PPP Vs. PFI: What's the Difference? Is Japan Missing out? What are the Opportunities for Japanese Private Sector in PPP projects abroad?

These are some of the questions that will be addressed in a seminar being organized by the Canadian Chamber of Commerce in Japan in partnership with the Embassy of Canada on May 22nd, at the Oscar Peterson Theatre of the Embassy of Canada.
The conference is designed for Japanese government officials and private sector companies that are contractors, financiers, and investors (including private and public pension funds) as a way to gain knowledge about this rapidly growing field of government/private sector collaboration in the delivery of infrastructure. This phenomenon is worldwide, yet in Japan, the PFI model has yet to equal the P3s in other developed countries in terms of scope, including services.
This seminar will elaborate on the advantages and disadvantages of the PPP vs. PFI model, and the risk/reward trade-offs from the perspectives of a contractor, financier and equity investor, and government procurer.

Background – What is PPP?

A **public–private partnership** (**PPP**) is a government service or private business venture which is funded and operated through a partnership of government and one or more private sector companies. These schemes are sometimes referred to as PPP, P3 or P^3 and PFI.
PPP involves a contract between a public sector authority and a private party, in which the private party provides a public service or project and assumes substantial financial, technical and operational risk in the project. In some types of PPP, the cost of using the service is borne exclusively by the users of the service and not by the taxpayer. In other types (notably the private finance initiative), capital investment is made by the private sector on the basis of a contract with government to provide agreed services and the cost of providing the service is borne wholly or in part by the government.

Global Context

Increasingly, governments around the world are realizing that the typical direct means to deal with infrastructure challenges are not working well; funding has become a major issue for most of these governments. As such, countries such as Canada, Britain, Australia, and, increasingly, the US are adopting the PPP model in order to harness the expertise and efficiencies that the private sector can bring to the delivery of certain facilities and services traditionally procured and delivered by the private sector. In addition, as many governments' increasingly lack fiscal manoeuvrability, PPP projects are embraced as they are structured so that the public sector body seeking to make a capital investment does not incur any borrowing. Rather, the PPP borrowing is incurred by the private sector vehicle implementing the project and therefore, from the public sector's perspective, it is an "off-balance sheet" method of financing the delivery of new or refurbished public sector assets.

The Canadian/US experience

Canada is a world leader in PPPs. Over the years Canada's PPPs market landscape has evolved considerably and has established Canada as one of the world's most stable and significant P3 markets in both volume and capital size of transactions with 206 projects procured. The increased adoption of PPPs can be attributed to the creation of dedicated P3 agencies at the provincial (Alberta, British Columbia, New Brunswick, Ontario and Quebec) and federal level. The projects are

procured in sectors like water infrastructure, waste water infrastructure, public transit infrastructure, railways, roads, air and maritime transport, green energy infrastructure, culture infrastructure, connectivity and broadband infrastructure etc.
The US on the other hand has had a somewhat slower start in the PPP realm. There are a number of reasons why the development has not been as rapid as has the UK and Australia or Canada. The reasons why this must and has been changing are much the same: the need for public authorities to turn to the private sector for finance: government treasuries everywhere cannot keep up with the public's demand for renovated or new infrastructures across all major PPP categories. The United States PPP market has the world's largest potential amongst advanced nations. They have turned to other jurisdictions such as the U.K., Australia and in particular Canada for guidance as to the establishment of a PPP system. The most recent example is the West Coast Infrastructure Exchange under a framework agreement adopted by partners in Canada's province of British Columbia, and the US states of California, Oregon, and Washington.

<u>Of Particular Note for Pension Funds and other institutional investors</u>

For the last two decades Japan has laboured under what the New York Times characterizes as "a low growth and corrosive downward spiral of prices known as deflation". Japanese Prime Minister Shinzo Abe has set about to offset this malaise with massive fiscal spending, aggressive monetary easing from the BOJ and structural reforms. The BOJ has now set an inflation target of 2% resulting in a lower yen making investment abroad more attractive to Japanese investors.
The first major Japan based P3 fund announcement was made earlier this month when a five-year, $2.7 billion, infrastructure co-investment agreement was entered into between Japan's Government Pension Investment Fund (GPIF), the Development Bank of Japan (DBJ) and the Ontario Municipal Employees Retirement System (OMERS).

P3 transactions are particularly attractive to pension funds because:

1. Long Term: they are generally multi-decade in length;
2. Relatively Risk Free: they are 'government backed' and mostly bankruptcy remote;
3. Relatively High Yields: they offer mid to high single digit returns to equity holders.

Japanese pension funds (both government related and private) and other institutional investors have much to gain from P3 types of investments. There are at least three reasons for this:

First, Japan's population of retirees is set to comprise more than 25% of the population by 2030 and the expected period of inflation will seriously erode their buying power in the coming years. As a result, Japanese pension funds now must target higher yields by diversifying portfolios from a concentration on fixed income vehicles such as government bonds (the JGB). As mentioned, P3 yields are much higher than the portfolios now maintained; the GPIF to date targeted a little over 4%, whereas offshore P3s yields are in the medium to "high single" to "low double" digit returns.

Second: Pension funds, in particular Japanese pensions, are inclined to be 'risk adverse' and therefore now tend to shy away from public market volatility seeking instead stable income gains similar to fixed incomes in terms of cash flow profiles. Since in P3 investments the opposite party is a government the risk factors are very much lower.

Third: P3s are typically multi decades in length.

Government backed infrastructure P3s are therefore highly attractive in this important context.