Accelerating infrastructure in Canada: a win win success strategy
By Gary Webster, KPMG in Canada

Introduction
The initial report by the Federal government’s Advisory Council on Economic Growth, Unleashing Productivity Through Infrastructure emphasizes the importance of infrastructure investment as a “powerful and scalable lever of economic growth” and that productive infrastructure translates into competitiveness for the many industries that depend on it.

The report also emphasizes that Canada has a significant infrastructure gap and that it is the role of government to provide more public assets and to improve public policy to fill the gap. Accelerating infrastructure in Canada will require governments to use new tools and techniques to stimulate infrastructure delivery and support a major and increased role for the private sector. It will also require enhanced public sector capacity to deliver quality projects on a timely basis. Moreover, implementing a set of initiatives to accelerate the delivery of infrastructure will require the driving force of a new federal institution, the Canadian Infrastructure Bank (the “Bank”).

The Prime Minister, the Minister of Finance and other federal ministers have indicated broad support to accelerate infrastructure in Canada and as a result, it is expected that the government will begin the process to establish the Bank as part of the March/April 2017 Federal Budget.

This paper is written with the intent to describe a “win/win” framework of policy initiatives designed to accelerate the delivery of infrastructure projects in Canada in a way that builds upon past successes and aligns the interests of all levels of government. Infrastructure development funding currently involves all levels of government while historically infrastructure project delivery has been primarily the responsibility of provincial and local governments, and therefore the alignment of interests of all levels of government is critical to the success of the strategy.

Below we discuss five key challenges in accelerating infrastructure delivery and five elements of a strategy to address those challenges.

Challenges facing the acceleration in the delivery of infrastructure
The need for more infrastructure is not news; clearly, there have been challenges to provide the needed infrastructure that has led to the current gap. The following are five key challenges facing governments today in endeavouring to accelerate the delivery of infrastructure.

1. The public sector does not have the fiscal capacity to fully bridge the infrastructure gap. Many governments in Canada, including the federal government, have already made significant fiscal commitments to increased funding of infrastructure. However, there is limited scope for further increases: the collective fiscal capacity of the federal, provincial and municipal governments is not sufficient to deliver the infrastructure needed in today’s political climate. Nor should the responsibility to finance new infrastructure fall solely on the taxpayer.

2. A more comprehensive range of funding tools is required. There are a variety of methods available for the delivery of public funding and, depending upon the circumstances, different methods can be more or less effective. Currently, to finance the delivery of infrastructure...
projects, a Canadian government relies essentially on taxpayer funding, some of which is based on receiving dedicated taxes revenues such as fuel tax, grant programs from senior governments and to a limited extent, user fees. With the advent of new technologies a number of these traditional sources of revenue are in the decline and within in the foreseeable future could effectively disappear. For example, the move away from fossil fuels to electric powered vehicles will eliminate the fuel tax revenue source. Canada does not adequately use the full range of funding tools that are employed in other countries; to further accelerate infrastructure delivery, the introduction of new funding sources including user fees on infrastructure which is currently free and the proceeds from the recycling of existing government-owned assets will be required.

In addition to new revenue sources, Canada also lacks a mechanism that mitigates critical project risks and thereby encourages more private financing. Mechanisms of this sort are attractive as they do not necessarily actually require the use of any government funds.

3 | There is a lack of a coordinated national infrastructure strategy. The federal government and many provinces and local governments identify their infrastructure priorities on an ongoing basis. The federal government and provincial governments also specify priorities for programs that provide financing for projects delivered by other levels of government. However, there is no coordinated national strategy that aligns priorities across all levels of government. A national strategy that communicates Canada-wide policies, priorities and opportunities to interested private sector participants is needed. Such a strategy would help avoid a continuation of projects starting and stopping as priorities change and would help industry gear up for the coming projects in an effective manner, thereby enhancing the competitiveness of upcoming procurements.

4 | The depth of government capacity and the use of leading practices varies highly across the country. Many jurisdictions in Canada have developed and adopted standardized policies and procedures for the planning, procurement and governance of public-private partnerships (“PPPs”), as well as for asset management. While it is critical to consider the unique aspects of each infrastructure project, standardization when applied to appropriate aspects of a project can reduce its time, cost and risk. Standardization across federal, provincial and local governments is lacking, which reduces the appeal of the Canadian market to private sector contractors and investors.

Planning and delivery of major infrastructure projects using “partnership” arrangements procured in highly competitive selection processes can be daunting, particularly for an inexperienced public entity. For smaller provincial governments, and local and First Nation governments, it can be difficult to develop and retain the necessary in-house capability to deliver a major project, as these projects occur infrequently. Consultants generally fill that void. It may also be beneficial to these entities to have access not just to the standardized documentation which is often readily available, but to the rationale underlying the policy decisions taken to develop the documentation in order to assess its applicability to the project at hand. Failing to add the necessary capacity and capabilities can raise the project costs for both the government agency and its costs for the project as prospective bidders when sizing up the agency’s capabilities may decide to pass on participating in the procurement, thereby lessening competition.

