

Recycling Ontario's Assets

A New Framework for
Managing Public Finances

BY MICHAEL FENN

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An informed public discussion about how Canadian governments should manage and monetize their public assets is overdue. That discussion must include the many successful approaches that are being used globally to monetize assets while protecting the public interest.

Executive Summary

Canada's infrastructure is aging and significant new investments are required. Raising new revenues through increased taxation is one option to respond to this urgent need. Yet governments and the public are resistant to this approach. But another option exists. It is called "asset recycling."

Put simply, "asset recycling" requires governments to dispose of legacy assets to generate capital to invest in new assets or to refurbish existing infrastructure. Australia points the way. In the past six years, more than half of all infrastructure construction (valued at A\$36B over the past six years) has been funded by the private sector, generally by recycling public assets.¹ Many of these capital investments provide 'public goods' that would otherwise not be available to the public, as well as delivering significant, sustainable returns for pension funds.

Governments around the world are re-examining how they ensure maximum public value from their assets. But in Canada we often maintain public ownership when we shouldn't—or dispose of our assets in haphazard ways. Globally, new approaches to asset management that protect the public interest while maximizing revenue generation have emerged and should be considered.

An informed public discussion about how Canadian governments should manage and monetize their public assets is overdue. That discussion must include the many successful approaches that are being used globally to monetize assets while protecting the public interest. Traditional 20th century debates between public ownership and privatization are increasingly irrelevant to the real choices facing governments.

At the same time, private capital—including public-sector pension fund capital—is looking to invest in public assets and infrastructure in reliable jurisdictions, like Ontario. A new framework for asset management and reinvestment based on the principle of asset recycling would allow increased investments in infrastructure, protect the public interest, and make use of both the expertise and large pools of capital available in Ontario.

This paper suggests a new policy framework for public assets to increase their value. By leveraging existing public assets—from land and infrastructure, to government enterprises and intangible assets like information technology—governments can unlock the wealth of legacy assets. Recycled assets can pay for new roads, bridges and public transit; education and healthcare facilities; more weather-resistant infrastructure; and even social and technological infrastructure.

This paper is intended to help governments develop a framework for managing and monetizing public assets. Some of the key recommendations include:

- » Federal and provincial governments should follow the lead of municipalities and clearly separate operating from capital revenues and expenditures. Debt financing to invest in long-life capital assets like infrastructure should be acceptable, while operating deficits should be avoided. This can only occur if budgets distinguish operating from capital more clearly.

¹ *Investment in Australia's Infrastructure*, Department of Infrastructure and Transport, Australian Government-Australian Trade Commission (Canberra: October 2012).

» Governments should develop frameworks for managing their assets, beginning with understanding what they own, and why. Asset management frameworks should identify the policy purpose for owning an asset and determine whether the original purpose is still compelling. Policy makers should look objectively at the alternatives available to protect the public interest, while increasing revenues to be used for public purposes.

» Governments should improve their capacity to manage assets by hiring those with the expertise necessary to monetize assets. Asset planning should take place centrally, rather than be undertaken by individual ministries and other government entities. Decentralized, departmental asset management often diminishes the public value of our assets, and individual departments are not always well-placed to make integrated decisions regarding the disposition of assets.

» Many of the accounting, audit, and tax rules currently governing the disposition of public assets will need to be reformed. We have designed these rules with the public interest in mind, but some have come to undermine good public policy. Currently, it is often necessary to book the proceeds from an asset sale in the year in which the sale took place, rather than allowing the proceeds from an asset sale to be saved, invested or deployed in ways that re-invest in public assets over a longer time horizon.

» A formal policy of asset recycling should be adopted, with the proceeds from asset disposition put into an Infrastructure Trust. This Trust would ensure that revenues from asset disposition would be used to invest in new, priority infrastructure. Such a Trust could take on the characteristics of an Infrastructure Bank.

Canada's current economic success and productivity stands on the infrastructure foundation built and financed by capital investment, including bonds and debentures issued in the low-interest decades following World War II. These post-war investments were then complemented by civic, hospital and educational infrastructure investment financed from development charges, philanthropy, debt-financed capital grants from the provinces, and periodic federal capital funding.

Our current prosperity and quality of life stand on the shoulders of these past investments. From transit facilities and water lines, to energy infrastructure and recreational

facilities, the need for new investment by governments is abundantly clear to citizens. We must either raise taxes to fund new investments or find ways of monetizing our current assets. This paper recommends a new strategic framework for asset management, referred to as asset recycling, that would protect the public interest, increase revenues with reduced burden on taxpayers, and permit a new wave of infrastructure renewal.

Traditional 20th century debates between public ownership and privatization are increasingly irrelevant to the real choices confronting governments that face mounting public debt and undiminished expectations from citizens.

1

Introduction

Ontario and other Canadian provinces are faced with a significant policy problem: much of our existing infrastructure is aging, significant new investments are required, and yet governments and the public have resisted raising the taxes necessary to reinvest. At the same time, private capital—including public-sector pension fund capital—is looking to invest in public assets and infrastructure in reliable jurisdictions, like Ontario. A new framework for asset management and reinvestment—including the concept of “asset recycling”—provides a potential solution to these policy challenges.

Governments around the world are re-examining how they ensure maximum public value from their assets in the wake of the global financial crisis. But too many governments in Canada have maintained public ownership when they shouldn't—or disposed of their assets in haphazard ways.

Globally, governments are increasingly using innovative approaches to protect the public interest while maximizing revenue generation for public purposes. These approaches go far beyond the usual public debate between traditional public ownership or asset sell-offs; they include the concept of “asset recycling”—that is, disposing of legacy assets in order to generate the capital to invest in new assets or to refurbish priority infrastructure.

Across the world, pension funds and sovereign wealth funds are investing in infrastructure and in a range of public assets, from publicly operated business enterprises and infrastructure, to information technology and even soft assets like data. Many of these capital investments provide ‘public goods’ that would otherwise not be available to debt-ridden governments and public agencies. Others are designed to produce streams of revenues to build or restore public infrastructure, while reducing the obligations on taxpayers.

These trends have thus far been relatively uncommon and often unpopular across North America. Despite Ontario's growing expertise in asset management and public-private partnerships, the province has been less ambitious than required in order to meet the necessary challenge of reinvesting in aging infrastructure or new technologies.

An informed public discussion about how Canadian governments and Ontario in particular, should manage and monetize public assets is long overdue. That discussion must include the many new approaches that are being used successfully by governments across the world to monetize assets in new ways while protecting the public interest. Traditional 20th century debates between public ownership and privatization are increasingly irrelevant to the real choices confronting governments that face mounting public debt and undiminished expectations from citizens.

This paper suggests a new policy framework be applied to public assets that would increase their value. The proposed approach conceptualizes public assets in a dynamic and cyclical way. By leveraging existing public assets—from land and infrastructure, to government enterprises and intangible assets like information technology—governments can unlock the wealth of legacy assets. Recycled vestigial assets can pay for urgently needed new or deteriorating public assets, including roads, bridges and public transit, education and healthcare facilities, and even social and technological infrastructure.

When older public assets are no longer required to fulfill some significant public purpose, they can be returned to society as taxpaying enterprises and/or managed effectively and efficiently by the private or not-for-profit sectors as facilities or services to meet community and consumer needs. Even where public assets actually meet an express public policy goal or need, the private and not-for-profit sectors can often play a role in more efficient and customer-focused delivery, or to generate better financial returns for government and the public.

