2018 Pre-Budget Consultation

A Submission to the House of Commons Standing Committee on Finance

Executive Summary

PB Capital Inc. is pleased to share its priorities with the House of Commons Standing Committee on Finance as part of its 2018 pre-budget consultations. We believe that the following three recommendations address the key themes that the Committee wishes to focus on this year, namely productivity and competitiveness. We recommend that Budget 2018:

1. **Require that all infrastructure projects have an approved plan for Asset Management, Sustainability and have assessed Bundling opportunities.**
2. **Require that infrastructure projects for smaller, rural and Indigenous communities are evaluated on their economic, social and environmental returns, and not just economic benefits.**
3. **Initiates steps to review the regulatory policy for assessing the risk weighting of infrastructure investments in Canada.**

Introduction

PB Capital is applying to establish a new Canadian bank—Pacific Bank of Canada--that would focus on financing the development of infrastructure projects that are less than $150 million and outside of the major urban centres in rural, northern and Indigenous communities. PB Capital has submitted its application to OSFI (the Regulator) and is currently in discussion on the key components of the bank's business plan.

The Canadian government has committed to invest $180 billion on infrastructure over the next 10 years in collaboration with provincial/territorial and municipal governments. This level of infrastructure investment will increase Canada's overall investment in infrastructure from an average of 3.4 per cent of Gross Domestic Product (GDP) in the early 2000s to over 6 per cent over the next 10 years. Investments in infrastructure are direct contributors to Canada's overall productivity and competitiveness and benefit Canadian citizens and businesses.

As part of the federal government's investments in infrastructure, it is establishing the Canada Infrastructure Bank (CIB). The CIB will not be a regulated bank under the Bank Act. The CIB's mandate is to focus on mobilizing large pools of capital for large infrastructure projects. The CIB's target market will represent less than 5 per cent of the total number of infrastructure projects in Canada. The proposed

Pacific Bank of Canada would be complementary to the CIB, with a specific focus on smaller projects that represent the other 95 per cent of infrastructure projects in Canada.

With these policy objectives in mind PB Capital respectfully submits the following three recommendations.

Recommendation One: the 2018 Budget require that all infrastructure projects have an approved plan for Asset Management, Sustainability and have assessed Bundling opportunities.

i) Managing infrastructure projects to realize long-term economic benefits

Organizations like the Conference Board of Canada and the Canadian Construction Association estimate that for every dollar spent on infrastructure, Canada's GDP will rise over the short run by between $1.14 and $1.43—a considerable economic multiplier. Over the long run, the Canadian Construction Association estimates that infrastructure investments which are properly managed will boost GDP by over twice the short-run impact. These are economic impacts that should be felt in all communities—from coast to coast to coast. What we do know is if these investments are not properly managed, maintained and amortized, the returns will be minimal and short lived.

At a more granular level, for every dollar increase in GDP, tax revenues across all levels of government increase by an estimated $0.35. The bulk of additional revenues generated from higher levels of GDP tend to flow disproportionately to the federal and provincial governments, as municipalities have essentially only development fees and property taxes, as well as the federal Gas Tax Fund, to rely on.

It is important to recognize that the benefits to communities and municipalities go well beyond just the dollar, or revenue, gains. It is the social and environmental benefits from infrastructure investments that also directly accrue to communities. These are the enhanced, non-pecuniary benefits resulting from infrastructure investments in housing, health, education and environmental sustainability that flow to communities.

To maximize the benefits for all Canadians, infrastructure investments need to be assessed with a clear understanding and focus on the intersection of economic, social and environmental priorities. In practical terms, this means applying three key principles to all infrastructure projects:

- Asset management: managing existing assets and new infrastructure projects as capital investments so as to maximize returns;
- Sustainability: managing infrastructure projects to ensure appropriate maintenance and replacement of depreciated assets throughout the life cycle of the project;
- Bundling: Bundling together similar types and sizes of infrastructure projects or bundling regional infrastructure plans into a larger project that generate economies of scale, effective management of costs and increased access to innovation and technological advances.

ii) Why this is important in supporting infrastructure investments in smaller, rural and Indigenous communities

Successful infrastructure projects are built around these three principles, providing the capacity for planning, engineering, financing and long-term management of infrastructure investments and projects.

