

# **Budget 2009: Economic Crisis, P3s and Municipalities**

Social and Economic Policy Department

Canadian Labour Congress

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## **I. Key Points:**

- In Budget 2009, the Conservative government announced limited infrastructure funding support for a range of municipal, provincial, federal and First Nations projects.
- It is time for the government to seriously re-evaluate the public-private partnership (P3) model that it has advanced since Budget 2007.
- The “traditional” model of infrastructure development means that the private sector designs and builds the project, while governments finance, maintain and operate the infrastructure. Public-private partnerships (P3s) allow the private sector to finance, construct and operate public infrastructure projects.
- The weaknesses of P3s have been magnified because of the lack of credit and the global financial crisis. Private sector analysts warn that P3s will be “unable to show value for money, meet affordability tests, or even complete their funding.”
- This is of serious concern now as Canadian governments cannot afford to waste time in getting infrastructure projects up and running so as to maintain jobs and incomes.
- The Canadian government should support public infrastructure projects that will deliver results quickly and in a cost-effective way. It should seek out public infrastructure projects because they are transparent, accountable and democratically-governed in the communities they serve.

## II. Snapshot

In Budget 2009, the Conservative government announced infrastructure funding support for a range of municipal, provincial, federal and First Nations projects across the country. The Conservatives are now in the process of determining the criteria by which proposed projects will be evaluated.

“Traditional” infrastructure projects are based on the assumption that the private sector designs and builds the project, while governments finance, maintain and operate the infrastructure. Public-private partnerships (P3s) are supposed to transfer risk to the private sector for financing, construction and operating public infrastructure projects. After 30 years or more the project reverts back to the public sector.

The economic crisis means that financial institutions are not lending to the private sector infrastructure consortia or are delaying their decisions. The weaknesses of P3s have been magnified because of the lack of credit and the global financial crisis.

One important way the government can strengthen the Canadian economy in this time of economic crisis is to support infrastructure investments. Because federal governments chose to cut taxes during the “surplus” years, municipalities are now ill-equipped to deal with deep economic crisis. Major reinvestments are now needed to support communities, reduce unemployment and decrease inequality.

Across the world, governments are looking for ways to prevent the current economic crisis from deepening. Most of the richest economies are aiming to infuse the equivalent of 2% of GDP in public spending into their economies. The Canadian government is lagging behind and has decided that a combination of tax cuts and only 1% of GDP in spending is sufficient.

Two years ago, the federal Conservative government decided to create a new crown corporation called PPP Canada Inc. This new entity was tasked with creating public-private partnerships (P3s) across the country. The 2007 Budget documents said that all large scale projects under the Building

Canada Fund would have to demonstrate that the P3 option had been “fully considered”.<sup>1</sup>

Since the economic crisis, the inability of private consortia to secure funding has demolished one of the central arguments used to defend P3s. As Moody's, the credit rating firm said in its January 2009 *Report on Canadian PPPs*, “there is a potential for P3 projects to be increasingly unable to show value for money, meet affordability tests, or even complete their funding.”

One of the most recent examples involves the collapse of British Columbia's plan to rebuild the Port Mann Bridge by means of a public-private partnership because the Australian investment bank behind the project could not finance the project. British Columbia will now assume the risk, and finance the construction of the new 10-lane bridge, but the investment bank will continue to benefit by providing “advisory services including financing and tolling operations”.

The Canadian government must ensure that the P3 model does not get in the way of effective stimulus to the economy. There should be no P3 screen on the dispersal of money allocated under new or continuing infrastructure programs. The P3 screen should be dropped for all investments in infrastructure, including through the Building Canada Fund.

The monies allocated to the P3 Fund should be joined with those of the Building Canada Fund. PPP Inc should be shuttered and its operating resources reallocated. Instead, the Canadian government should support public infrastructure projects that will deliver results quickly and in a cost-effective way. It should, furthermore, reconsider the value of public infrastructure projects which are transparent, accountable and democratically-governed in the communities they serve.

In this moment of economic crisis, P3s cannot build infrastructure projects faster, or at a lower cost to taxpayers. The federal Conservative government should not delay or threaten these projects by the decision to use the P3 model of finance and operations. This is of serious concern now as Canadian governments cannot afford to waste time in getting infrastructure projects up and running so as to maintain jobs and incomes.