There are three phases to the lifecycle of most public assets: acquisition, operation and disposition. During all three phases, assets can potentially be better leveraged to generate improved performance, greater public value, risk-transfer, and financial returns to governments and public agencies (including reduced public subsidies). Done properly, the cycling of public assets through these three phases can reduce public debt, attract new investment, provide competitive returns for pension funds and other investors, and allow new needs to be met from legacy assets.

How Canadian governments manage our public assets is a pressing public policy issue across the country but decisions about how to manage public assets are rarely easy. Governments must account for a complex range of priorities, including public opinion, fears about “privatization,” stakeholder interests, political cycles and timelines, and short- and long-term calculations over revenue opportunities. They must also consider the broader public interest around issues as diverse as the protection of public health and the environment, and ensuring that more remote communities have access to energy, clean water and economic activity.

This paper is intended to help governments wrestle with these questions by providing a way of thinking about public assets. This report builds on a range of one-on-one interviews with a cross-section of thought leaders in Canada, mostly in Ontario, as well as the perspectives of an equally diverse selection of reviewers. The conclusions also draw extensively on the many international reports that have reviewed governments’ evolving approach to public asset management and focused attention on particular case studies. The result is a report that adapts global lessons for the Canadian experience. We use Ontario as a case study throughout the report to highlight how our lessons can be applied in a practical way, but we believe that

the conclusions are generally applicable to all Canadian governments, including the Government of Canada and our local governments.

We suggest a framework for considering public assets and conclude that an approach focused on asset recycling will produce the greatest public value. In arguing for an asset recycling approach, we look at the experience of Australia which provides useful lessons for Ontario, including how to overcome obstacles within government and ensure that the private sector will be willing to invest capital and accept risk transfer, under terms and conditions that respect the public interest.

There are often very good reasons for governments to own public assets. But governments should be very clear about the rationale behind public ownership on a case by case basis.

2

The Public Asset Opportunity

Governments across Canada own significant assets. In 2013, for example, the Ontario Ministry of Finance reported in its public accounts that the province holds \$164 billion in public assets. These include \$18 billion worth of Government Business Enterprises (GBEs) (e.g., LCBO, OLG, OPG, Ontario Hydro) and over \$85 billion worth of tangible capital assets, managed mostly by Infrastructure Ontario (e.g., land, buildings, hospitals, transportation infrastructure). The remaining \$61 billion is comprised of investments, cash, and other assets.² It should be noted that these figures very likely understate the value of these assets and their market-monopoly in commercial terms, particularly in a low-interest-rate environment. Were a commitment made to monetize these assets, their value would increase significantly.

Not included in this total are the intangible assets of the provincial government, such as privileged access to information and data, intellectual property, and brand equity. The value of these assets in monetary terms is unmeasured, while the value to the public that could accrue from using some of these assets, like data, to improve program delivery and value-for-money in policy interventions is not known.

Public discussion of how best to manage these assets has failed to consider the broad range of options available to governments. Too often, the public debate devolves into a choice between public ownership and privatization, when in fact the range of tools and approaches is far more sophisticated and diverse.

These tools include regulation, leasing, concession arrangements, franchises, alternative management approaches, and special purpose trusts created from the proceeds of an asset sale or lease. Depending on the circumstances, one or more of these options may be better placed to maximize public value from an asset. Looking at public assets through an “asset recycling” lens is more likely to produce the best value for the public and optimize reinvestment in new infrastructure.

The objective of this paper is to outline an approach for governments to use when considering meeting their obligations through the use of public assets. Three principles should guide government calculations: 1) protection of the public interest, which will often include protection of health and safety, the environment and the consumer; 2) potential for long-term revenue generation for government (or, on occasion, others) to be used for public purposes; and, 3) whether the quality, quantity, equity and choice of services provided to the public can be maintained or improved.

On occasion, these three principles may appear to conflict, but they often are complementary or even mutually reinforcing. While the government is sometimes the best-placed or only actor that can successfully protect the public interest, it is unreasonable to assume that the public interest is always best protected through public ownership of an asset or an economic monopoly. In fact, there is reason to believe that governments are sometimes not the most appropriate managers of public assets. Ontario’s experience and that of other jurisdictions demonstrates that it is often possible to adopt alternative

² Ontario Ministry of Finance, 2013. *Public Accounts of Ontario 2012-2013: Consolidated Financial Statements*. Accessed online at http://www.fin.gov.on.ca/en/budget/paccts/2013/13_cfs.html, March 24, 2014.

approaches to asset management that increase revenues and improve service delivery, without having any material impact on the protection of the public interest.

There are often very good reasons for governments to own public assets. But governments should be very clear about the rationale behind public ownership on a case by case basis. Governments should assess various approaches to asset management with a focus on identifying which approach is best able to achieve the stated policy objective. Those “very good reasons” can also change over time.

Equally, there might be good reasons to dispose of an asset, but governments should not presume that such a disposition will necessarily result in more near-term revenue or better service quality. And short-term fiscal considerations should rarely drive decisions about asset disposition. Assets need to be assessed on a case-by-case basis, as part of a coherent overall approach.

Explicitly outlining the rationale for public ownership as part of an ongoing strategic asset review will be a useful first step in determining whether that rationale for public ownership still applies or whether some other approach would be more effective. Assessing which model of asset management is best able to advance the public interest, maximize revenue, deliver quality services, and improve the fiscal picture should all be part of every government’s on-going strategic asset reviews.

What we find is that an approach of asset recycling, employed in part in Australia, often is the best way to protect the public, deliver public value, generate revenue and make it possible to continue to reinvest in new and refurbished public infrastructure.

By recycling assets, governments can unleash value and capital to invest in the infrastructure that will support the next wave of prosperity.

3

What's the Problem with the Status Quo?

Our key informants outlined a large number of problems with the current approach to public asset management. Several should be highlighted.

1. Perhaps most important is a **lack of capital** needed to reinvest in new infrastructure, replace aging infrastructure, or to achieve the best results for the consumer from government business enterprises. Raising taxes is one option and it is true that government spending in Canada as a percentage of GDP is low compared to the previous 70 years. But unless both governments and citizens are prepared to accept higher taxes, alternative sources of revenue will need to be found. Private capital—including public-sector and private-sector pension funds—is one potential source.
2. Asset management suffers from a **lack of comprehensive long-term strategic planning**. In particular, planning across departments or agencies does not take place as a matter of course. For example, large scale infrastructure developments in preparation for the Pan Am Games have not sufficiently considered the long-term savings from the installation of district heating capability in new developments. This was in part because of the higher up-front costs required to install district heating, with the savings spread-out over a longer period across many ministries. Because no one ministry had a long-term financial interest in making up-front investments, the long-term savings to the Ontario public and government were sacrificed. This example is symptomatic of a larger problem across Canadian governments. The current approach to planning and managing assets usually makes it difficult to ensure that energy, water, environment and infrastructure issues are being examined from an integrated, long-term perspective.

This is exacerbated by existing **accounting, budgeting and taxation rules** that often require or encourage governments to manage their assets in inefficient ways, degrading their potential value. For example, some asset sales must be booked in the year in which they occur and not reinvested in trusts for the longer term.

3. There is a **lack of commercial expertise** within government and many commentators expressed surprise that policy generalists were often asked to undertake an assessment of business or partnership opportunities for which they had little if any background. The overall conclusion was that governments were straying into new lines of business and new approaches to managing assets without having sufficiently trained their workforce for these new roles. Unlike major pension funds, governments are unwilling or unable to pay the market price necessary to recruit or engage the required talent to manage, dispose of, or make investment decisions about public assets.
4. Governments frequently have **little idea of the true value of an asset**, or the potential for technological or commercial enhancement. The full value of an asset if it was leveraged or reformatted to meet citizen, client or market needs is not always appreciated. Arguably, for example, the Ontario Government misread the true value of the 407ETR toll road. It was initially pleased with the sale price, until private operators demonstrated that more aggressive tolling rates created a significantly enhanced market value for the asset. The lesson of the 407ETR that often goes unnoticed is that the revenue generation that has arisen for the private operator has increased the value of all highway infrastructure because the monetized value of these public assets has been made clear.