5 | Smaller governments and First Nations can have difficulty accessing capital. In relation to the size of the country, Canada has very deep and efficient domestic markets for debt and equity financing for infrastructure; in fact, Canada is a major exporter of capital for infrastructure. Canada also is seen as a very appealing market for international investors in infrastructure. Nevertheless, there are instances where governments in Canada can have difficulties raising capital for infrastructure on viable terms. Typically, the financing of infrastructure requires long term capital commensurate with the length of “partnership” contracts. Smaller governments and First Nations do not have ready access to these sources of capital, and consequently their infrastructure projects rely on bank lending which generally comes with shorter maturities and the risks associated with refinancing. Even for larger governments, the size of infrastructure projects can be very large, again presenting challenges in accessing capital at attractive rates.

Element 1 | Clear and visible federal infrastructure strategy

Above, the challenges associated with the lack of a coordinated national infrastructure strategy are discussed. It will not be easy to get all levels of government to jointly develop and agree on a national strategy. In that context, a good start in developing a national strategy would be the development of a clear and visible federal infrastructure strategy designed to become the cornerstone of a national strategy.

A federal infrastructure strategy needs to identify priority sectors and, within this context, proactively identify priority federal projects, particularly those of “national significance.” The visibility of these priorities and the project pipeline would help ensure that both other Canadian governments and private sector participants are fully aware of federal government intentions. This would assist other governments in developing/refining their own infrastructure strategies and aligning their interests (and funding applications) with the federal government, which would in time lead to the creation of a national infrastructure strategy. Australia and the United Kingdom provide useful precedents for the usefulness of national strategies.

Element 2 | A Canadian Infrastructure Bank

The Canadian Infrastructure Bank would be the driving force behind the implementation of the federal infrastructure strategy and would coordinate with other levels of government to create a national infrastructure pipeline, including “projects of national significance.” It would be mandated with a full set of tools, including the identification
of opportunities for new revenue sources and recycling to address the fiscal constraints on Canadian governments to fully plug the infrastructure gap. It would also be mandated with mechanisms to de-risk projects in order to attract more private investment.

Support from the Bank would be contingent on recipient governments demonstrating how projects fit within as a minimum, a local infrastructure strategy that is based on broad common objectives, as well as implementing leading practices in the governance, assessment and delivery of projects and programs. The Bank would also assist federal departments and agencies with infrastructure planning and delivery.

**Element 3 | Increased federal contributions**

An Infrastructure Investment Bank, managed by the Canadian Infrastructure Bank, should be established to make investments to stimulate more infrastructure projects. The publically-owned, Canadian Infrastructure Bank would make innovative and strategic investments to stimulate and accelerate infrastructure projects. The investments would be focused on mitigating project risks and financing gaps that were preventing projects from moving forward, and could take the form of loan guarantees, revenue guarantees or mezzanine loans. The objective of the investments would be to “crowd in” additional private sector debt and equity capital. The investments would be at subsidized rates but repayable, and future repayments would help replenish the Fund and sustain the Bank.

**There should be no reductions to outstanding commitments in current grant programs,** and new initiatives such as the Infrastructure Investment Fund should not be funded from previously announced grant programs. Even though the investments would be at subsidized rates, the federal government should view the Fund as an investment and quite different from the grant programs that also support infrastructure projects.

**Opportunities for asset recycling should be assessed.**

The Bank should prepare business cases to assess whether certain assets could be monetized while still meeting public policy objectives. There is very significant financial capacity and investment appetite within pension funds, life insurance companies and infrastructure funds for such assets, and this capacity would thereby be used indirectly to accelerate new infrastructure delivery. Since institutional investors are primarily focused on existing infrastructure assets that are in the operations phase (“brownfield assets”), rather than projects in procurement and under construction (“greenfield assets”), the Bank should implement a recycling program to extract value from ownership or leases of brownfield assets and contribute the proceeds to the Infrastructure Investment Fund. Moreover, to get maximum leverage from institutional investments, new infrastructure projects stimulated by the Bank could then be recycled once in the brownfield stage.

**Element 4 | Increase the effectiveness of the overall Canadian infrastructure market by building upon mature provincial markets**

The Bank should not be designed to take over the work of the existing provincial agencies that deliver infrastructure projects. Instead, the Bank should be designed to complement existing provincial agencies as well as supporting major federal infrastructure projects. Provincial agencies should remain responsible for provincially-sponsored projects and in some cases, for the projects of local governments within the province.

**The Bank should coordinate and help implement Canada-wide leading practices.** Specifically, the Bank should coordinate the efforts of all governments in Canada in developing and standardizing leading practices in planning, procurement, governance and asset management. Part of this work would involve the Bank maintaining a “knowledge bank” of these leading practices and learnings on behalf of all Canadian governments.

