

# Enabling Consolidation and More Investment in Municipal Infrastructure

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## **Asset recycling related is closely related to consolidation and investment in new, critical infrastructure**

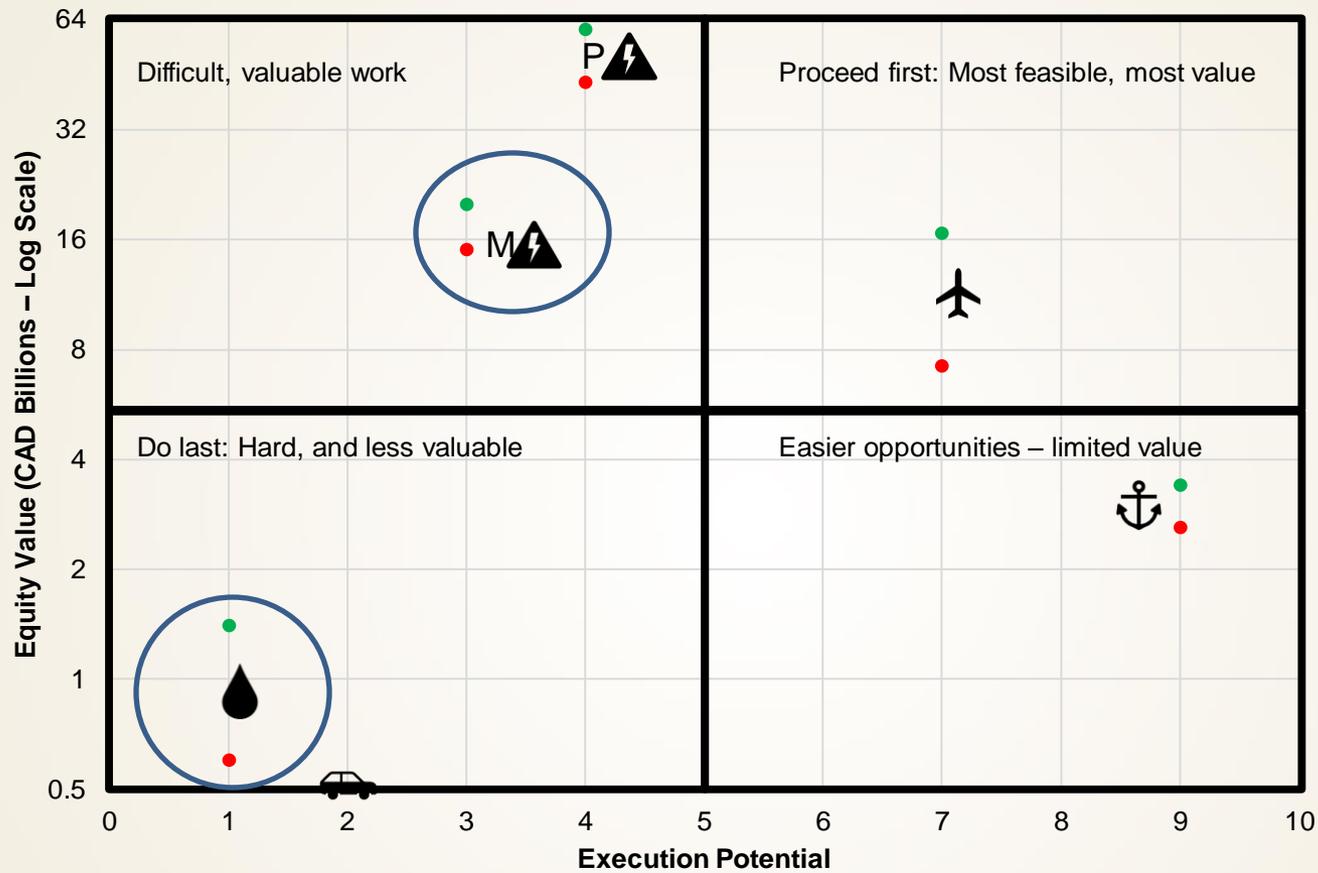
- ❖ **What is asset recycling?**
- ❖ **What are the benefits of asset recycling?**
- ❖ **Asset recycling in municipal electricity distribution**
  - ❖ **How to get it right**
- ❖ **Asset recycling in municipal water and wastewater**
  - ❖ **How to get it right**