5. Existing assets are often subject to **intense pressure from stakeholders**. Decisions can often be made for short-term political reasons rather than longer term sound management of the asset, undermining its value. Even if asset-dispositions proceed, ‘uncosted’ political and stakeholder compromises can impose unattractive, uneconomic conditions on potential investors, which get priced into bids, reducing the value to the public.
6. It is also sometimes **difficult to raise the capital at competitive rates for new ventures** because private investors are often reluctant to build and operate new (“greenfield”) public infrastructure, or to launch an unproved government enterprise. This is not the case with already existing or operating assets. For example, proven levels of transit ridership or toll-road users, or telecommunications revenues, can be demonstrated using past experience. This avoids bidders pricing-in those risks, or simply demanding an “availability fee” approach, which commits a government to help to ensure a bidder’s profitability. But on new infrastructure, revenues and costs are more difficult to predict.
7. The **absence of rigorous asset management frameworks** hampers effective decision making over asset disposition. Governments often feel pressure to divest themselves of an asset for a variety of reasons. These could include a lack of funds to invest and maintain the asset, political risks associated with managing it, or because collective-bargaining has become too challenging. All of these pressures can lead governments to want to dispose of an asset, but they often lack a good financial or policy framework under which they can explore their options for asset disposition beyond simply selling it off.
8. Major pools of “patient money,” such as public-sector pension plans, increasingly invest outside the country in order to generate the financial returns needed to meet their obligations, whether pension liabilities or the expectations of long-term investors. **The lack of domestic investment opportunities in infrastructure and government business enterprises (GBEs) is a missed opportunity** for the Canadian economy and for all Canadians.

Faced with this range of problems, many commentators are proposing the “leveraging” of government assets. To achieve such a goal, we must first change the decision-making context and framework.

Other jurisdictions have been successful in overcoming hostile policy, political and decision-making contexts. This paper will review those lessons, particularly from Australia.

It is well known that good public infrastructure promotes economic prosperity through enhanced productivity. By recycling assets, governments can unleash value and capital to invest in the infrastructure that will support the next wave of prosperity. Asset recycling and repurposing can also be undertaken in a manner that focuses on community benefit. This has been used with success in many European countries to reinvest in community assets and social infrastructure. Depositing the proceeds of asset-disposition into a Public Asset Trust could include an assessment of community benefits and a guaranteed reinvestment in community assets supporting local communities.

Our current prosperity and quality of life stand on the shoulders of past investments and past visionaries. From transit facilities and water lines, to energy infrastructure and recreational facilities, the need for new investment by governments is abundantly clear to citizens.

4

Why Act Now?

Much of Ontario's seventy-five years of economic success stands on the foundation of urban, regional and energy infrastructure that was largely built and financed by capital investment, including bonds and debentures issued in the lower-interest decades following World War II. By the 1970s, as interest rates rose, civic, hospital and educational infrastructure investment continued—increasingly financed from development charges, hospital and university fundraising, debt-financed capital grants from the province, and periodic federal capital funding, such as Canada Mortgage and Housing (CMHC) funding for social housing projects (as well as CMHC mortgage-insurance support for residential growth).

The subsequent lag in tax-supported infrastructure investment in the 1980s and 1990s—at all three levels of government—likely had more to do with the rising cost of capital financing than with resistance to tax increases to support that capital investment. In fact, taxes at all levels of government rose considerably during that period.

Our current prosperity and quality of life stand on the shoulders of past investments and past visionaries. From transit facilities and water lines, to energy infrastructure and recreational facilities, the need for new investment by governments is abundantly clear to citizens.

Fortuitously, we have now returned to an environment where the cost of borrowing is very low and the carrying costs of long-term debt are more easily sustained. In a protracted period of low-interest borrowing rates, there is considerable opportunity for governments (and others) to raise capital to invest in infrastructure or government business enterprises (GBEs). If projects with a multi-decade lifespan are to be undertaken, they will likely never be more affordable than now, in terms of financing cost (which in other periods might have doubled the original construction cost).

Some would argue that it is now possible to raise taxes or undertake significant new public debt-financed investments in our aging infrastructure or GBEs. But unless the public's appetite is there for either of these approaches, an alternative is necessary if decision-makers are to deal with society's pressing needs. If investment debt can be financed with a future stream of payments, unrelated to general taxation, the case for using debt becomes much stronger, and the risks much lower. Likewise, if a private investor in a public asset, such as a GBE, can enhance its value (e.g., profitability, productivity, revenue-generating potential, market reach, new products or services), the value of that asset rises materially from the current under-estimated values in government accounts.

The ability of a purchaser of a public asset to acquire a public monopoly (or an entity operating within a protected regime) further enhances the value of the asset (and the bid price). Restraint-of-trade and market-regulation practices may be positive or negative, but their impact on asset value is fairly predictable.³ The value of public assets is also much higher during periods of low inflation and low interest rates.

3 Often overlooked is the value of market-dominance by Ontario's public assets. Ontario is one of the largest single-payer healthcare entities in North America, which has great potential significance for proof-of-concept healthcare delivery systems, as well as for joint-venturing medical, pharmaceutical, bio-medical and bio-imaging research. Holding long-term government leases can dramatically enhance the appraised value of privately owned office buildings, or secure the financing needed leverage the property's asset value. The LCBO is likewise one of the world's largest single-purchasers of wines and spirits. All of these are procurement positions the value of which General Motors or Walmart have proved in other settings. The scale and integration of Ontario's public entities have unrealized market potential, both domestically and globally.

Investors are looking for safe places to put capital. Interest rates and inflation are at historic lows, but they will not stay there over the medium term. It is likely that the value of public assets is at their peak and at their most attractive for private investors.

What does this mean for monetizing and leveraging current public assets? If governments are to realize maximum value from existing and legacy public assets to finance new infrastructure or to discharge debt obligations they should move expeditiously.

Committing to a policy of asset recycling would mark a sea change in fiscal policy for Ontario. As with most major policy reforms, it would involve disruption, controversy, teething problems, and plenty of criticism, both general and specific.

5

The Case for Asset Recycling

The case for “recycling” public assets has an elegant simplicity to it:

STEP 1

A government chooses to dispose of vestigial public assets that may have grown in value but no longer need hands-on government attention or no longer achieve a priority public purpose.

STEP 2

The government uses the disposition proceeds to fund new or renewed public assets that by their nature (or by public choice) should be in the hands of government entities.

However, while the concept is simple, operationalizing it is complex. Many challenging issues arise when seeking to implement a policy framework that governs asset recycling.

Looking at Australia and other experienced jurisdictions, successful asset recycling policies tend to incorporate a number of common features that make the concept more appealing both to risk-averse governments and sceptical citizens.

