Federal Budget 2018 Strategy Submission
Attracting Specialized International Capital for First Nations Utility Infrastructure
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Executive Summary

Resolving an obstacle which impairs First Nations access to capital for water utility infrastructure will reduce the deficit and accelerate the government policy objective of improving drinking water in First Nations communities. A current budget line item expenditure of $1.8 Billion for water utility infrastructure at 71 First nations communities could be substantially displaced by private financing from specialized international sources of capital and favourable government accounting recognition of a contingent liability at 25% of present value.

The Alberta provincial government guarantees bonds and financial instruments issued by Alberta Capital Finance Authority to support water, sewer and power infrastructure in small communities and even Metis settlements. However the federal government explicitly prohibits guarantees to support the financial instruments issued by First Nations Finance Authority for similar purposes by equivalent sized First Nations communities. This prejudicial treatment by the federal government imposes substandard living conditions on a select group of Canadians.

1. Opportunity An opportunity exists for Canadian federal government departments to plan and implement in the 2018 budget a financial strategy that will accomplish the following results:

Advance the government policy priority of improving First Nations water utility infrastructure

Update federal legislation and credit enhancement regulations which currently impair small First Nations communities access to capital for water, sewer and power utility infrastructure, compared to other equivalent sized small municipal communities in Canada.

Reduce the federal budget deficit, by displacing part of the current $1.8 Billion budget allocation for improving First Nations water utilities with international private sector financing

Demonstrate a new model for international capital investment in infrastructure in Canada.

Establish a competitive advantage for Canada to attract investment in infrastructure projects from a large specialized pool of international capital through the new Infrastructure Development Bank of Canada.

2. Collaborating Departments The proposed collaborating federal departments and agencies are:

Finance: Which has a mandate to coordinate the federal budget including a $1.8 Billion/5 year allocation for water and wastewater treatment at 71 remote First Nations communities

Indigenous and Northern Affairs (INAC): Which has a mandate to deliver a program managing the process of designing, building and operating improved First Nations water and wastewater treatment facilities, and to administer the First Nations Fiscal Management Act and the associated Credit Enhancement Fund Regulations

First Nations Finance Authority (FNFA): Which has a mandate to issue bonds and financial instruments and make the proceeds available to support First Nations public infrastructure including water and wastewater utilities.

3. Financing Community Infrastructure

Existing Canadian provincial government financial agencies (eg: Alberta Capital Finance Authority) issue bonds in capital markets to support the financing of water, sewer and other public infrastructure projects by small municipalities.

As provided in The Alberta Capital Finance Authority Act, section 26, bonds issued by ACFA are guaranteed by the Alberta provincial government. The proceeds from the bond issue are then distributed to the small municipalities to undertake public infrastructure projects. Institutional investors buy these bonds because the government guarantee backstop offsets any project construction completion risk, which for water and sewer infrastructure projects is quite a low level of risk in any event. This provides small municipal communities with access to capital at a reasonable cost of capital.

4. Financing First Nations Community Infrastructure

The First Nations Fiscal Management Act (FNFMA) created the First Nations Finance Authority (FNFA) with a mandate to raise capital for First Nations community infrastructure projects by issuing bonds and financial instruments in capital markets. That purpose includes, community centres, clinics, and water, wastewater and power utilities.

The FNFMA preamble paragraph 4 includes as a stated purpose, enabling First Nations communities to access capital markets to finance public infrastructure in the same manner as that economic development opportunity is made available to other municipal governments. However, bonds issued for small First Nation communities are not supported by a federal government guarantee in the same manner that bonds issued for small municipalities are supported by a provincial government guarantee. Opportunities for economic development are handicapped.

The FNFMA section 60 (2) prohibits granting a government guarantee to investors that buy FNFA bonds. Accordingly only a small value of bonds has ever been issued by FNFA during its existence. Also the small communities most in need of improved utility infrastructure are not scheduled under the FNFMA which is a requirement to qualify as a borrowing member of FNFA .

