Roundtable

Canada

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Time to invest at home?

Canada's new government is making infrastructure spending a priority to boost the economy. Four industry professionals and **Joel Kranc** explore how this might affect prospects for private investors

Canada is experiencing change. An economy that was once the darling of the OECD and the world is now faltering and lagging behind its southern neighbour. A relatively new Liberal government is reversing the policies of the previous Conservative government and promising to spend money, and increase deficits, in order to assist with economic growth. One of those promises for growth is directly tied to infrastructure spending.

In its spring budget announcement, Prime Minister Justin Trudeau's government promised it would spend C$11.9 billion ($9.3 billion; €8.2 billion) on infrastructure over the next two years. A sizeable amount of that money will focus on transit and water/wastewater needs. Finance Minister Bill Morneau told Parliament: "When there is slack in the economy and interest rates are low, for every dollar a government spends on infrastructure, substantially more than a dollar of economic activity is generated."

Against that backdrop, *Infrastructure Investor* gathered Fengate Real Asset Investments' Lou Serafini, InstarAGF Asset Management's Gregory Smith, the Greystone Infrastructure Fund's Jeff Mouland and bcIMC's Lincoln Webb to discuss the prospects for future Canadian infrastructure investing.

THE BUDGET

All our participants agreed that the budget is a good first step in the push towards further infrastructure investment. The question then becomes: How does any of it translate into investment opportunities in the future? "The main thing about the budget is that it

recognises there is a need for infrastructure spending in Canada," says Serafini. "The part that seems 'to be determined' is what the involvement of the private sector is, and there is no clear outline of how we can be actively involved."

The budget was defined by two main themes, the first being investment in infrastructure and the second being innovation, themes that intersect in an interesting way, notes Smith. "Applying innovation to infrastructure procurement, financing, design and delivery is what creates unique, higher-value investment opportunities and more attractive returns for investors," he argues.

"Technology and private sector innovation together have the potential to rethink and modernise our community infrastructure, whether it is advances in light rapid transit, the use of transponders on toll roads, more sustainable and reliable power systems, or improvements in water treatment and re-use," he adds.

The idea is that spending on infrastructure and spending on innovation go hand-in-hand, resulting in new technologies that can directly support key infrastructure initiatives. Smith points to the fact the government budget proposed money for innovation centres and clean energy initiatives, which, for example, can lead to new tools that will foster sophisticated, sustainable and efficient infrastructure. "I've always liked the intersection between innovation and infrastructure because it keeps evolving," he explains.

WHERE TO INVEST?

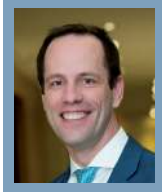
But not all of the potential opportunities will be what investors are looking for, stresses Mouland. He says that while there is a strong desire to invest in Canada, defining infrastructure will make a big difference in how capital is deployed. "I believe that, while infrastructure is getting mentioned a lot in the Canadian public discussion, it is not clear what is executable and what will motivate private capital to invest domestically in the near term, " Mouland notes. "For example, smaller greenfield projects are often more of a contractor play rather than a material long-term equity opportunity. If you're a contractor or developer, this is great, but if you want to deploy meaningful capital quickly, I really don't see the dial moving that much over the next couple of years. Especially if an investor has a mandate to also pursue opportunities outside of Canada, on behalf of its client base."

Webb agrees: "The budget was certainly a start. For large private investors, phase II of the federal government's infrastructure initiative may be more important, however. I think in the latest budget [the government] is being constructive on some of the real areas the country needs to focus on – such as water and wastewater projects in small and remote communities. For private investors, many will look to phase II initiatives by the government to potentially help unlock the significant infrastructure investment capacity that exists, particularly within the large pension managers in the country."

Some note what is not in the budget is just as important as what is in it. Serafini discusses the issue of a lack of transparency in Canadian infrastructure spending, since all it addresses is the capital need. "What the budget needs to address is how the spending will occur over a very long period of time because they are looking for ways to 'cut ribbons' and those aren't always the best use of dollars."

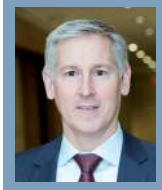
Smith says the challenge within Canada has never been access to capital. There are leading institutional investors and private fund managers with money to spend. Rather, the challenge relates to dealflow. "We need a predictable, transparent, process-oriented environment

AROUND THE TABLE



Gregory Smith, president & chief executive, InstarAGF Asset Management
InstarAGF founder 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.