1. The value of public assets is recognized and there is a commitment to enhancing their value.
2. Governments assume the role of system manager and prioritize, ensuring the right people with the right expertise are in charge of assets. Their decisions are guided by a transparent and rigorous policy framework for recycling assets.
3. Governments have a clear understanding of the size and value of their asset portfolio (including intangible assets).
4. Public support is enlisted for asset recycling. Governments explain that public assets will be disposed under terms and conditions that the average taxpayer would see as fair, transparent and consistent with the public interest. Depending upon the nature of the public asset (e.g., GBES), the public may need further assurances that the products or services of ‘disposed’ assets will still be available to society under reasonable terms and conditions, or perhaps even be improved, ‘under new ownership’.
5. Widespread consultation and engagement with labour is undertaken to ensure buy-in and gain insight on how to enhance the value of assets.
6. The proceeds of asset dispositions in infrastructure and other capital assets are protected and reinvested—creating new public assets or enhancing the value to the public of existing ones. The temptation to use one-time proceeds from capital-asset disposition to reduce the government’s annual operating deficit is recognized as an unsound fiscal policy.
7. When choosing which assets to retain, enhance or divest, governments keep focused on the longer-term goals of how assets can contribute to enhanced productivity and the creation of new economic activity. The first assets to be chosen during the roll-out of an asset recycling policy are those that offer considerable financial impact and precedent-setting value.

Australia's Experience with Asset Recycling: Lessons for Canada

Australia has pioneered an approach to asset management and renewal, commonly referred to as "Asset Recycling," that has effectively leveraged the domestic investment community and pension fund industry. A number of lessons are relevant for Ontario and Canada.

In 2011, the Financial Services Council of Australia (supported by consultants Ernst & Young Australia) undertook a review of the Australian pension industry's appetite for investment in public infrastructure. They solicited views on a variety of issues related to investment in public assets at all stages of the cycle with a view to informing the investment and divestment policies of the state and federal governments of the Australian Commonwealth.

The consensus that emerged was the novel idea that Australia's governments should adopt a formal public policy of "recycling" public assets. The federal government would review the operating assets still held by Australian governments, identify those that could be sold or recycled and see the capital reinvested in so-called "greenfield" assets. In the end, the government embraced the concept of recycling capital assets and using the proceeds to build and finance infrastructure.⁴

The approach would include attracting pension funds to invest in core infrastructure projects. In particular, brownfield projects with a strong operating history were particularly desirable as investments.

John Brogden, the CEO of the Financial Services Council of Australia, summarized the case for using pension funds to invest in infrastructure in Australia:

Over the past 20 years, Australia's superannuation [pension] funds under management have grown from \$140 billion to \$1.3 trillion. As superannuation funds have grown, Australia's infrastructure gap has widened. So can Australian superannuation funds solve our infrastructure black hole?

...Superannuation [pension fund investment] is not a cash cow to fund particular economic ills in Australia. However, superannuation funds do invest in infrastructure and will continue to do so where it delivers an appropriate risk weighted return for the investor. Superannuation has a central part to play in Australia's macro economy and the goals of maximising returns and facilitating economic growth are consistent. By investing in assets that maximise returns to members, superannuation funds are also maximising economic growth...⁵

⁴ *Infrastructure Australia*, 2013. June 2013: National Infrastructure Plan. Available online at: http://www.infrastructureaustralia.gov.au/coag/files/2013/2013_IA_COAG_Report_National_Infrastructure_Plan_LR.pdf, March 24, 2014. pp. 18, 21 inter alia.

⁵ "Ernst & Young. 2011. *Financing Australia's infrastructure needs: Superannuation investment in infrastructure*. Accessed online at [http://www.ey.com/Publication/vwLUAssets/Financing_Australia_infrastructure_needs/\\$FILE/Superannuation_Investment_In_Infrastructure.pdf](http://www.ey.com/Publication/vwLUAssets/Financing_Australia_infrastructure_needs/$FILE/Superannuation_Investment_In_Infrastructure.pdf), March 24, 2014. pp. 2-3.

If these features are in place, asset recycling is likely to be more attractive to governments and will ensure that the public interest is advanced. But any asset-recycling program must also meet the needs of the private and non-profit sectors. They must be persuaded to play a meaningful role, to invest their capital, and to accept risk transfer.

From the Australian experience, it is clear that a number of preconditions are necessary in order to engage the private and not-for-profit sectors as partners in an asset-recycling initiative. These include transparent and streamlined transaction processes; the effective and fair pricing of risk; the right balance being found between the need for political oversight and the risks and costs of political interference; assurances on the impact of the electoral cycle; decisions about regulation being guided by a focus on outcomes; and tax regimes that promote asset recycling.

The case for an Infrastructure Trust Fund

Unlike using the proceeds from asset disposition to pay down debt or fund existing programs, it is much more politically acceptable to direct asset proceeds to financing current and future capital needs, provided the public sees some early evidence of construction and periodic delivery. If the proceeds are substantial, there is less political claim on general taxation revenues to fund new capital projects, with their unwelcome added legacy of debt-service costs. Equally, revenues from general taxation are freed up to reduce deficits and accelerate debt reduction.

Most governments already maintain an active capital program, with annual contributions to and amortized from the current account. Ideally, most governments also segregate their capital and operating funds. As result, a degree of “budget substitution” can ultimately accomplish both objectives—debt/deficit reduction and asset acquisition.

The most effective way of enlisting public support for an asset recycling strategy is to establish a dedicated fund or trust, either to underwrite new capital projects or to defray the actuarial impact of future obligations, like pensions.⁶ In the meantime, such funds or trusts can accumulate profits by investing the proceeds of asset dispositions, while awaiting the call for their specific use. Several sovereign wealth funds are designed in this way.⁷

For decades, Norway has squirreled away revenues from North Sea oil, in its somewhat misnamed “Government Pension Fund”. A similar approach to government petroleum revenues has been taken by governments as diverse as the emirates of Kuwait and Abu Dhabi, the Government of Alberta, and even the Shetland Islands (unlike the rest of the UK).⁸

6 “...a National Infrastructure Bank, similar to those that exist in many U.S. states, could be an important source of new funding. The federal government and private pension funds would co-invest in the bank, which in turn would finance major infrastructure projects using long-term bonds”, Warren, R.M. 2013. “Politicians ignore creative ways to fund our crumbling infrastructure”. *Toronto Star*, March 19. Available online at: http://www.thestar.com/opinion/commentary/2013/03/19/politicians_ignore_creative_ways_to_fund_our_crumbling_infrastructure.html, accessed March 24, 2014. See also: Galston, W. and K. Davis. 2012. Setting Priorities, Meeting Needs: The Case for a National Infrastructure Bank. Brookings Institute. Accessed online at: http://www.brookings.edu/~media/Research/Files/Papers/2012/12/13%20infrastructure%20galston%20davis/1213_infrastructure_galston_davis.pdf, March 23, 2014.

7 Some jurisdictions have allowed withdrawals from the fund or trust to be used to pay down debt obligations, or to help meet other budgetary obligations, although this practice is fraught with risk (including political temptation) unless the trust is very large and its investment returns are substantial.

8 Gompertz, Simon. 2012. “Has the UK squandered its North Sea riches?”, *BBC Business News*. Accessed online at <http://www.bbc.co.uk/news/business-19871411>, March 24, 2014. See also: Norges Bank Investment Management. 2011. “Government Pension Fund Global” Accessed online at: <http://www.nbim.no/en/About-us/Government-Pension-Fund-Global/>, March 24, 2014. Examples of other “sovereign wealth funds include the Kuwait Investment Authority and Kuwait Future Generations Fund; (details at <http://www.swfinstitute.org/swfs/kuwait-investment-authority/>); the Alberta Heritage Savings Trust Fund (<http://www.finance.alberta.ca/business/ahstf/faqs.html#mission>); and the Abu Dhabi Investment Authority (<http://www.swfinstitute.org/swfs/abu-dhabi-investment-authority/>).