## **Selling equity stakes in public infrastructure to institutional investors**

**Governments could then use the proceeds from such sales to invest in new infrastructure**

- ❖ **Our pension funds: \$87 billion invested in infrastructure worldwide.**
  - ❖ **OMERS owns gas and electricity transmission in Czech Republic, Texas, Scotland, England, Finland, and Sweden; CPPIB owns electric utilities in Chile and Washington; water utility in eastern England.**
  - ❖ **Few Canadian examples: OMERS small stake in Alectra**
  
- ❖ **Other investors: Brookfield, insurance funds, utility companies, other infrastructure companies**

# What is asset recycling?

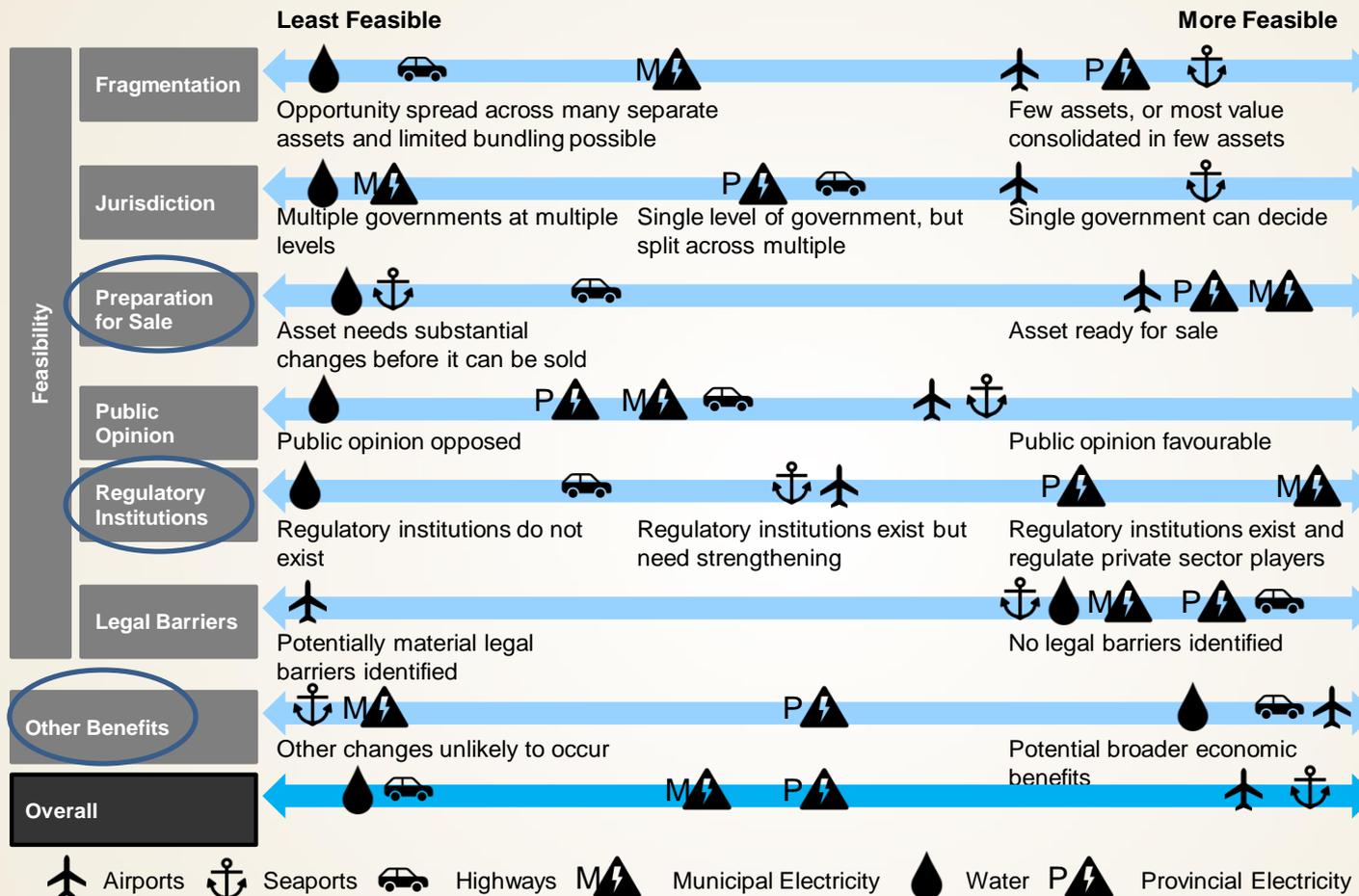


● Low Value ● High Value

✈ Airports    ⚓ Seaports    🚗 Highways    M Municipal Electricity    💧 Water    P Provincial Electricity

Source: Robins (Forthcoming)

# What is asset recycling?



Source: Robins (Forthcoming)

## Less risk to taxpayers

Government has a lower cost to borrow than private sector, right?