5. Strategy

Institutional investors avoid project construction completion risk, and typically delay investing in infrastructure until the project has been completed and is operating with an established revenue stream. Getting expensive construction loan financing for a project remains a challenging obstacle and the high interest rate for that loan increases the total cost of the project. Total project costs are further increased because upon completion a re-financing transaction is needed to discharge the construction loan and convert it into a long term debt finance obligation at a lower interest rate.

If the Canadian federal government provided institutional investors with a guarantee supporting FNFA issued bonds, it would overcome the gap in providing the financing needed to undertake water utility infrastructure projects. The guarantee addresses the construction completion risk exposure concern of institutional investors, unlocking a large pool of capital to enable utility infrastructure projects and reducing the total project cost.

By simply providing a low risk contingent guarantee, the resulting early stage private sector financing attracted will displace the need for a significant portion of the existing direct federal budget allocation of $1.8 Billion for First Nations water utility infrastructure. This would contribute to a reduction in the federal budget deficit, the hallmark of prudent public sector administration.

Federal accounting rules for the recognition of contingent liabilities attributable to a government guarantee permit it to be recorded at 25% of present value. Displacing a budget line item expenditure with recognition of a guarantee that attracts third party financing is a prudent cost reduction and financial management strategy.

6. Specialized Instruments for Global Capital Sources

The Rotman School of Business Management in Canada contributed to the preparation and presentation of a report for World Bank on Mobilizing Specialized International Sources of Capital into P3s for Infrastructure in Developing Nations to a closed door invited audience of global financial executives and stakeholders in Kuala Lumpur Malaysia in May 2017. This follows an invited interactive workshop session with international finance executives in Dubai in March 2017. The international sources of capital participating included a specialized division of a global financial institution with existing branches in Canada.

Details at:

KL Infrastructure Finance Session
KL Infrastructure Finance Session Outcomes

First Nations in Canada are like a Russian doll containing a developing nation suffering from grossly deficient water and power infrastructure, embedded inside a G7 country. International sources of capital can take comfort in the rule of law and democratic framework that would benefit an investment in infrastructure in a "developing nation" inside Canada.

If FNFA issued a financial instrument that provided investors with a reasonable return determined by prioritized distribution of earned revenue instead of a mathematically certain interest rate calculation, that instrument will comply with the principles required by a specialized large pool of international capital.

Transactions accessing that international pool of capital have already been undertaken in Canada using this approach, including a $2 Billion asset based lease financing structure to support railroad tankcar oil transportation infrastructure. Details available upon request.

7. Attracting International Sources of Capital for Infrastructure in Canada

A successful demonstration of this financing structure to international capital sources will provide Canada with a competitive advantage in attracting investment from specialized international pools of capital for various types of infrastructure projects in Canada. This is aligned with the objectives of the Infrastructure Development Bank of Canada.

This will also provide Canada with a competitive advantage in attracting syndicated investment from specialized international pools of capital in collaboration with the new Canada Development Finance Institution under Export Development Corporation. The DFI will be leading and coordinating financing to support Canadian engineering firms undertaking international infrastructure projects in developing countries.

Generating a competitive advantage has become strategically important to Canada now that the USA has announced its intention to provide $200 Billion of government funding for infrastructure, leveraging a call for a further $800 Billion of private sector investment. This massive competing effort to attract private sector investment into North American infrastructure in the USA in $USD will overshadow opportunities in Canada in $CDN. International institutional investors are concerned about the risk of poor economic performance and a declining currency in Canada as the country suffers the impact of NAFTA changes, border adjustment taxes, softwood lumber duties, dairy product duties and other US trade policies.

8. Recommended Next Steps

The FNFMA section 74 (e) expressly includes in the purposes of the FNFA the mandate to provide advice to government regarding the development of long term financing mechanisms for First Nations.

Department of Finance leadership to sponsor an evaluation of this strategic opportunity, engage qualified expertise and deliver a report with recommendations to inform the 2018 Budget planning process would be a progressive step forward.