Pay more, get less. P3s

FACT SHEET

P3s and the Financial Meltdown

March 2009

Public-private partnerships make no economic sense in the best of times, but the current financial meltdown has eroded their credibility even further.

The current credit crisis is making it difficult for private-sector P3 partners to access capital and credit, which threatens to leave their public partners in the lurch. At the same time, the cost of government borrowing has declined, which has further increased the difference in public sector and private borrowing rates.

A December 2008 global review by PriceWaterhouseCoopers found that the credit crisis has led to a sharp increase in borrowing costs for infrastructure projects of about 1.5 to 2.0 percent above the lowest rates that governments can obtain. PWC summed up the situation for P3s: "The debt markets have all but dried up…The outlook for the near term remains grim. Few [P3] deals will close. Many have already been put on ice….Bank debt is simply insufficient, and inefficient, as a source of long term finance….It is a naïve notion to expect the markets to revert to the low pricing obtained in the first half of 2007. Such conditions are unlikely to be seen again."[1]

PriceWaterhouseCoopers also noted that the global recession and credit crisis has also created problems for existing P3s. First, the recession reduces income for some P3s, like toll roads, making it difficult to repay interest and loans. Second, many P3s increased short-term debts to launch their project with the expectation that it would be refinanced at lower interest rates when the project became operational. These P3 partners will now find difficult to get new loans without increasing the cost of interest payments. "They may face the double hit of worse than forecast debt terms and revenues, or even be unable to refinance at all."[2]

P3 projects wounded by economic crisis

In the United Kingdom, only 34 PFI projects were signed in 2008, the lowest number since 1997. A January 2009 report by the U.K.'s National Audit Office warned that PFI waste management projects are already delayed and will face further delays and uncertainty due to the "difficulties in

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[1] As cited in David Hall, *A crisis for public-private partnerships (PPPs)?*, Public Services International Research Unit, January 2009, p. 2.

[2] Ibid.

the financing markets." A leaked memo to the *Guardian* newspaper in the same month warned that hospital projects were at risk because of the PFI credit crisis. Health authorities were told to "expect a capital desert in 2010/2011."[3]

In January 2009, the *Vancouver Sun* published a story that detailed how the financiers of nine B.C.'s P3 projects were hard hit by the economic meltdown. Many of the P3 financial backers have seen their stock plummet and/or have received government bailouts.[4]

The Golden Ears Bridge P3 project, for one, almost collapsed when its financiers nearly defaulted. Depfa Bank's parent company, Hypo Real Estate Holding AG, required a bailout of $80 billion of credit from the German government and $50 billion of state guarantees. Another bailout is being negotiated. Dexia, the other financier of the P3 project, also needed a government bailout.

Depfa is not only involved with the Golden Ears Bridge project. The company is also helping to finance two other B.C. P3s: the Royal Jubilee Hospital being built in Victoria and Surrey's new outpatient hospital.

In February, the $3.3 billion Port Mann Bridge project collapsed as a P3 after the government of British Columbia was unable to reach a funding deal with the private consortium. The consortium was led by Macquarie Group, an Australia-based toll-road operator and investor that saw its share price plunge 82 percent from May 2007 to February 2009. The provincial government will now proceed with the bridge project as a publicly funded design/build project. [5]

Babcock & Brown, the parent company of Babcock & Brown Public Partnerships Ltd., which was contracted to build and operate Alberta's 18 P3 schools, lost 98 per cent of its market value due to the credit crunch and temporarily halted the trading of its stock twice this year. Babcock & Brown Public Partnerships Ltd. recently laid off one-quarter of its staff. Babcock is also implicated in a number of P3 projects in B.C.[6]

In Montreal, the global credit crisis has put the P3 financing for two mega-hospital projects in jeopardy. Partenariat CUSM is bidding on the $1.1 billion contract to build and manage the future hospital of the McGill University Health Centre, but the consortium lost John Laing Investments Ltd. last November, leaving Madrid-based Obrascon Hurarte Lain SA as the only major partner in the consortium. Meanwhile, the other hospital project, the Centre hospitalier de l'université de Montréal, is on shaky ground given that the consortium bidding on the project, Accès Santé CHUM, includes the troubled Babcock & Brown Infrastructure Group.[7]

P3 proponents on the defensive

The financial crisis has put P3 proponents on the defensive, forcing them to advance new schemes that would see the public sector take on the risk of financing P3 projects.

[3] Ibid., p.3.
[4] "Nine B.C. projects and where they stand," *Vancouver Sun*, January 23, 2009.
[5] Lori Culbert, Private financing for new Port Mann project vaporizes," *Vancouver Sun*, February 28, 2009.
[6] Jonathan Fowlie and Lori Culbert, "B.C.'s P3 projects not immune to world financial meltdown," *Vancouver Sun*, January 23, 2009.
[7] Aaron Derfel, "Superhospital financing doubt," *The Montreal Gazette*, February 28, 2009.

For instance, the Canadian Council for Public-Private Partnerships published a commentary on their website “A Matter of Time: Will the Credit Crisis Impact Canadian P3s?” which concluded, “The lack of availability, together with the overall increase in the private finance cost, will require both the public and private sectors to reassess how they tackle funding. We believe that greater consideration will be given to the use of co-financings and other structures where the public sector acts as a liquidity provider on projects.” [8]

In other words, the CCPPP is suggesting that private sector “partners” take advantage of the government’s lower cost of borrowing in order to make P3s viable. This begs the obvious question: why wouldn’t governments simply finance the infrastructure project themselves using the traditional public sector procurement process?

Unfortunately, ideology seems to trump common sense with most right-wing politicians. B.C. Premier Gordon Campbell has said he is not concerned about the economic stability of his province’s privately funded P3 projects. “I have no doubt there are additional challenges. But I also believe these are exactly the kinds of projects that financial institutions look for . . . long-term returns that are secure in terms of their support.”[9]

Nonetheless, last November the B.C. government raised its threshold for capital projects requiring a mandatory P3 review from $20 million in provincial funding to $50 million. The move was undertaken “as part of the government’s commitment to accelerate capital infrastructure projects”[10] - an implicit admission of the red tape and delay involved with P3 projects.

When Prime Minister Stephen Harper was in Surrey earlier this year to support the South Fraser Perimeter Road P3 project, a reporter asked him if he was concerned about the financial stability of these projects given the credit crisis.

Harper responded, “I would say that projects like this, with the involvement of both levels of government and the private sector, are exactly the kind of thing our economy needs, and the private sector and our financial institutions need to bolster confidence. I think this is a great project at any time, but it’s a particularly great project at this time for the very reasons you’ve outlined.”[11]

Indeed the Conservative federal government is proceeding with the establishment of PPP Canada, a Crown corporation that will promote the further development of Canada’s P3 market. Meanwhile, Canadians continue to wait for a real stimulus package that would fast-track several overdue public infrastructure projects.

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8 The Canadian Council for Public-Private Partnerships, “A Matter of Time: Will the Credit Crisis Impact Canadian P3s?”, November 14th, 2008 available at http://www.pppcouncil.ca/blog/

[9] Jonathan Fowlie and Lori Culbert, “B.C.'s P3 projects not immune to world financial meltdown,” *Vancouver Sun*, January 23, 2009.

[10] Government of British Columbia news release, “Province raises capital standard threshold for PPPs,” November 7, 2008.

[11]Transcript from a News Conference with Prime Minister Harper on the South Fraser Perimeter Road, Source: CBC Newsworld, January 12, 2009 available at http://www.pppcouncil.ca/pdf/news_pm_01122009.pdf