### ❖ Wrong!

- Lower interest rate is a result of lenders viewing taxpayers as the guarantors of any cost overruns or late delivery
- The lower interest rate is an insurance benefit that taxpayers implicitly provide lenders.
- Risk has a cost, and not charging for it is a hidden subsidy given by taxpayers to private interests.

## Lower economic cost

Government infrastructure investment comes from taxes

### ❖ Taxes have economic costs

- Taxes mean some businesses invest less and people work less.
- That creates a wider economic cost – publicly funded infrastructure must yield very high societal benefits to be economical.
- When users pay for infrastructure instead, there is no wider economic cost.



## Why is asset recycling of municipal electricity a good idea?

### ❖ Spur private-led consolidation

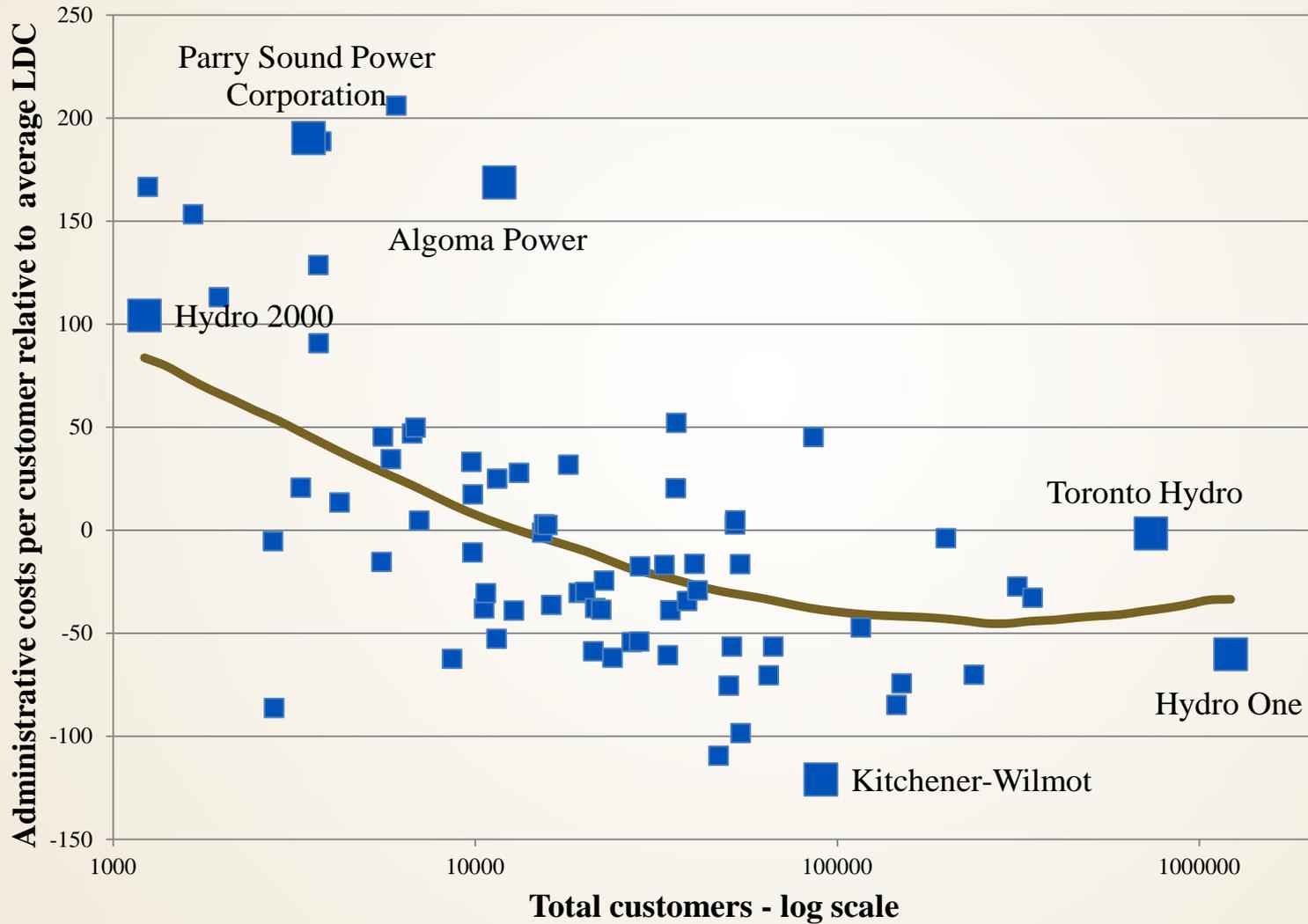
- End-delivery charges are now over one-third of the total bill for a typical residential customer
- Smaller companies have higher costs per customer...to a point
- Private-led consolidation can determine market-driven test of whether consolidation makes sense