In his Fall 2013 Statement to the Legislature, when he tabled the 2013 Ontario Economic Outlook and Fiscal Review, the Ontario Finance Minister lent clear support to the concept of asset recycling, when he said:

*“We plan to create a new fund. A fund specifically for those important infrastructure projects — the Trillium Trust. Gains from asset sales, such as from the sale of GM shares, would help fund this Trust.”*⁹

What is the potential from asset recycling for Ontario?

Committing to a policy of asset recycling would mark a sea change in fiscal policy for Ontario. As with most major policy reforms, it would involve disruption, controversy, teething problems, and plenty of criticism, both general and specific. So why bother?

The simple answer is that the potential benefits to Ontario and its future will make it worth the effort.

Recycling public assets represents opportunities to:

1. Invest in much needed public infrastructure and other assets while stabilizing the province’s finances

We all recognize Ontario’s needs for critical infrastructure, from healthcare to transportation, after two generations of under-investment. It is also apparent that attacking that infrastructure deficit will require a strategy that is sustainable for decades, not just a few years.

Estimates of the accumulated public infrastructure deficit in Ontario and Canada, including the broader public sector and local government, are hard to quantify, but it is safe to assume they run well over a hundred billion

9 In the body of the Review, the Trust is explained as follows: “...To focus this effort, your government plans to create a special fund dedicated to the support of our province’s most pressing and important infrastructure projects. The Trillium Trust would receive revenue gains from asset sales, such as the sale of our interest in GM shares, and put that money to work by creating jobs and building an even stronger Ontario...”, “...The \$249 million increase in Other Non-Tax revenue reflects the gain on the sale, announced on September 10, 2013, of the Province’s interest in 10 million shares of General Motors Company. The government is committed to using the proceeds from this sale in the future to strategically invest in Ontario’s infrastructure. The government proposes to establish the Trillium Trust to ensure the proceeds are invested strategically and at the appropriate time...” 2013 Ontario Economic Outlook and Fiscal Review: Introduction; and, Chapter III: Fiscal Outlook (Section B: 2013–14 Fiscal Performance)

dollars.^{10 11} Correspondingly, the value of public assets is equally substantial, with the estimated value of Ontario's public assets running to nearly \$165 billion.¹² Even more intriguingly, the estimated values of GBEs are largely based on current operations, whereas the experience of divestiture is that government assets prove, over time, to be worth considerably more in the hands of successor owners.

If assets could be disposed on a schedule and with proceeds that parallel a manageable, sustainable program of investment in public infrastructure, Ontario could deploy its \$11 billion annual debt-service expenditure to address the annual deficit (and accumulated debt), rather than trying to reduce the deficit through fiscally-motivated program cuts.

As every mortgagor knows, when payments go progressively to reducing the principal, rather than paying interest, budgetary flexibility increases. Going forward, the portion of the province's annual operating budget devoted to debt-service and contributions to capital would be reduced on an accelerating basis. Fortuitously, this potential decade of increased budgetary flexibility parallels the anticipated rise in program expenditures in healthcare and other areas, associated with the aging of the population. It is a pleasing fiscal alternative to the significant tax increases and reductions in the range and quality of public services that Ontario is otherwise facing.

2. Provide a platform for investing “at home” the billions that pension funds and other domestic pools of capital are investing outside Canada

Much has been said and written about the size and sophistication of Ontario's major pools of investment capital, most notably its large, public-sector pension funds. Their asset allocation and investment profile favours the acquisition of public assets, as they have demonstrated globally. But their willingness to invest domestically in assets other than electricity has been noticeably restrained.

“Direct Investment Programs” in Ontario have allowed institutional investors to develop in-house expertise that supports their investment in public assets. Canadian pension funds have been pioneers in this area. The Ontario Teachers' Pension Plan (\$130-billion) and the Ontario Municipal Employees Retirement System (\$65-billion) among others, have capabilities that other national governments (such as the UK) are still trying to develop domestically.

Billions of dollars from domestic pension funds such as the Canada Pension Plan Investment Board and OMERS have been flowing into infrastructure assets in recent years. But few of these investments are made in Ontario. Coupling the global capital located in Toronto and the province's need for significant infrastructure investments, more opportunities should be made available in Ontario through a policy of asset recycling.¹³

If Ontario could package the disposition of public assets in a way that meets the needs of pension funds and other similar domestic investment pools, the potential is for reliable investment counter-parties for the government, with sufficient expertise and funds to price and purchase public assets at a premium valuation.

10 Mackenzie, H. 2013. *Canada's Infrastructure Gap: Where It Came From and Why It Will Cost So Much To Close*. Canadian Centre for Policy Alternatives. Accessed online at <http://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2013/01/Canada's%20Infrastructure%20Gap.pdf>, March 24, 2014. In 2012, Public-Private Partnerships Canada estimated a requirement of \$400 billion in infrastructure upgrades over the next decade. Canadian municipalities have projected a civic infrastructure deficit of \$125 billion, excluding a further \$70 billion on public transit.

11 Burelton, D, and B. Caranci. 2008. *Mind the Gap: Finding the Money to Upgrade Canada's Aging Public Infrastructure*. TD Financial Group Accessed online at <http://www.pppcouncil.ca/pdf/mindthegap.pdf>, March 24, 2014. pg.ii.

12 Ontario Ministry of Finance. 2013. *Public Accounts of Ontario 2012-2013: Consolidated Financial Statements*. Accessed online at http://www.fin.gov.on.ca/en/budget/paccts/2013/13_cfs.html, March 24, 2014.

13 Bourque, J.C. 2013. "Ontario needs to think about investing in infrastructure." *The Globe and Mail*, Thursday, May 2. Accessed online at: <http://www.theglobeandmail.com/news/politics/ontario-needs-to-think-about-investing-in-infrastructure/article11675582/> March 24, 2014.

If bidders know that they will have responsibility for operating key elements of a new facility or service, not just building it or financing it, they will be much more likely to invest in longer-lived and productivity-enhancing designs and technologies.

6

The Lifecycle of Public Assets—Policy Considerations and Approaches

All public assets—whether they are infrastructure, GBEs or intangible assets—go through lifecycles, from creation or acquisition, through ongoing operation and evolution, to their eventual sale, lease, decommissioning or other disposition.

The timeframes for this cycle can be short or long term. Some public assets with a potential for disposition are continued as public assets over extended periods because there is no compelling fiscal or public policy reason to dispose of them. To use an extreme example, a few European and Middle-Eastern communities still use civic infrastructure built by the Romans!

The great variety of different public assets, including huge variations in their life cycles, creates confusion in public discussions about acquisition, use and disposition—and how to ensure public value at each stage.

Phase One of the ‘Asset Lifecycle’: The Acquisition Phase of Public Assets

In the ‘acquisition’ phase, funds are used to build or acquire public assets. Governments have a variety of options. These include the manner in which the asset is created or assumed, and whether the private sector or other governmental or non-profit partners can contribute to the efficiency or productivity of the asset being acquired.

Using output-focused specifications, or design-build construction processes, governments can benefit from the innovation and expertise of the private sector, including performance-based contracts and innovative financing mechanisms that serve the needs of both the government and its partners.

Infrastructure Ontario (IO) has pioneered a largely successful model to build, finance, operate and ultimately transfer public assets, ranging from hospitals to municipal transit. One of the less noted elements of the IO process is the industry-wide effect of its rigid adherence to standard procurement processes and standard contracts, with few change orders. Some have complained of these practices, and suggested that they fail to include policy considerations or to promote diversity and innovation in bidding. However, the IO processes have created a level of predictability that attracts return bidders and reduces the need to price-in uncertainty risk.