### **III. Analysis**

In Budget 2009, the Conservative government announced infrastructure funding support for a range of municipal, provincial, federal and First Nations projects across the country. The Conservatives are now in the process of determining the criteria by which proposed projects will be evaluated. It is time for the government to seriously reconsider the public-private partnership (P3) model that it has advanced since Budget 2007. Since late last year, evidence has been mounting that the P3 model is not working. The weaknesses of P3s have been magnified because of the the lack of credit and the global financial crisis.

Since late last year, evidence has been mounting quickly that the P3 model is unable to live up to its own claims to provide a credible bargain with the public sector. There is no real risk transfer to the private partner with P3s and the public sector continues to pay higher costs. The weaknesses of P3s have been magnified with the pressures of the global financial crisis.

The Federation of Canadian Municipalities is concerned about the time delays caused by the imposition of a P3 screen on proposed projects. The Canadian Union of Public Employees, in their Budget Analysis, has also registered concerns with the lack of funding to municipalities and the delays in allocating funds that have been announced. Financial institutions are not lending to the private sector infrastructure consortia or are delaying their decisions. Governments, in the end, will be responsible to take over the projects in crisis mode should the operators fail.

#### **Economic Crisis and the Risk of P3s**

The current economic crisis has shown how risky the P3 model really is. As Moody's, the credit rating firm said in it January 2009 *Report on Canadian PPPs*, "there is a potential for P3 projects to be increasingly unable to show value for money, meet affordability tests, or even complete their funding."<sup>2</sup>

Moody's is most concerned about the risk of P3s at the financing and building stages. At the moment, governments are the only ones with the capacity to borrow. Moody's expects the only way for P3s model to be saved is if governments extend grants, participate in debt or equity and share risk.

Other financial observers from Ernst & Young note that the “infrastructure bond markets are effectively closed”. As a result, the current lack of private financing options “is introducing time and risk into the government procurement processes”.<sup>3</sup> This is a huge liability now when Canadian governments cannot afford to waste time in getting infrastructure projects up and running. Governments, analysts are concluding, will be asked to provide financing and shoulder more of the risk. Daniel Roth, Managing Director, Infrastructure Advisory program at Ernst & Young clearly states the assumption:

if things were to go badly wrong for the private partner, the asset would revert to government, and the public service would likely continue to be provided in one way or another.<sup>4</sup>

So, we must ask, what is the societal value of public-private partnerships? They cannot be built faster, or at a lower cost to taxpayers. They cannot provide private sector credit. Government will be responsible to take over the projects should the operators fail.

### **The Need for Public Infrastructure Investments**

One important way the government can strengthen the Canadian economy in this time of economic crisis is to support infrastructure investments. It would cost \$12 billion each year for the next ten years to fix the crumbling municipal infrastructure across this country. To meet the outstanding transit needs of communities, we would need another \$8 billion each year for five years.<sup>5</sup> Public hospitals, child care centres, schools and other public institutions also need significant financial support to upgrade their physical infrastructure. Because federal governments chose to cut taxes during the “surplus” years, municipalities are now ill-equipped to deal with deep economic crisis. Major reinvestments are now needed to support communities, reduce unemployment and decrease inequality.

The Federation of Canadian Municipalities reports that there are hundreds of infrastructure projects ready to go across the country.<sup>6</sup> These include:

- 386 water and wastewater projects (more than 30,000 jobs);
- 144 public transit projects (more than 86,000 jobs);
- 362 projects in roads and bridges (more than 23,000 jobs).

Late last year, the Conservative government was nearly toppled by opposition to its “business-as-usual” approach to dealing with the crisis hitting the world economy. The government increased funding slightly in the February 2009 Budget, but the government maintained its commitment to the failed model of unregulated markets and limited public spending.

Across the world, governments are looking for ways to prevent the current economic crisis from deepening. Most of the richest economies are aiming to infuse the equivalent of 2% of GDP in public spending into their economies. The Canadian government is lagging behind and has decided that a combination of tax cuts and only 1% of GDP in spending is sufficient.<sup>7</sup> Even the TD Bank disagrees with this approach:

Domestic public spending offers more bang for the buck in stimulus terms in that it has less leakage than other forms of stimulus, such as a cut in the GST. When a dollar of government revenue is foregone in the form of a sales tax cut, much of that goes toward spending on imported goods, assuming a consumption boost is actually achieved in the first place. Similarly, when a dollar is returned to a tax-payer in the form of income tax cuts, he or she can, and often does, save a portion.<sup>8</sup>

The Canadian government is on the one hand, reluctant to make public investments, and on the other, choosing an ill-fated mechanism to deliver the investments it is making.