### ❖ Use revenues for critical assets

- \$3 billion in potential infrastructure financing for small cities
- Toronto Hydro, Alectra, Hydro Ottawa, Veridian equity value: \$8.2 billion, total
- Municipal governments don't need to own distribution companies to keep costs down
- The Ontario Energy Board keeps a close regulatory eye on all price changes regardless of who owns the companies

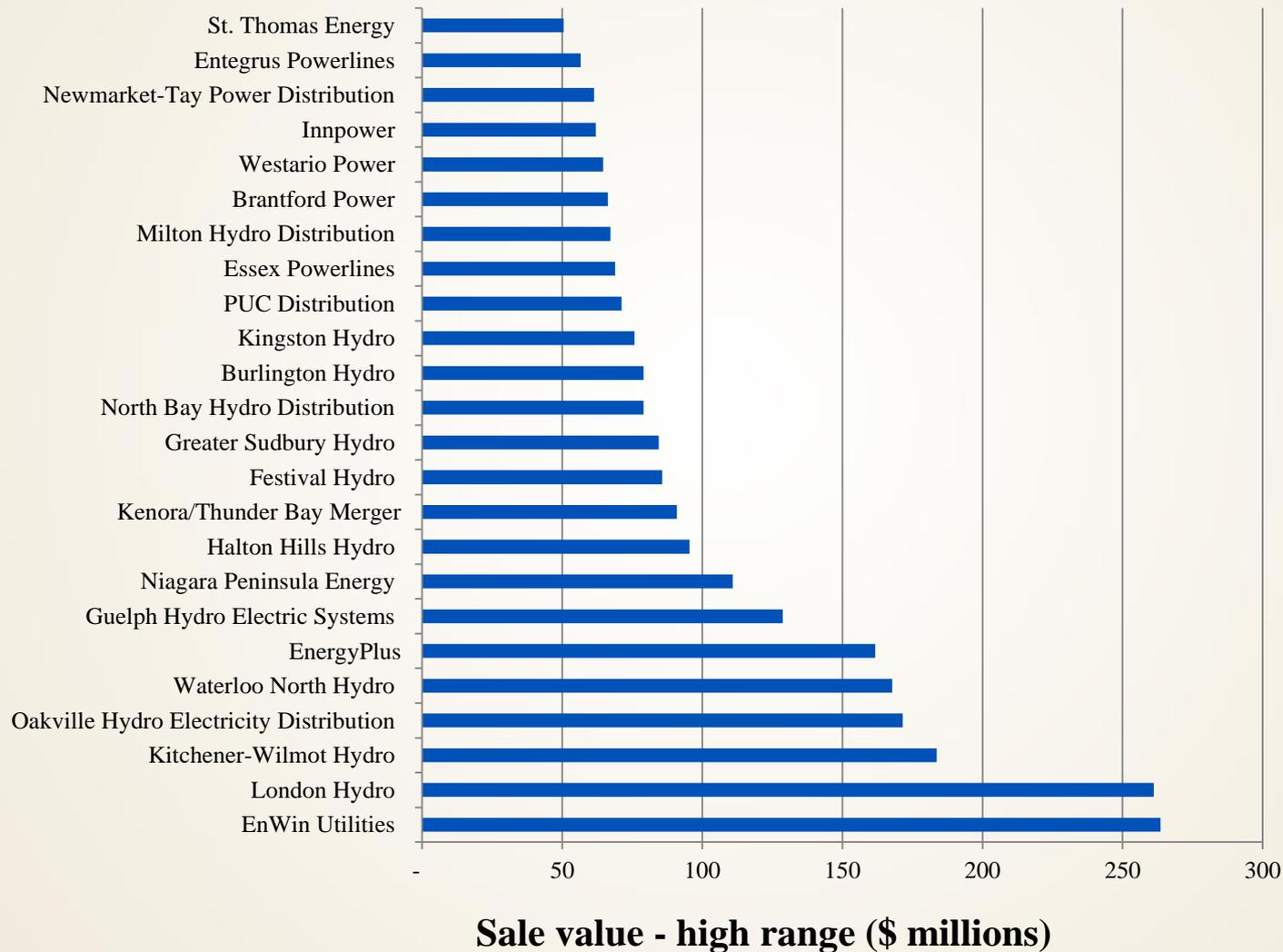


### LDC Administrative Costs Per Customer - Controlling for Density, 2013

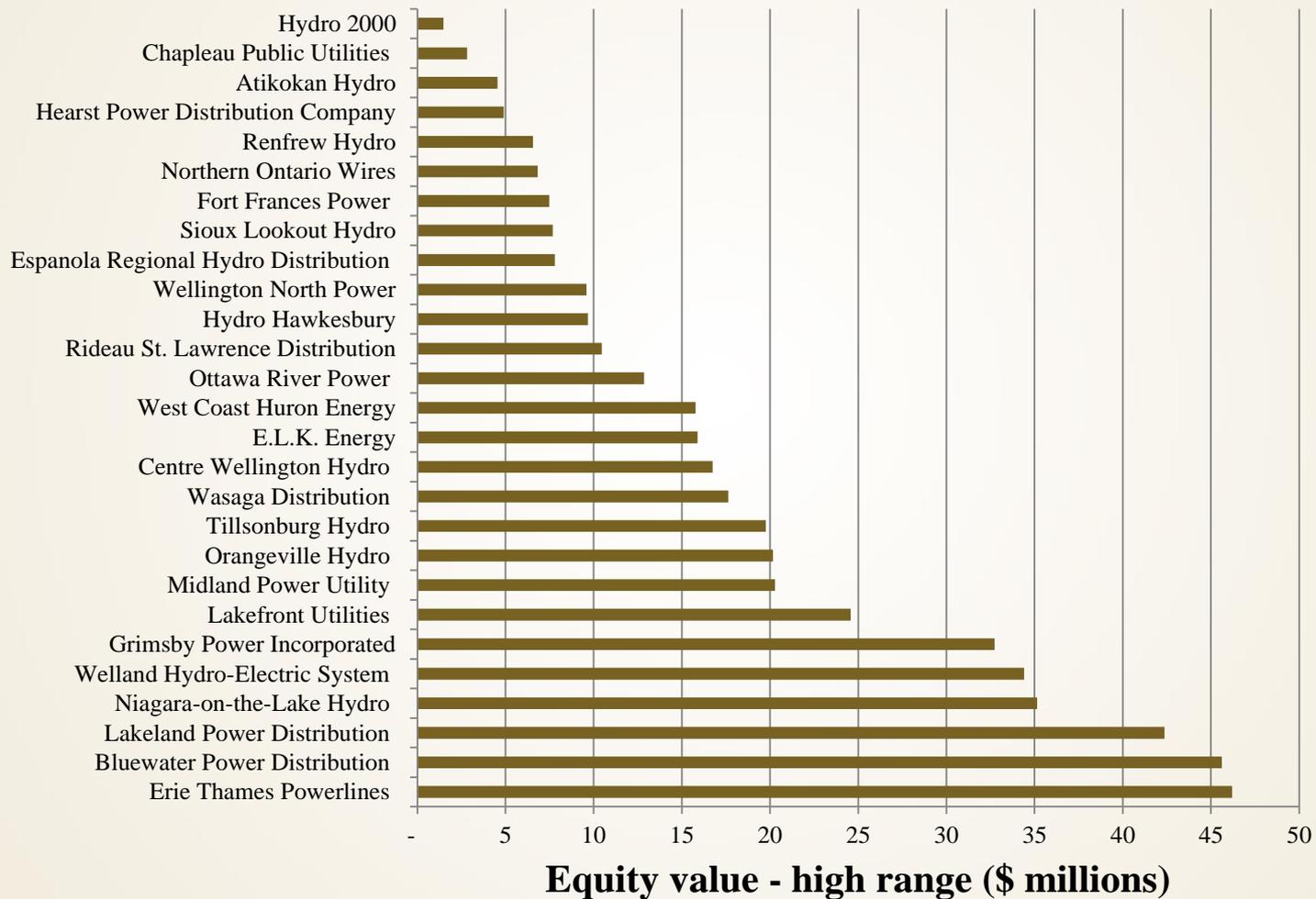


Source: updated from Fyfe, Garner and Vegh (2013)