Jeff Mouland, head of infrastructure, Greystone Infrastructure Fund
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.



Lincoln Webb, senior vice-president, private markets, bcIMC
Based in Victoria, British Columbia, Webb come onboard bcIMC in 2002, charged with the overall management of the firm's private markets asset class including setting strategic direction for bcIMC's private equity, infrastructure, and renewable resource programmes. The private markets group manages some C$15 billion and has been investing globally since 1995.

Lou Serafini, president & chief executive, Fengate Real Asset Investments
Serafini joined Fengate in 1995, becoming president of one of Canada's leading alternative asset managers in 2002. With over 20 years of experience in real estate and infrastructure, Serafini oversees all aspects of the investment process, including sourcing investment opportunities, arranging financing, project delivery and the management of asset portfolios.

that gives us a line of sight to various sectors and a pipeline of emerging, viable investment opportunities," he contends.

DETAILS

When looking at the numbers the Trudeau government has laid out for infrastructure spending, transit leads the pack with a proposed C$3.4 billion commitment, with water and waste infrastructure second with a C$2.2 billion commitment.

As with the budget in general, our participants believe these numbers are a good start, but will need to evolve and grow for larger investment to be possible. "It's a strong step forward, however there are a number of large projects that will need significant capital support in the future and the full extent of the federal government's role in these initiatives is still unclear," notes Webb on issues of public transit in the west coast of Canada, for example.

In many cases, dealflow is at the local level, with municipalities, universities, schools and hospitals – known as MUSH institutions – and smaller dollar amounts. While it is the mega-deals that make the headlines, Smith says 70 percent of the infrastructure deals in North America are less than $1 billion.

"Over the next two years, the government's infrastructure programme will focus on rapidly deploying capital to smaller projects that are more local in nature with the longer term focus being on larger-scale projects. There will be an ongoing role for the private sector for many years to come in and help MUSH institutions to improve and better manage their infrastructure for their constituents," he says.

At the other end of the spectrum, larger-scale investment opportunities can arise through long-term concessions for assets such as airports, for example. And it is in areas like this, Smith says, where the government could look to re-deploy the capital it frees up to a central infrastructure bank, thereby facilitating an environment for new infrastructure investment.

"It's about risk transfer," adds Serafini, when discussing the federal government's role in creating opportunities. "The government needs to allow the private sector to bring its expertise to the table." He adds there is not enough risk transfer on infrastructure projects to entice institutional investors to begin looking at home-grown opportunities for investment.

Serafini also says the government has to be aware of the degree of expertise at the municipal level, where many of the projects are occurring. He points out that projects can be delayed due to the learning process and the government has a role in educating these municipalities.

As for transit, the largest item earmarked in the budget, Serafini notes that investible opportunities will come when

> "It is not clear what is executable and what will motivate private capital to invest domestically in the near term"
>
> Mouland

the risk transfer starts to include a user pay system, which will ultimately lead to wider equity models for investors.

Certainly when compared to other parts of the world, Canada seems to be be lagging somewhat, according to our participants. "Putting aside smaller P3 projects, in terms of the role of private infrastructure equity investment, I would say we're quite a bit behind when you look at the extent of large investment opportunities compared to the UK, Australia or certain European countries," says Webb.

"Many of the projects within Canada are concentrated in municipal and urban areas. While the large urban areas get a lot of attention, you have real infrastructure needs that have to be addressed in smaller communities. However, given the size of the deals, investment interest may be limited, especially where there are concerns around the lack of experience or track record of municipalities executing on the procurement side," explains Mouland.

THE BUNDLING APPROACH

So how do larger investors, with equity to spend and a desire to invest in Canadian infrastructure make it worth their while? Mouland says that an aggregation strategy, where investors have the ability to invest in a broader growth platform will make investments more palatable, since there will be a clear sight-line for staged equity deployment. "I feel when opportunities are scalable, based on aggregating smaller municipalities where there are definite infrastructure requirements, there will be greater interest from investors and a willingness to invest long-term private capital."