### **Public-Private Partnerships and PPP Canada Inc.**

“Traditional” infrastructure projects are based on the assumption that the private sector designs and builds the project, while governments finance, maintain and operate the infrastructure.

P3s are based on the assumption that a consortium of private sector companies will accept risk for financing, construction, and operating public infrastructure projects if they are given control of the assets and the ability to make profit over the long-term. After 30 years or more (when it becomes costly), the project reverts back to the public sector.

Two years ago, the federal Conservative government decided to create a new crown corporation called PPP Canada Inc. This new entity was tasked with creating public-private partnerships (P3s) across the country. The new crown corporation will manage a \$1.25 billion fund that will contribute 25% of the costs of providing municipal infrastructure according to the P3 model. It will also determine how P3s should be used in other federal infrastructure projects and it will promote P3s across Canada. The P3 Fund was first announced in Budget 2007 and has been announced three years in a row.<sup>9</sup>

The 2007 Budget documents said that all large scale projects under the Building Canada Fund would have to demonstrate that the P3 option had been “fully considered”.<sup>10</sup> Since its announcement in 2007, only \$300 million of the \$1.5 billion Building Canada Fund has been spent.<sup>11</sup>

From *Budget 2007*, “Public-private partnerships can be beneficial in building infrastructure projects faster and at a lower cost to taxpayers. Private capital and expertise can make a significant contribution...The private sector is also better placed to manage many of the risks associated with the construction, financing and operation of infrastructure projects.” (p.169)

### **The 2009 Budget and infrastructure spending**

Budget 2009 made a number of new and continuing allocations for infrastructure spending in different areas. Over the next two years, the federal government will spend \$6.4 billion for provincial, territorial and municipal infrastructure investments.<sup>12</sup> This is a small amount given the current need and well below the commitments other governments are making to economic stimulus spending. Nor is it linked to a Made-in-Canada purchasing policy.<sup>13</sup>

A further \$515 million will be spent on infrastructure in First Nations communities. This is both long-overdue and still short of what the Assembly of First Nations knows is necessary. There is no provision for Aboriginal communities to be supported by local procurement and hiring policies.

The Finance department will also extend \$2 billion in low-cost loans to municipalities so they can borrow money from Canada Housing and Mortgage Corporation to pay for their share of federal infrastructure programs.<sup>14</sup> This means that the federal government is making it easier for municipalities, who cannot afford to participate in shared-cost programs, to go deeper in debt.

### **Economic crisis and the risk of P3s:**

The evidence that public-private partnership model is a casualty of the economic crisis is mounting fast:

- In January 2009, the BC government had to assume greater responsibility for the financing of the new Port Mann bridge - a P3 toll-bridge because Macquarie, the Australian investment bank behind the project, could not finance the project.<sup>15</sup> By the end of February, it became clear that this partial rescue would not work. On March 1, it was announced that British Columbia's plan to rebuild the Port Mann Bridge and widen Highway 1 by means of a public-private partnership had collapsed. What had started out as a "public-private partnership" reverted to "traditional" financing mechanisms in the wake of the economic crisis. This means that British Columbia will now assume the risk, and finance the construction of the new 10-lane bridge. Users will be charged \$3 tolls to recoup the costs.<sup>16</sup> Marquarie, however, will continue to benefit by providing "advisory services including financing and tolling operations".<sup>17</sup>
- The Golden Ears Bridge in Greater Vancouver was turned into a P3 in 2006. The private partner, Golden Crossing Finance, was downgraded on February 19 2009 by Moody's credit rating agency because of the likelihood that the project will need new liquidity sources. Moody's also foresees the increased risk of default.<sup>18</sup>
- In British Columbia, the \$1-billion South Fraser Perimeter Road does not yet have a deal with private partners for financing. The BC government has not yet found a private partner to complete the \$1.4-billion Evergreen Line.<sup>19</sup>