A condition of federal assistance should be to require project sponsors to utilize leading practices, whether through the use of consultants and/or the application of the standardized practices of their province (if the province has a provincial agency which delivers infrastructure) or of the Bank if the province has no such unit, in all instances ensuring that all work associated with the project is tailored to the unique aspects of the project. The provincial sponsor should be free to choose how to access the leading practices, as not all will necessarily want to engage the provincial agency for some or all of its projects or use the standardized practices which were developed for a province as opposed to a municipal level of government.

**Element 5 | The Bank should have access to new financial tools to stimulate project delivery**

The Infrastructure Investment Bank should be focused upon eliminating market or “viability” gaps that otherwise would prevent priority projects from attracting private investors. The Bank’s investments could include mezzanine debt, which would “de-risk” and attract additional, more senior debt from the private sector; or loan guarantees, which would credit enhance the project and encourage incremental private sector lending at reduced rates. These financial instruments would require repayment, although potentially at “below market” rates, so as to stimulate the delivery of priority projects. The Infrastructure Investment Fund could be used to enable government to move projects forward while retaining the use and benefits of private sector partnerships and financing. This approach is not untested; the TIFIA and WIFIA programs in the US are analogous to the Infrastructure Investment Fund.

Here are some examples of how the Canadian Infrastructure Investment Bank might be used to stimulate priority projects:

**Example:** Large municipal and regional governments in Canada have strong credit ratings and access to long tenor capital markets at attractive rates (although some large municipal borrowers, like the B.C. Municipal Finance Authority,
have policy restrictions against issuing debt with tenors over 10 years). Smaller local governments have strong credit ratings but are limited to the bank lending market, where tenors typically do not exceed 10 years. Since public private partnerships generate the most benefits when at least part of the private financing is long term, as in 20 – 40 years, the Bank could, in this instance, be used to enhance the credit of the small local government so that it can raise debt for the project with tenors exceeding 10 years. First Nations have lower or no credit ratings although they now have access to the First Nations Financing Authority and the Authority’s activities would be enhanced if its credit was enhanced through the use of the resources of the Bank.

**Example:** Many large local/regional governments are currently examining the viability of transit projects where the capital costs are very large in relation to the particular government’s ability to borrow. To expedite project delivery, the projects require combinations of grants and investments from various levels of government (including local/regional government which will typically fund ongoing operating and maintenance costs or availability payments if the responsibility for those activities are transferred). In addition such that the remaining financing requirements can be raised from private sector sources on a basis that is “self-supported” by user fee and other revenue, with no or limited availability payments. The Infrastructure Investment Fund could, in this instance, be used to provide mezzanine financing subordinated to private sector financing to enhance the project’s ability to raise the required financing. To the extent that the project achieves its forecast revenues, the mezzanine investment by the Bank would earn an appropriate rate of return.

As mentioned, in addition to user fees, private investment can be raised on the strength of other revenue. An example of that is the concept of using the property tax increments that are expected to result from increased property values associated with proximity to the new transit line. “Tax increment financing” or more generally “land value capture” would in effect expand the financial capacity of local governments to deliver large projects now. To encourage the use of such an approach for governments which have (or can acquire) the authority to generate these types of revenue, the Infrastructure Investment Bank could participate with both private investors and local governments in sharing associated tax revenue risks.

**Example:** Provincial electric utilities often provide above-market power purchase prices and/or floor revenue guarantees to encourage the private financing of “green” independent power projects. The Infrastructure Investment Fund could stimulate project delivery by providing incremental support through mezzanine investments. With this additional capital in place, the more senior debt provided by the private sector would have increased appeal and the private financing should become more viable and available on better terms, thereby stimulating infrastructure projects that otherwise could be non-financeable.

**Conclusions**

The strategy outlined above would build upon the strengths of the current Canadian infrastructure delivery system. It would:

- build on the current role of the public sector investing in infrastructure;
- demonstrate a significant commitment by the federal government to provide grant funding for infrastructure in priority sectors;
- complement the work of provincial infrastructure agencies in delivering infrastructure projects;
- coordinate the development of a level of standardization of leading practices in project delivery and planning across the country.

It would also provide new initiatives designed to accelerate the delivery of infrastructure and improve the quality and timeliness of project delivery. Elements of the plan could include:

- The Bank as the driving force behind the federal infrastructure initiative, and the leader of coordination with other Canadian governments;
- Increased federal government funding of infrastructure through the recycling of in service assets (into a new Infrastructure Investment Fund, managed by the Bank);
- Specific measures to increase the effectiveness of the existing Canadian market for partnerships with the private sector to deliver infrastructure.

For more information

**Contact us**

**Gary Webster**
National Leader, Infrastructure
**T:** 604-646-6367
**E:** gwebster@kpmg.ca

**Will Lipson**
Partner, Infrastructure
**T:** 416-777-3557
**E:** wlipson@kpmg.ca

**Stephen Prendiville**
Partner, Infrastructure
**T:** 416-777-3498
**E:** stephenprendiville@kpmg.ca