One example of that is the Ontario Provincial Police bundling a significant number of police stations for re-builds, which made the cost of debt more efficient for investors. Also, in Alberta, many schools have bundled their needs to attract the right investor to the project. "The government's key role with respect to this type of funding is the requirement

> "Technology and private sector innovation together have the potential to rethink and modernise our community infrastructure" Smith

> "The government needs to allow the private sector to bring its expertise to the table" Serafini

of how this procurement takes place," says Serafini.

Large investors are particularly interested in bundling or developing infrastructure investment platforms to achieve equity scale, adds Webb. An example of bcIMC's approach in this respect has been an investment in Corix, a Vancouver-based water and wastewater utility that develops and manages infrastructure in small and mid-size communities across North America.

"Corix has been a very effective investment platform for us, addressing an attractive space with clear demand for private capital that is of a scale that would normally be very difficult for us to investment directly in. The experience and expertise within Corix allows the company to operate in the local community context and invest in smaller, but very interesting projects," Webb explains.

Smith agrees and says this bundling method is exactly the way investors have to go to get the scale of investment that is worth their while. "We start with a couple of projects, put them together and build a company or management team around it to go after smaller projects whether it's in a sector vertical or a geographic area."

The next extension of the bundling trend is the improvement of existing infrastructure. Rather than building new schools or hospitals, Smith says the next trend is to refurbish them, using new technologies to upgrade the energy efficiency of buildings, for example, or implementing other improvements to help modernise MUSH sector infrastructure.

Likewise, opportunities within First Nations communities, where infrastructure is even further behind than in major urban areas, exist for investors. Much like the size issue related to smaller municipal projects, First Nations projects are also relatively small in scale.

"Indigenous communities have a huge need," says Serafini. "There are dollars allocated to it but it becomes a question of: How does the procurement process work, or what is the risk of the transaction closing or not closing? There has to be a clear and in-depth assessment around 'financeability' of these transactions."

Mouland also believes there are opportunities with First Nations communities, but all parties have to be aligned to ensure execution risk is sufficiently mitigated. He argues there has to be a true partnering approach in which transactions are structured to provide long-term benefits to indigenous communities as well as attractive economics to the private sector. Once a proven and scalable model has been established, keeping in mind the respective needs of each First Nation community, there should be a domino effect relative to other partnering opportunities across the country. But clarity and certainty of investment processes and parameters are extremely important, he contends.

What about pricing? Some have argued that global infrastructure has overheated to some degree, but how does this play out in a Canadian context?

"Absolute returns are lower today than they were 10 or 15 years ago for infrastructure assets, especially for large-scale assets," argues Smith. "But if you separate your equity risk premium, and with lower long-term bond rates, you are getting a higher premium today for that same asset than you were 10 years ago. While absolute returns are lower, this is still an attractive return profile for institutional investors."

Mouland notes there is a significant amount of capital in the infrastructure space that is looking for opportunities to write large equity cheques. Given the intermittent nature of large "auction-driven" deals, combined with the underlying need for funds to deploy their clients' capital, Mouland argues there is upward pricing pressure on these transactions. He points out that on a relative basis, there is a strong global mid-market opportunity set that allows relationship-driven deals to be completed at fair pricing and with certainty around execution. "Infrastructure platforms that have the ability to write smaller cheques across a range of sectors and jurisdictions have the potential to invest client capital in a more predictable manner," he concludes.

"In terms of the role of private infrastructure equity investment, I would say we're quite a bit behind" **Webb**

THE FUTURE

Looking ahead and beyond the budget, infrastructure investment in Canada is moving towards higher-tech areas such as energy storage and efficiency. As technology grows and things like electric cars come to market, for example, power grids and other areas will need to be upgraded to accommodate more uses. This is just one way technology may drive further infrastructure needs. Also, adds Webb, infrastructure spending will be focused on upgrading what we already have, like street lighting, building systems and more.

The consensus, for the time being, is that the federal budget is a good way to get the conversation going and capital moving – but it is only a start. The numbers won't really add up until a few years from now, when increased spending and projects come online and technology changes infrastructure needs. And while larger investors will still have few deals with the right scale to invest in, municipalities are certainly in need of funds and will continue to look for ways to attract private sector for investment. ■

Joel Kranc is director of Kranc Communications in Toronto