One of the major hurdles to private investment in “smaller” infrastructure projects (i.e., below \$100 million) is the extensive and idiosyncratic ‘due diligence’ process that investors must conduct before they are willing to commit their funds, especially over the long term. Standardization and a potential to “bundle” similar projects opens the door to many smaller provincial and local government infrastructure projects that might otherwise not attract the interest of major construction firms, pension funds and other domestic investment pools. Given that many public asset projects are small, both in the ‘acquisition’

and ‘disposition’ phases of the cycle, it is useful to attract investors to projects that may be “small” but are important to the communities that they serve.

The capacity of the private sector to operate public assets can be enhanced (and its bids made more price-competitive) if it has the opportunity to integrate or re-engineer the various components of the asset.

Too often in government, however, the potential for increased asset performance through integrated approaches is compromised. Some capital projects, for example, have removed supporting services that would likely have benefitted from competitively bid contracts, such as HVAC, laundry, catering, vehicle maintenance, back-office systems, etc. If bidders know that they will have responsibility for operating key elements of a new facility or service, not just building it or financing it, they will be much more likely to invest in longer-lived and productivity-enhancing designs and technologies. They will also have a stronger incentive to commit to ongoing maintenance and refurbishment to protect the value of the asset.

Privatization advocates often favour fully integrated DBFOM models (design, build, finance, operate, maintain) for this reason. This strategy emulates the practices of turn-around investors in the private sector, who seek internal synergies and use cross-subsidization of business units, along with a reassessment of lines-of-business, to achieve a more productive, revitalized whole enterprise.

Governments do not need to own an asset in order to achieve an outcome. They can ensure facilities or services are provided through regulation and other methods. Governments have the option to “own” a service or facility, or just to “cause” the service or facility to be available to the public on reasonable terms and conditions, including serving ‘marginal’ customers or regions. Governments can regulate to ensure that policy objectives are achieved. For example, governments have made this choice in the energy sector, where electricity became a group of public assets, whereas the natural gas network was created through standardized municipal franchises and regulatory oversight. The same choice is often available to those considering a new expressway, airport, transit facility, or major bridge project.

For the past century, Canadian governments have favoured the “we’ll do it” approach without much consideration of the alternatives. Globally, there are many different approaches

to asset acquisition. Given the current fiscal and political environment, governments should consider these successful, alternative approaches in order to create maximum public value.

Phase Two of the ‘Asset Lifecycle’: The Operation Phase of Public Assets

Once established, public assets require continued reinvestment, development and review. Operators must explore options to contain costs, increase operating revenues, improve delivery models, and enhance client and citizen experience. Above all, operators must achieve the public policy objectives for the asset and enhance public value.

Key to these ongoing activities is looking at the public asset as both a public-policy vehicle and a business operation, with the former typically being a narrower frame of reference than the latter. A useful way to see this distinction is to consider the typical city parks and recreation department. Municipalities offer a range of programs and amenities to serve the fitness and recreational needs of their communities. These basic programs benefit from taxpayer-financed facilities, like arenas or community centres. But the program offerings, and their degree of cost-recovery, vary by clientele and consumer appetite. Programs for at-risk youth or those with special needs are subsidized. Other programs, or premium-quality supplements to basic programs, typically command a higher registration fee, a minimum threshold of patronage, and charge higher user fees at popular times of the day or week.

Governments can make important decisions that affect the ‘operations’ phase of a public asset. If an asset is to remain in public ownership for the medium or long term, the government has the option to hive-off elements that are not crucial to its public policy objectives if a more productive or economical operating model is available. Governments can contract for the services mentioned above (HVAC, catering, laundry, vehicle, computer maintenance, and other back-office systems), while maintaining full ownership. Governments may own and operate highways, transit systems, social housing units, cultural institutions and landfill sites, but they can leave collateral, labour-intensive functions to private providers (e.g., highway maintenance, residential waste collection and recycling).

Linking a public asset's lifespan to its financing

It is important for governments to avoid creating conditions during the “acquisition” or “operation” phases that they might regret when subsequently considering the restructuring or disposing of a public asset.

Often ignored is the fact that many public infrastructure assets (bridges, hospital wings, water lines, generating stations, etc.) have an initial ‘useful life’, after which they may need replacement or refurbishment that may exceed the asset’s original cost. In Canada, it is common for all assets to be pledged as security for all government debt obligations (“full faith and credit”). But there is an attractive alternative practice which matches the purpose and / or the term of debt-financing obligations to the useful life—or extended life—of an asset. Project-specific financing is common in the United States and in Europe. As noted, these assets may be substantially repaired or refurbished to extend their useful life, but those new investments and financing obligations can also be financed on an amortization schedule that parallels the extended life expectancy of the public asset.

Over the past few decades, Ontario and its municipalities have moved away from the historic model of tying specific assets to specific financing. This shift in financing now favours general-recourse debt and lump-sum capital payments (e.g., provincial capital grants to the broader public sector entities; development charges and developer-financed growth-related civic infrastructure; and local service improvements by the whole tax-base or all utility ratepayers). While this may be easier, it is not necessarily best practice.

This general-taxation approach rations capital in response to taxpayer resistance, thereby denying specific projects the opportunity to proceed based on the willingness-to-pay or ability-to-pay of the direct beneficiaries or project supporters, much less the need for new technology or expanded capacity.

The debt-service costs of general-recourse financing also place a direct and tax-related burden on the annual operating budgets of provinces, municipalities and other broader public sector entities. It tends to encourage being “debt free”—or at least debt-reduction—as a fiscal strategy,

which may appear laudable. However, given the need for new and replacement infrastructure, “debt free” really means deferring investments and deferring maintenance—missing ‘installment payments’ on vital and underinvested public infrastructure and other public assets.

The fiscally prudent practice of segregating capital and operating expenditures should not come at the cost of one another. For example, if a municipality or a P3 operator must assume both the operating and ‘debt-service’ costs of new infrastructure, they will (or should) pay much more attention to designing facilities that have reduced maintenance needs and / or that protect the initial capital investment through programmed maintenance.

Government business enterprises (GBEs) also face the lifespan challenge. As market conditions change and technology advances, GBEs must evolve and invest to meet public (and consumer market) expectations. New retail formats for liquor stores, new smart-meter technologies for electricity providers, new developments in the gaming industry, technological and customer-service advances in transportation—they all require GBEs to seek substantial and ongoing reinvestment. Some of this reinvestment inevitably comes at the expense of increasingly coveted net government revenues from those enterprises. In other cases, reinvestment is denied or delayed because of constraints on the ability or willingness of governments to authorize or finance them. In practice, a combination of capital rationing by deficit-reducing governments and an understandable lack of commercial expertise by public servants makes a strong case for exploring private-sector options, either as equity partners, or as owners or operators.

Freed from the constraints of the governmental decision-making environment, and with the cost-benefit equation deciding investment decisions, it is reasonable to assume that public assets would benefit from technological investment and productivity improvements, where they enhance the performance of the asset.

Learning from the Municipal Experience

International bond-rating agencies routinely rate larger Ontario municipalities, particularly those in suburban metropolitan settings, as among the most credit-worthy entities in the investment world. While the sovereign debt of some European nations has dipped to “junk bond” status and US state and city governments have huge debt and pension liabilities, AAA and AA+ credit ratings for Ontario municipalities are not uncommon.

By law, Ontario municipalities cannot run operating deficits, even under dire circumstances. Municipal debt can only be incurred for capital purposes, like bridge-building and water-treatment plants. Likewise, pension obligations are established and managed through a successful, mandatory pension fund (OMERS) and funding pensions is not subject to the discretion of individual municipal governments.

