a more optimistic view. He agrees that while moving from strategy to execution always carries the risk of "veering off the rails," it appears that there is a strong foundation for the bank and momentum towards success. Enlisting Leech to help establish the bank and bringing in other talented people with the right level of expertise and seniority suggests the government wants to do this right. "I am optimistic that they are focused on setting up a separate corporation rather than a government agency, which should facilitate operational excellence and foster the

"I think there is less chance to crowd out the private sector with the Canada Infrastructure Bank than under traditional models, such as public-private partnerships" Smith

A bank's beginnings

by Andrew Vitelli

During his tenure as chief executive of Ontario Teachers' Pension Plan, Jim Leech found infrastructure to be both valuable and frustrating as an asset class.

"We invested a great deal in infrastructure around the world," Leech tells *Infrastructure Investor.* "But I always saw this problem where there was the private sector money prepared to go into brownfield projects and society requiring greenfield projects, and you could never bridge that gap."

As the head of the transition team looking to establish the Canada Infrastructure Bank, Leech is taking the lead in what he calls a "bold attempt" to fill that role. On 11 April, the country's House of Commons introduced legislation to create the C$35 billion ($26.1 billion; €24.5 billion) bank, which has been in the works since the fall and is hoped to be up and running by year's end.

The bank, which will be led by a chief executive and governed by a board of directors, aims to bring in private sector capital that would not otherwise invest in infrastructure to finance transformative projects that would not otherwise get built. It will target large projects requiring around C$100 million in equity or more, with a focus on greenfield development. The ideal projects would be revenue-generating, but not easily bankable without the government's help.

"The government's intention here is to expand the amount, scale and impact that it could achieve solely by itself by bringing in other parties and partners to the table," says Bruce McCuaig, who stepped down from his role as chief executive of Crown agency Metrolinx last month to become an executive advisor for the team setting up the bank.

Leech uses the example of a proposed toll road; without the bank's help, uncertainty over expected traffic may scare away investors. The bank, however, can absorb some of that risk in the first few years of the deal in exchange for an ownership stake in the asset.

The bank's funding will include C$15 billion from the government's C$180 billion infrastructure spending plan, with C$5 billion each earmarked for public transit, trade and transportation corridors, and green projects. Government officials believe the bank can bring in four or five dollars of private money for every public dollar invested.

The bank will be an "arm's length organisation", and a true arm's length is seen as key to the bank fulfilling its potential free of pressure from lobbyists or lawmakers. The text of the bill, released as part of a wide-ranging government omnibus, has added to concerns over the bank's independence. The bank will need government approval for its corporate plan, its capital and operating budget and any loan guarantees issued, while directors can be appointed or dismissed by the government.

"The bank's board is going to be very reliant on the government of the day for continued political support," Steven Robins, a researcher with the CD Howe Institute, a think tank, tells *Infrastructure Investor.* He calls the bank a step in the right direction, but said he hopes the government goes farther in giving it autonomy.

> "The bank's board is going to be very reliant on the government of the day for continued political support" **Robins**

Robins points to Infrastructure Australia, which saw its role and independence expanded in 2014, as a model.

"We don't have a similar agency in Canada with a similar degree of independence," Robins explains. "What I am hoping that the infrastructure bank can do is provide some independent third-party review to ensure that projects are likely to create value for taxpayers."

Leech sees much of the criticism as overblown. He notes that the bank is unlikely to guarantee third-party loans, but can do so with its own equity if necessary. And Leech believes that the government, as the bank's shareholder, should decide who sits on its board of directors after consulting with other board members.

"I do not like boards insulating themselves from the shareholders artificially", he explains.

Then there's the question of working with regional organisations, such as Infrastructure Ontario and Partnerships BC, as well as PPP Canada, a Crown corporation which helps deliver public-private partnerships. The institutions have helped Canada outpace many developed countries, particularly the US, in utilising PPPs.

The government has a significant transition team – around 20 people spanning several departments, Leech says – working on getting the bank up and running. Leech compares the work done prior to the omnibus bill's introduction as the "plumbing that you don't see" of what will become the bank.

