Intelligence MEMOS

From: Miville Tremblay

To: Canadian Infrastructure Observers

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Re: **Infrastructure Is Not Simple, but Pension Plans Can Help**

I'm not trying to sell you the Champlain Bridge, believe me. I only want to suggest that it is appropriate to consider the financing of public infrastructure by pension funds, which need these assets to ensure the payment of our pensions.

A few days ago, Mark Machin, head of CPP Investments, which manages a $457 billion tranche of the Canada Pension Plan suggested that cash-strapped governments should sell off airports, toll roads, utility companies and other public infrastructure.

"There is so much capital chasing private assets that if governments are looking for money, they are going to get incredible prices for their infrastructure," he told The Globe and Mail. Bonds with poor yields are being partially replaced by investments in infrastructure, which are less risky than stocks and offer modest, but relatively stable income.

The sale of some public infrastructure is an option. The other is the invitation to patient investors to consider building new infrastructure. This second option is the strategy favoured by the federal government with its Canada Infrastructure Bank (CIB).

However, in the eyes of the institutional investor, there is a huge difference between existing infrastructure and new projects. For comparable equipment, the former are much less risky than the latter.

New projects are subject to schedule and construction cost overruns, while future revenues are uncertain. Wind farms and solar project are the exceptions that prove the rule.

If the Port of Montreal were put up for sale, for example, the acquirer could rely on past traffic to establish a price, and could better take the risk of the planned expansion at Contrecoeur. The same goes for Aéroports de Montréal, which needs capital to continue its modernization.

Heresy? The Caisse de dépôt et placement (Caisse), which invests Quebec Pension Plan money, has significant interests in Heathrow Airport in London, as well as in a dozen ports and terminals around the world, including British Columbia. CPP Investments and other large pension funds and sovereign wealth funds compete to buy infrastructure projects put up for sale because they are beneficial to their principals.

This is what explains why the Caisse gamble on Montreal's new 26-station light rail project, the REM, is a bold one. Rather than paying a high price for existing infrastructure, why not create some? However, this is a much riskier, even if potentially more profitable, and an avenue most other investors are not yet ready to take.

Hence the original idea of the infrastructure bank, which was to absorb part of the risk to help attract private investors. However, until now, it has contented itself with low-interest lending, a rather timid incentive.

For the REM, the CIB is extending $1.3 billion over 15 years at an interest rate of 1 to 3 percent. The Quebec government's contribution of the same amount takes the form of subordinated non-voting shares, while the Caisse has put in $3 billion in the form of preferred shares with an 8-percent yield. Here, Quebec is taking the risk of the least certain return.

The three-year-old CIB's first steps have been slow and painful. This spring, Michael Sabia was appointment as new board chair. This appears to be no accident: the former Caisse boss was one of those who convinced the Trudeau government to create this institution.

The CIB website lists 10 projects, but the REM is the only one to have emerged, the others remaining at various stages of planning. And of these, only the hydroelectric and fiber optic link project between Manitoba and Nunavut obtained pension fund support, that of Ontario Teachers.

In early October, Ottawa pledged to invest $10 billion of the CIB's $35-billion pot over the next two to three years. The focus will be environmental: electric buses, clean energy, irrigation, energy efficiency of public buildings as well as the establishment of rural high-speed internet.

Sabia is still keen to finance profitable projects capable of attracting private capital, which could multiply those of the CIB. Governments and investors have different interests, but also a common interest in certain projects, under certain conditions. The challenge is to identify suitable infrastructure, find responsible and patient investors, but above all, to determine the sharing of risks between the parties.

This process takes time. If we are just going to stimulate the economy, John Maynard Keynes ironically suggested, "the government should pay people to dig holes in the earth and then fill them." A little more useful, I might add, would be plugging the holes in the existing infrastructure.

If, on the other hand, we want to strengthen the economic structure and productivity growth, we must take the time to do it properly. And why not by mobilizing our pension fund capital?

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