Municipal ‘fund accounting’ rigidly segregates the capital fund from the current operating fund (except for routine debt-service obligations), yielding a fiscal position that avoids accumulating financial problems over time, and thus comforts investors. All municipal debt is used for long-lived capital works and systems, or for land acquisitions and development projects. What this means is that municipal debt creates public assets. Most of these assets have intrinsic value and can be pledged as security for related (or general) debt obligations.

These legal constraints and accounting requirements create a conservative fiscal culture in municipal governments: ‘Capital is capital, and operating is operating’. In practice, development charges (levies on builders) are scrupulously retained for growth-related infrastructure. Likewise, when municipal assets are sold, or when new fiscal capacity is created by retiring debenture debt, these new sources of revenue are routinely assigned to the capital fund, to reduce other debt, or to help to finance new assets.

Significant new investments in infrastructure and GBEs are necessary, if jurisdictions like Ontario are to sustain our prosperity. One key ingredient in the solution to our ‘infrastructure deficit’ is to ensure that capital funds, both from borrowing and from asset-disposition proceeds, do not find themselves siphoned into operating budgets or tax-expenditures (e.g., tax credits).

In Ontario, a consistent segregation of capital and operating budgets is a key both to past municipal fiscal sustainability and to future investments in capital assets by all orders of government. It is also the basis of the concept of “asset recycling”. Of course, this does not mean that P3s should not contain both current and capital components, as that synergy is often a key to their success. But it does mean that building and maintaining assets for public use should be insulated from the many other worthwhile claims on the public dollar.

Phase Three of the ‘Asset Lifecycle’: The Disposition Phase of Public Assets

When governments begin to consider the potential disposition of some or all of a public asset or a set of public assets, a number of considerations emerge.

1. Governments must decide whether the original policy objective for acquiring and holding a public asset continues to be best served by owning the asset. If not, the government should consider the full range of disposition options.
2. When disposing of public assets, governments must consider the best way to ensure the public policy objective—if still relevant—continues to be achieved, and, more broadly to ensure optimum financial return on the public’s investment while still protecting the public interest.
3. Governments must provide reasonably favourable conditions for disposition, so that there are willing investors to participate in the transaction, with attractive bids.

Canadian governments are not even sure which assets they have, tend not to report what they hold in one place, fail to assess their intangible assets and rarely have coordinated conversations across departments about how to manage or integrate assets.

7

How to Move Forward? Policy Recommendations

The consensus that emerged across our interviews was that governments often do not know why they own an asset, what they are trying to achieve through ownership, and whether the current ownership model is the best one to maximize public value and achieve the stated policy objectives.

1. Inventory all government assets

Canadian governments are not even sure which assets they have, tend not to report what they hold in one place, fail to assess their intangible assets and rarely have coordinated conversations across departments about how to manage or integrate assets. These gaps deprive governments of many opportunities both to better protect public well-being and maximize revenues. As a first step, governments should make a commitment to conducting more rigorous inventories of their assets and realistically assessing their value.

Inventories should include intangible assets, including data, some of which could be made public or monetized. There are opportunities to generate revenue through commercializing or licensing certain intangible assets over which the government has control—including, for example, energy data (particularly since the implementation of smart-meters), data on citizens' interactions with government services/websites and geo-spatial data. An indication of the potential commercial value of government information comes from Statistics Canada's experience. StatsCan generated nearly \$100 million through fees for its data in 2012-13.¹⁴ Provincial governments have not kept pace.

A determination that an intangible asset has commercial value would not necessarily mean that the asset should be commercialized. Indeed, the advocates of Open Data policies suggest making much of government's non-personal data freely available on-line and for data-mining. But failing to identify intangible assets with potential value means that commercial, policy and program options and implications cannot even be considered.

2. Governments should undertake an assessment of all government assets to determine how best to enhance their public value. Public value can be understood as including the protection of the public interest, revenue maximization, and improved services to citizens.

There was broad consensus among those interviewed for the study that all Canadian governments need a more rigorous and systematic approach to asset management. Rigorous frameworks for assessing the public value of assets abound,¹⁵ but they are deployed inconsistently across Canada. Applying a public value lens to all public assets would begin with a series of fairly specific questions that have been used in other jurisdictions to good effect.

¹⁴ Statistics Canada. 2013. 2012-2013 *Report on Plans and Priorities*. Accessed online at <http://www.tbs-sct.gc.ca/rpp/2012-2013/inst/stc/stc-eng.pdf>, March 24, 2014.

¹⁵ See for example: European Commission Director Generalate for Regional Policy. 2003. *Guidelines for Successful Public-Private Partnerships*. Accessed online at http://ec.europa.eu/regional_policy/sources/docgener/guides/ppp_en.pdf, March 24, 2014; Ontario Ministry of Public Infrastructure Renewal. 2004. *Building a Better Tomorrow: An Infrastructure Planning, Financing and Procurement Framework for Ontario's Public Sector*. Accessed online at http://www.moi.gov.on.ca/pdf/en/bbt-framework_en.pdf, March 24, 2014; British Columbia Ministry of Finance. 2002. *Capital Asset Management Framework*. Accessed online at <http://www.fin.gov.bc.ca/tbs/camf.htm>, March 24, 2014; Victoria Department of Treasury and Finance. 2013. "What is Asset Management?" Accessed online at <http://www.dtf.vic.gov.au/Investment-Planning-and-Evaluation/Understanding-investment-planning-and-review/What-is-asset-management>, March 24, 2014.

As part of this process, governments should identify those assets that are most suitable for early asset recycling. The identification of which assets to recycle first would include identifying those whose disposition would have the most precedent-setting value for an asset recycling policy (in order to demonstrate proof-of-concept, maximize revenues, and increase the value of other assets for later “asset recycling”).

3. Governments should establish a framework that can then be deployed to determine what should be done with public assets. This framework should begin with a clear assessment of the purpose for owning a public asset.

There are public assets that probably should remain in public hands but it is not clear which those are because governments do not have appropriate frameworks at their disposal to make that evaluation systematically. As a starting point, governments should ask why they own an asset. In some cases, the purpose may no longer be valid. In others, there are better ways of achieving the stated purpose through regulation or other means.

Assets might be owned for the purposes of economic development, revenue generation or protection of public health and safety. The purpose may change over time. For example, the LCBO was initially established as a public corporation for moral purposes but today government ownership is more often defended in terms of revenue generation. A variety of purposes may be valid, but too often the purpose for ownership is fuzzy.

If governments begin by clearly articulating why they own an asset, then an assessment can be undertaken to determine whether the objective is being achieved in the best way possible. If the government says it owns an asset to generate revenue, then alternative management approaches can be analyzed to determine whether the current public ownership status does indeed generate maximum revenue for public purposes. If the government is not transparent or sure about why it even owns an asset, then any assessment concerning maximization of public value is impossible.

There is no reason to believe that turning assets over to the private sector will invariably drive down costs or deliver more public value. Sometimes this will not be the case. But governments can only determine when and where private

sector or not-for-profit partners are appropriate if they have established a framework for determining whether objectives are being achieved and with what costs, beginning with a clear statement about the policy objective they are trying to achieve through ownership.

Such analysis will often lead governments to conclude that neither public ownership nor asset divestiture is the best approach. Other approaches, including selling a majority stake but maintaining a minority position and the more widespread use of concession, licensing and leasing agreements, would often be more successful at unlocking public value and protecting the public interest. Enhanced but reliable and consistent regulation or oversight will often be necessary with these arrangements.

4. Establish a formal Framework for Asset Recycling, which should include the creation of an Infrastructure Trust.

Governments should make a clear policy commitment to the concept of asset recycling, which would see the value of current assets being unlocked to reinvest in future assets. Such a commitment would lead to recognizing and then enhancing the value of public assets.