Governments routinely announce multi-billion dollar infrastructure projects in large urban centres. At the same time, the discourse misses the infrastructure needs of smaller, rural and Indigenous communities where the state of infrastructure is generally very poor and the ability of these communities to prosper are significantly limited.

Rural areas comprise over 95 per cent of the country's land mass and preserve Canada's cultural fabric, natural landscape, and wildlife while also serving as a key driver of the national economy. For example, rural industries such as agriculture, fishing, forestry, and mining account for approximately 13 per cent of the GDP and 60 per cent of Canada's exports (Infrastructure Canada, 2012). Also, small and rural communities provide food, energy, and raw materials to larger urban centers, fueling and supporting their growth.

The infrastructure challenges faced by small-sized communities are not merely a result of a lack of investments. In addition to funding constraints, smaller-sized communities face additional structural challenges. A lack of in-house capacity and ready access to skilled human capital needed for infrastructure planning, construction, and maintenance are serious structural constraints for smaller-sized communities. In the absence of skilled staff, such communities will be limited in their ability to identify and explore innovative solutions for infrastructure financing, sustainable asset management, and life cycle planning to achieve economies of scale and efficiencies.

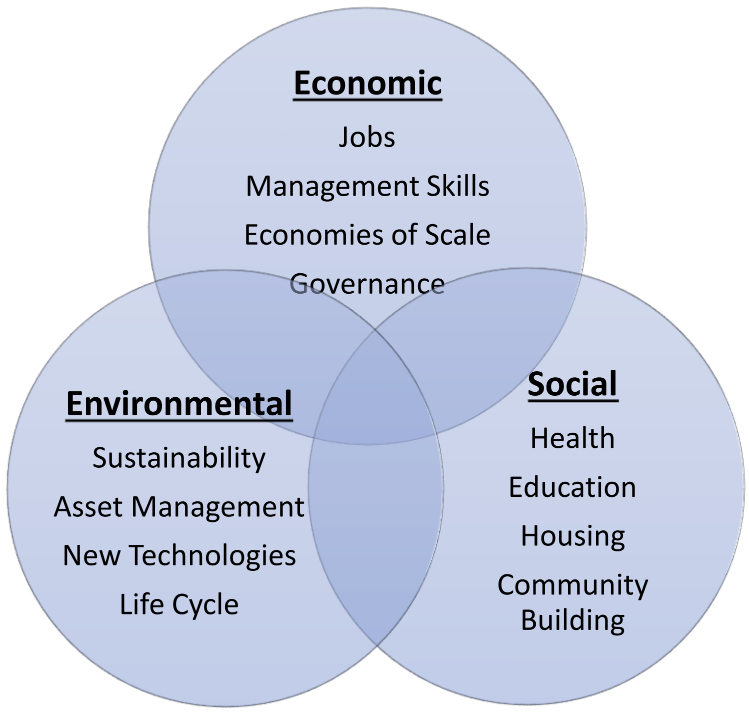
Federal and provincial governments are inclined to approve projects that have made significant headway in the project planning cycle by undergoing pre-construction due diligence and regulatory compliance. Such approach favours larger sized communities that have the means to finance and undertake the pre-planning tasks. Smaller-sized communities lack the means to undertake the prospective planning tasks. Furthermore, federal and provincial government funding often does not fund prospective planning tasks or lifecycle costs associated with infrastructure. Such misalignment of planning priorities and needs adversely affects smaller-sized communities.

Good governance and good outcomes go hand-in-hand. Governance involving the clear and effective oversight of infrastructure investment is crucial if we wish to realize the economic, social and environmental returns from such investments. But achieving effective governance involves a delicate balance given the multilevel nature of governance of infrastructure projects.