### Equity Value of Ontario Electricity Utilities (largest half)

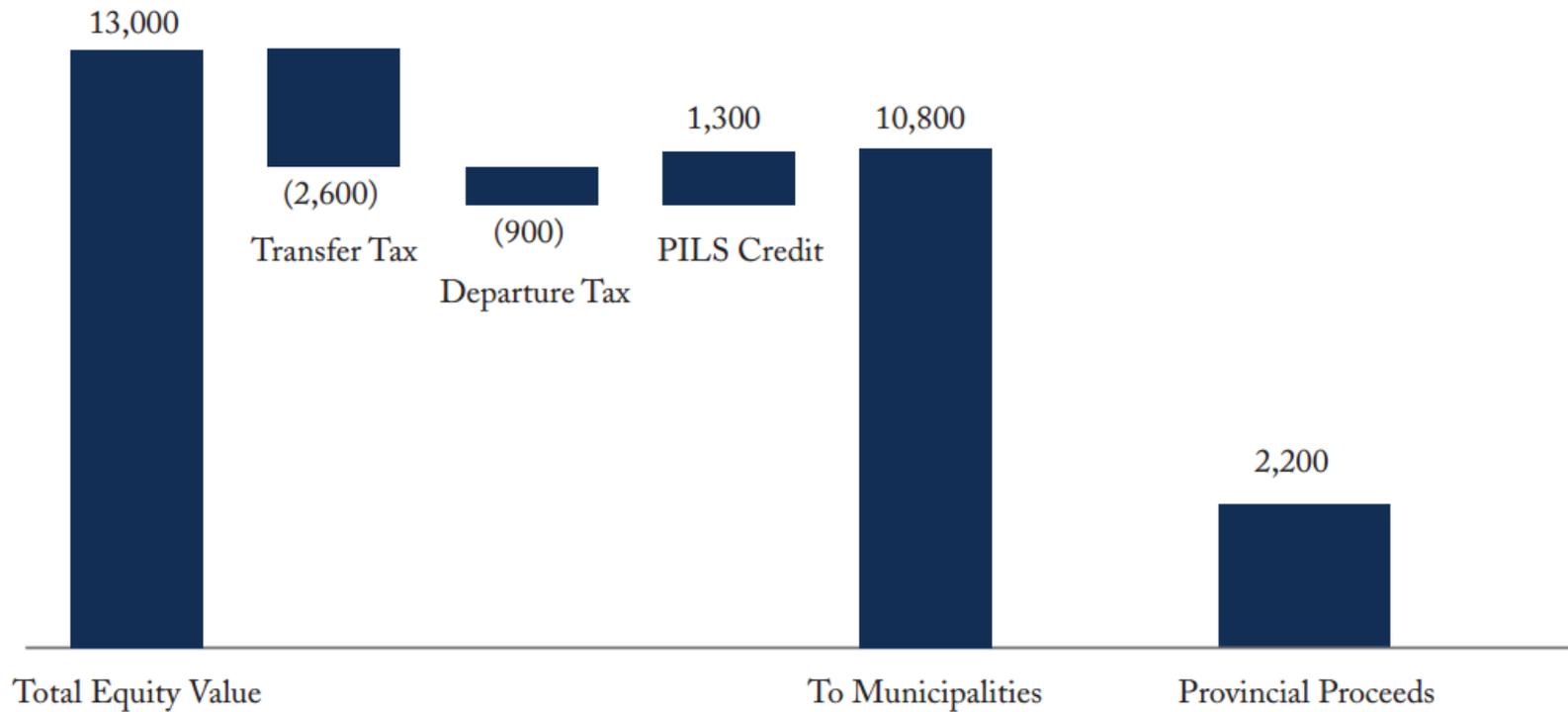


### Equity Value of Ontario Electricity Utilities (smallest half)



## Asset recycling in municipal electricity distribution

Distribution of Average Sale Proceeds (Ontario)  
(\$ Millions)