Funds from asset recycling should be segregated and dedicated to funding capital expenditures. This Infrastructure Trust could make investments that would include traditional hard infrastructure, like roads, waste water treatment and public transit.

It could also include community-based infrastructure. Increasingly, assessments of community benefit are also being incorporated into procurement and other government contracts. The use of Community Benefit Agreements, as part of an overall framework of asset recycling, would allay some public concerns and would ensure that local communities see real benefits from a process of asset disposition. Another approach to enlisting stakeholder support is to allow trade unions or employees to participate financially in the success of the divested asset or its ownership.

Other aspects of a framework for asset recycling would include: finding the right balance between the need for political oversight and the risks of political interference; making the transaction process less complex, expensive and inconsistent; recognizing that greenfield projects

have unique risks for the investor or private operator; and identifying new opportunities for asset recycling that focus on improved productivity and quality of life for residents.

5. The Framework for Asset Recycling should be developed using an integrated, centralized, whole-of-government approach.

Governments across Canada remain too constrained by the Westminster system of government, where ministries make planning and management decisions independently from one another. Although many efforts have been undertaken to break down these silos, progress has not been fast enough.

The problem is particularly evident when it comes to managing public assets. For example, the management of water, transportation, and energy infrastructure takes place across a range of ministries—and independent agencies—without practical obligations or incentives to coordinate. Other large private and not-for-profit sector organizations can take a bird's eye view of their operations and make more integrated decisions across divisions. In an age when successful organizations are those that can quickly share and deploy information to arrive at strategic decisions, siloed ministries managing their own assets simply don't make sense.

In Ontario, responsibility for many functions is currently shared between Cabinet Office, the Ministry of Finance, and the Ministry of Infrastructure, along with the independent agency, Infrastructure Ontario. No one organization within the Ontario Government has the capacity and expertise to assess and monitor opportunities for asset monetization and recycling. As part of a more coordinated, whole-of-government approach to managing assets, a central partnerships office should be created.

The federal government is currently experimenting with such an office and its creation is in response to a recognized need within the federal government for better coordination and management of existing assets. The Projects Office is still in early days, but much can be learned from its experiences to date. Provinces should follow the federal lead.

6. Governments should ensure that they have the skills and expertise to properly manage and recycle public assets.

The professional public service in Canadian governments has great expertise in assessing the impact of policy or regulatory changes on the protection of the public interest. They also have solid training in operational issues, are skilled at delivering public services and many have specialized skills, including IT support, environmental management or public accounting.

However, most public servants have little training or expertise in assessing the value of public assets, pricing expertise or identifying ways to maximize revenues. Although there are some pockets of commercial expertise within government, this expertise is not widespread. Public servants should not be asked to assess business opportunities and alternative approaches to monetizing assets if they do not have the training to do so. Governments should make a more concerted effort to hire or engage those with the requisite expertise and provide on-going training to public servants involved with asset management.

With the right expertise, governments will be better able to structure investment opportunities in ways that are intentionally attractive to private investors, but also maximize public value.

7. Governments should change their auditing, accounting, tax and other rules to avoid perverse impacts on good public policy.

Some provincial accounting and auditing rules have been interpreted to read that asset sales must be treated as in-year revenues, meaning that they must either be expensed in the fiscal year in which the sale took place or used to pay down the provincial debt.

Using the one-time revenue from an asset sale to fund current spending is not a sound approach to public or fiscal policy. Likewise, applying one-time capital revenue to debt reduction—and hence reducing debt-service costs—may sometimes be a reasonable public policy approach consistent with the public interest. However, there are many other alternatives that are often more beneficial, both in

terms of revenue maximization and deploying resources for public purposes. Tax rules may also need to be changed to facilitate asset recycling for both governments and private sector investors (such as addressing the impact of the transfer tax on the potential sale of local electrical utilities).

Audit rules should be changed to permit more flexibility. In particular, the creation of special purpose public trusts should be encouraged. These could be used in the case of either an asset sale or instances of asset monetization that produce an on-going revenue stream.

Revenues from high-occupancy vehicle (HOV) lanes could be applied to public transit. Revenues from the LCBO could be applied to public health interventions. Funds from major asset sales could be deposited in a public trust that invests in community or social infrastructure.

There are instances in Canada where successful models have been developed. For example, the Toronto Lands Corporation, through sales and leases, disposes of properties not required by the Toronto District School Board and uses the proceeds to meet school board capital budget priorities. In this way, the stock of existing capital is renewed through the disposition of under-used assets, and the taxpayer is relieved of the obligation to fund the entire cost of new school infrastructure.

8. Ensure that private investors choose to invest in asset recycling in Ontario.

Developing a Framework for Asset Recycling that works for government and the public is one step. But the framework must also be one that works for private investors, otherwise they will choose to continue to invest their infrastructure and asset funds elsewhere.

A Framework governing asset recycling will need to reassure private investors that there is certainty around many elements of deals, decreasing the risk premium and increasing public value by ensuring that politics will not interfere in outcomes. This will also provide a clear signal that the government recognizes that investors have expectations of reasonable returns on their investments, and the possibility of political interference creates disincentives for private investors and drives down the value of public assets. Creating a transparent “pipeline” of public assets scheduled for disposition will also create conditions whereby a wider range of private investors will engage with the process of asset recycling, thus increasing public value.

9. Engage in widespread consultation with stakeholders, labour and the public on how to put in place a framework for asset recycling.

The concept of “asset recycling” is simple to comprehend. However, the policy, financial, labour and regulatory framework that would fulfill the promise of asset recycling—increased funds to continually reinvest in public infrastructure and GBEs, with risk transferred to the private sector—is much more problematic.

Concerns will no doubt be raised about the risks of “privatization” and threats to the public interest, as well as concerns by public sector trade unions over job security, salaries, benefits and management practices. In many cases, there are legitimate concerns that will need to be addressed through the appropriate legal and regulatory frameworks, or post-disposition collective bargaining.

But most Canadians understand the challenge: we need to invest in new infrastructure to deal with population growth, transportation needs, climate change, new technology and the simple passage of time. Although raising taxes remains an option, asset recycling may prove more acceptable as a first resort. But it must be well-understood and its implementation designed with the input of an array of stakeholders—in order to produce clear benefits for society.

Only through engagement and consensus across multiple stakeholders will it be possible to undertake the transformation necessary to unlock the value of public assets, to protect the public interest and to reinvest in new assets.

8

Conclusion

Governments in Canada need to unleash private capital to invest in public assets, to ensure their sustainability and integrity. But they must do this in a manner that protects the public interest, does not require an avoidable increase in taxes, and provides the possibility of greater returns for pension plans and other domestic investors. Recycling public assets—especially government business enterprises—offers an opportunity to use past and vestigial public investments to fund new infrastructure needs, and create more value.

Such a process of asset recycling will require a robust policy framework, developed in partnership with the private sector, governments, civil society organizations, and organized labour—and the citizens and consumers potentially affected by the changes. Only through engagement and consensus across multiple stakeholders will it be possible to undertake the transformation necessary to unlock the value of public assets, to protect the public interest and to reinvest in new assets. But equally, a degree of decisiveness and determination by decision-makers, and a willingness to withstand the criticism of vested interests, will also be needed.

The conclusion is clear: unless we find new capital to invest in new assets, all orders of government—Ontario, Canada and local—risk being drawn into a prolonged spiral of economic stagnation or even decline. Using asset recycling is a great opportunity to change our fortunes for the better, using our existing resources.

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