<u>Recommendation Two</u>: the 2018 Budget require that infrastructure projects for smaller, rural and Indigenous communities are evaluated on their economic, social and environmental returns, and not just economic benefits.

i) Triple bottom line approach for infrastructure in Canada

The objective of Canada's infrastructure investments should not be narrow in scope, but broad-based to maximize, collectively, the economic, social and environmental returns. This requires taking a long-term perspective. Only then can infrastructure investments support smaller, rural and Indigenous communities across the country through enhanced productivity and sustained economic growth. Productivity and economic growth go together, providing the prerequisites to achieve our shared economic, social and environmental goals.



Evaluating smaller, more complex infrastructure projects from a more holistic approach that includes assessment of economic, social and environmental costs/benefits goes well beyond the traditional pure economic multiplier analysis. We need to expand our cost/benefit analysis to be inclusive of the costs of environmental degradation and social in-cohesiveness. Environmental integrity is critical to the long-run vibrancy of smaller communities, as is social cohesiveness in terms of promoting community values, commitment and the health of community members.

While it is admittedly more difficult to quantify both the benefits and costs of taking such a holistic approach to the assessment of infrastructure projects, the evidence unquestionably points to the benefits outweighing any additional costs that might be incurred by departments. And while some might also argue that the capacity to undertake such assessments currently doesn't exist, modern-day analytic techniques, data availability and our overarching goal of improved productivity and competitiveness as a nation argues that this capacity should be in place

<u>Recommendation Three:</u> the 2018 Budget initiate steps to review the regulatory policy for assessing the risk weighting of infrastructure investments in Canada

i) **Aligning public policy objectives with regulatory requirements**

The federal government through its last two budgets has focused on infrastructure investment as crucial to Canada's economic growth and increasing the country's productivity and competitiveness. The federal and provincial governments also acknowledge the need to have the private sector involved in the planning, development, maintenance and operation of the infrastructure assets. PB Capital's proposed new bank would be focused on providing innovative financial solutions to support the development of infrastructure projects in Canada. PB Capital's proposed bank must comply with regulatory requirements for financial institutions as managed by the Office of the Superintendent of Financial Institutions (OSFI).

The CIB will be able to support the government's policy for infrastructure development and will not be subject to these regulatory requirements because it will not be governed by the Bank Act.

A significant challenge exists for policy makers to balance the need for private capital for social, green and public transit infrastructure with the regulatory requirements being applied by financial institutions regulators around the world. Jurisdictions around the world are putting increased emphasis on infrastructure development as a key driver for economic growth and are investing billions of dollars in infrastructure plans. Governments are looking to the private sector to provide innovation, know-how and capital to support the infrastructure plans. At the same time, regulators are increasing capital and liquidity requirements for banks which are lowering their leverage capabilities and reducing their returns. Internationally, banks and other regulated financial institutions are limited in how they can support the public policy objectives for increased infrastructure lending.

The Canada Council for Public Private Partnerships tracks over 260 infrastructure projects worth over $120 billion that have a high component of private sector involvement and investment. There have been no major defaults or any financial losses on any of these projects. Banks and Insurance companies are lending to infrastructure projects at low rates that reflect the low risks and government obligation to pay for the infrastructure asset upon completion.

OSFI's current regulatory framework does not provide for infrastructure loans as a distinct asset class. Nor do they recognize the low risk and loss experience of infrastructure assets in applying risk weighting for capital adequacy purposes.

As such, OSFI requires new banks to apply a 100 per cent risk weighting to infrastructure lending on the same basis that it would for commercial loans.

The European Union is working on policy that will support infrastructure investments and have their regulator incorporate infrastructure as a distinct asset class for risk assessment at a rate that would encourage financial institutions to lend for government-sponsored infrastructure projects.

Failure to align Canada's public policy objectives for infrastructure with regulatory requirements would represent a lost opportunity for Canada to rebuild and invest in critical infrastructure in smaller, rural and Indigenous communities.

PB Capital respectfully requests that the Committee recommend a review of the policy of assessing infrastructure lending risk in Canada to support better alignment of the regulations with public policy objectives with a view to encouraging financial institutions to increase their lending to infrastructure projects.

Thank you for considering our three recommendations. PB Capital would be pleased to appear before the Committee to discuss our recommendations in greater detail and respond to any questions that Members may have.