## What will it take to spur municipal asset recycling and consolidation?

### ❖ Province should permanently remove transfer and departure taxes

- Transfer tax has little justification: should be eliminated
- Departure tax trickier: only tax-exempt entities (like EPCOR) exempt. Hydro One no longer exempt
- Transfer tax exemption for small LDCs only in place until December 2018. After that, transfer tax paid would increase by \$4 billion

### ❖ Federal government can return any new tax it collects from private LDC to province

- Any sale of LDC would result in province losing tax revenues to Ottawa
- Federal government no worse off with a rebate
- Federal government can follow Australian model of returning up to 15% of sale value if money reinvested

## Why is asset recycling of municipal water and wastewater a good idea?

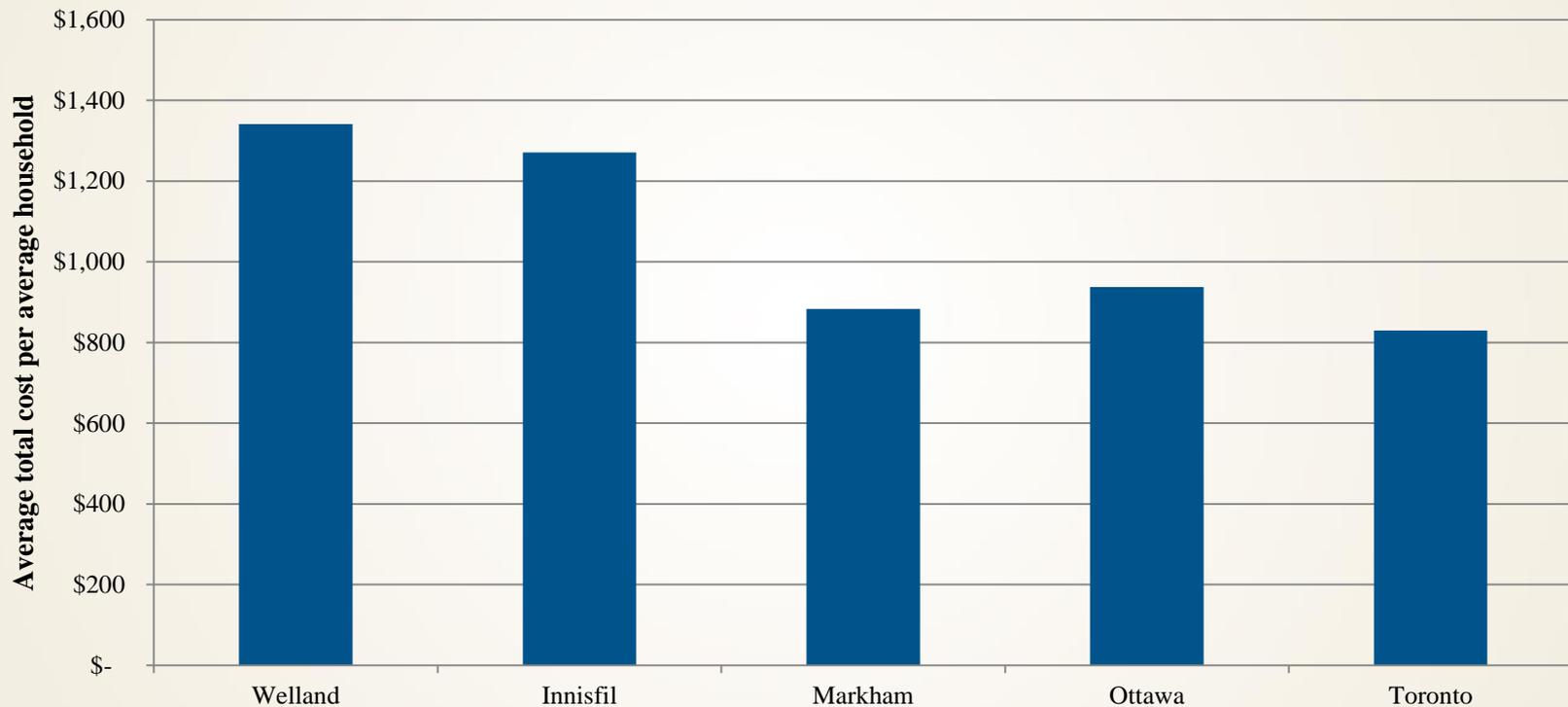
### ❖ Spur private-led consolidation

- Scale economies likely present in water and wastewater utilities – less data to prove this (stay tuned)
- Evidence shows that competition for providing water and wastewater services – not necessarily whether the service is public or private – results in reduced costs