The bank will continue to take shape in the coming months. Its location, personnel and leadership have yet to be decided. But to those in on the ground level, its future looks promising.

"This is a really great opportunity to think about how we can build the kind of foundational infrastructure that is going to support Canada, its economy and the various communities across the nation," McCuaig says.

appropriate governance environment." He admits there is a risk the bank might crowd out private sector dollars, but stresses the bank's actual mandate is to leverage private sector funds for capital and growth. "I think there is less chance to crowd out the private sector with the Canada Infrastructure Bank than under traditional models, such as public-private partnerships."

Overall, it is clear the government is not looking to build the next hospital, free road or courthouse through the infrastructure bank. There has to be a revenue line, such that it requires subsidies to be built but not to operate. "This naturally leads you to services you can charge for," highlights Claerhout. Examples could include transportation systems, where fees are generally collected, but might also include waterways or electricity systems, district energy systems, micro-grids and social accommodation. Smith adds there should be some regional allocation, depending on the type of consultation that comes from the provinces and municipalities.

Mouland, however, says the focus of future infrastructure development should be based on impactful benefits, "where there is a fundamental long-term essentiality, in which investment decisions are able to make a generational impact, rather than discretionary investing that is short-lived and based on an electoral cycles".

PRIVATISATION: A DIRTY WORD?

When our conversation turns to privatisation, Smith notes that many in the general public think of it as a 'dirty word.' But the concession or public-private partnership model, where ownership is retained by the government while, for example, an airport is operated by the private sector under a long-term contract, is seen as a viable option for many of Canada's airports, which currently operate under a non-profit lease. Moving to a public-private concession is "only half a step more", and can attract different types of capital to the table. Once that nuance is understood, the conversation shifts, because Canada's airports are already out of government hands. The new conversation then focuses on improving the day-to-day operations and overall quality of the airports while creating value for passengers and stakeholders, as well as generating broader economic benefits.

Claerhout explains that OTPP, when looking at opportunities such as investing in airports, has encouraged government to include the land that it owns because a lot can be done regarding logistics. "The model the government has now was the right one 30 years ago, when Canadian airports were run-down, capital-starved and needed additional funds to bring them up to world standards. But we are now at a

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place where it is the right timing to bring in investors with global airport experience to drive efficiencies and improve the customer experience."

While some people or groups see privatisation as a scary word, Mouland says they are missing the point: "It's about how we can make things commercially work with other agencies, ensuring alignment of interest by allowing private capital to enhance and facilitate infrastructure development, benefiting public interests."

Everyone around the table agrees, though, that selling all eight major Canadian airports and other port authorities at the same time would be a problem. Starting smaller, perhaps with airports in Halifax or Edmonton, to see how the process works, would be a better way to get the initiative going. "Let's learn from the process. Refine, enhance and repeat," suggests Claerhout.

As large-scale investors, the more important issues are predictability and transparency rather than flooding the market with projects. "You don't want to bite off more than you can chew," warns Lee, "so starting with Montreal, Toronto or Vancouver is not the best idea." But, he warns, democratic cycles sometimes force governments to "start big" in order to raise money, or stay in office.

Should the Canadian government take a leaf out of Australia's playbook and introduce its own asset recycling programme, that would make privatisation more palatable to the public. Says Claerhout: "I do think it provides a simple and sensible rebuttal for the government to say: 'Look, we're doing this in order to raise capital to reinvest in critical infrastructure,' and I would encourage them do to that."

NEXT STEPS

Given the increased density of urban areas and the need for core infrastructure, all participants agree that urbanisation is dictating a lot of the projects that will move forward, and likely be where investment comes to play. Areas such as social infrastructure and the needs of First Nations are also coming to the forefront, albeit in a smaller way.

Nevertheless, the government's commitment to moving forward on more projects with an infrastructure bank in place (albeit a not yet developed one) is creating positive momentum for investors within Canada. That, along with potential privatisations, may produce robust opportunities over the next few years – or at least as long as the current federal government remains in power. ■

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