- Access Justice Durham, the company building the new court house in Durham Region, Ontario was placed under review for downgrading by Moody's in late January. The consortium now operating the new Gordon & Leslie Diamond Health Care Centre in Vancouver, AHV Access Health Vancouver Ltd, was downgraded by Moody's in late January. Access Roads Edmonton Ltd, now operating the new ring road in Edmonton, is under review for downgrade by Moody's, also in late January.
- November 2008, the BC government said it would no longer make projects smaller than \$50 million P3s because of the crisis. The Canadian Construction Association has registered its concern that smaller and local construction firms are excluded from the P3 model, in favour of the largest companies that can make 30 year financing commitments.<sup>20</sup>
- In September, 2008 Babcock & Brown Public Partnerships Ltd. (BBPP) won a 32-year contract for the design, construction, finance and maintenance of 18 schools in Calgary and Edmonton. The company is investing 75% of the equity, which amounts to \$28 million.<sup>21</sup> BBPP's parent company is struggling to avoid bankruptcy after incurring a debt of \$3 billion and having its shares suspended.<sup>22</sup>
- James McKellar, professor at the Schulich School of Business at York University wonders whether companies engaged in new P3s will still be afloat once the work is started. He asks, "are the assumptions we made five, six or 12 months ago still valid?"<sup>23</sup>
- In Quebec, the two consortia bidding on a \$1.1 billion hospital contract in Montreal is having trouble obtaining financing and are threatening to withdraw their bids. They are asking the government for several hundred million dollars in guarantees. Broad opposition is being mounted. Even the finance minister who is reported to have said that the government should not assume the risk.<sup>24</sup> The decision on whether the P3 will go forward has not yet been announced.

- The new hall for the Montreal Symphony was originally going to be built as a PPP. Because of the lack of private credit, it has recently been decided that the government will assume the responsibility for financing the P3 to the tune of \$75 million.<sup>25</sup>
- Engineers in Quebec have registered their concern about the long and complicated contracts that are an attempt by private owners and financiers to limit their risk.
- In February 2009, the Ontario Auditor General (A-G) released a report on the P3 Brampton Civic hospital . The A-G concluded that the hospital cost \$394 million more than if it had been built within the public system, including \$200 million in higher interest costs. Instead of 716 beds that the public hospital would have included, the P3 hospital only has 479 beds.<sup>26</sup> In light of this disaster, Ontario's Peel Memorial will be rebuilt using traditional financing models and not a P3 model.<sup>27</sup>
- The expansion of Ontario's private highway 407 will be public.<sup>28</sup>
- CitiGroup Properties , the private company that committed to design, build, finance and operate the court-house in Moncton has made a 30 year commitment to the \$60 million project. Due to the secrecy of the P3 contract, few details are available on who and how the financing was arranged. <sup>29</sup>
- In England, the London underground (subway) reconstruction was left in disarray when its private partner folded in 2007 and the City of London brought 6000 workers back in house.<sup>30</sup>
- In the UK, many P3s (called PFIs) have stalled and are slowing down the economic stimulus plans of the government. The HSBC bank has withdrawn from all of its PFI projects in Europe. The first PFI hospital in Northern Ireland has run into difficulty as a result. A £4.4 billion waste management project in Greater Manchester has stalled, as have a series of primary care health centres across England. As reported in the Guardian, "just 12 PFI contracts, with a total capital cost of £1.5 billion, have been signed since lending conditions deteriorated in June

2008, compared to £3 billion of investment in the previous six months.”<sup>31</sup>

- The government in the UK is being asked by the PFI industry to deliver £4 billion in long-term bridging loans to the private sector to allow the public-private partnerships to continue. Government may be asked to provide up to 40% of the project costs.<sup>32</sup>
- Privatization in general is coming under criticism in many countries. After facing ongoing opposition in the state legislature, the consortium behind the privatization of the Pennsylvania Turnpike pulled out of the deal.<sup>33</sup> The privatization of the German railways, the British post-office and the French post-office have been turned down because of the credit crunch. Researchers have identified many examples of failed and failing projects in different countries.<sup>34</sup>

## **Conclusion:**

The Canadian government must ensure that the P3 model does not get in the way of effective stimulus to the economy. There should be no P3 screen on the dispersal of money allocated under new or continuing infrastructure programs. The P3 screen should be dropped for all investments in infrastructure, including through the Building Canada Fund. The monies allocated to the P3 Fund should be joined with those of the Building Canada Fund. PPP Inc should be shuttered and its operating resources reallocated. Instead, the Canadian government should support public infrastructure projects that will deliver results quickly and in a cost-effective way. It should, furthermore, reconsider the value of public infrastructure projects which are transparent, accountable and democratically-governed in the communities they serve.

In this moment of economic crisis, P3s cannot build infrastructure projects faster, or at a lower cost to taxpayers. The federal Conservative government should not delay or threaten these projects by the decision to use the P3 model of finance and operations. This is of serious concern now as Canadian governments cannot afford to waste time in getting infrastructure projects up and running so as to maintain jobs and incomes.

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