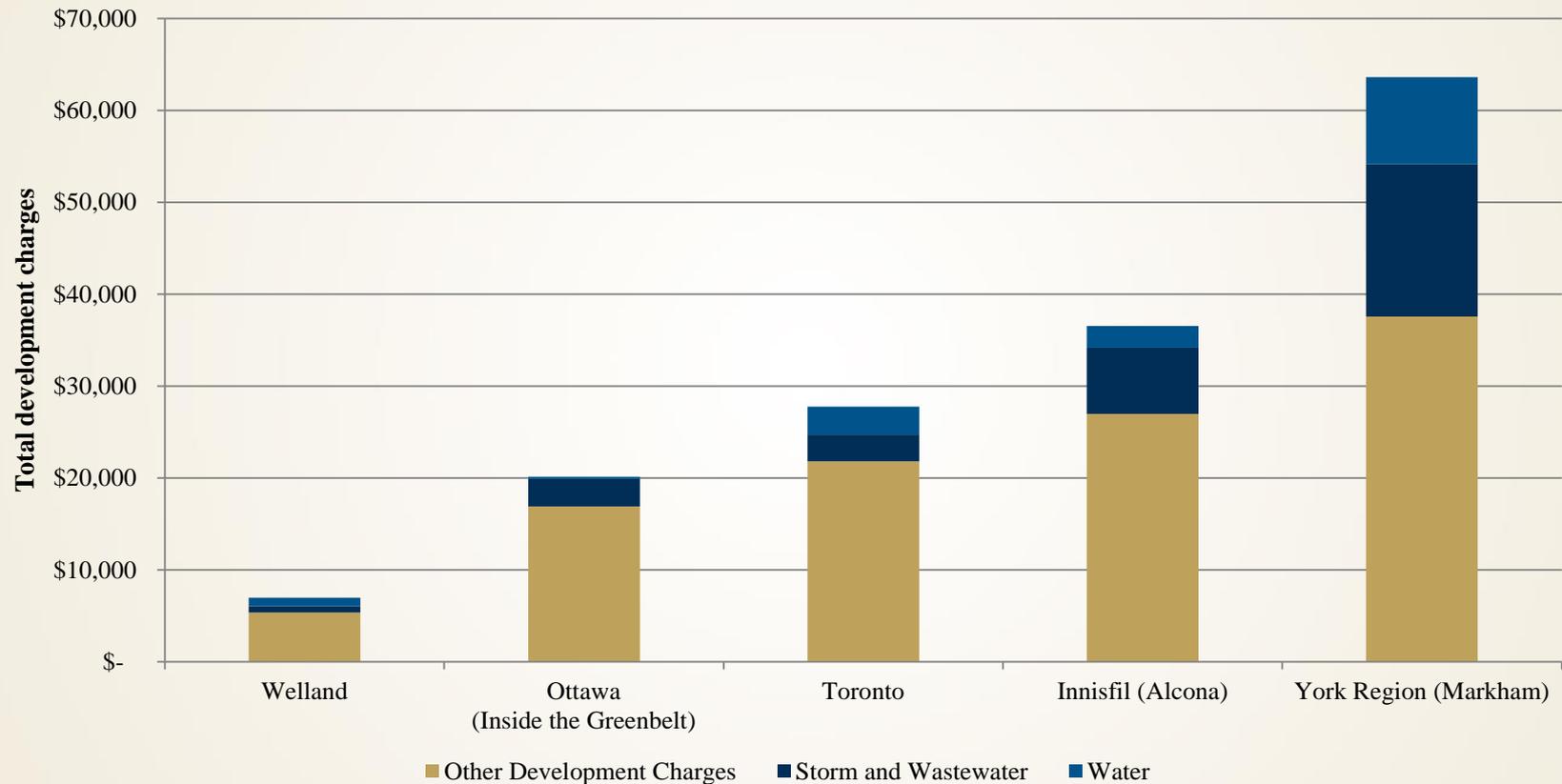
### ❖ Move away from upfront development charge cost onto homebuyers

- Largest component of many development charges is for water and wastewater
- Developers aren't the final payers: homebuyers are
- Current municipal accounting system incents cities to finance water and wastewater infrastructure upfront: utilities don't do that

## Average annual water and wastewater costs in Ontario municipalities (2017)

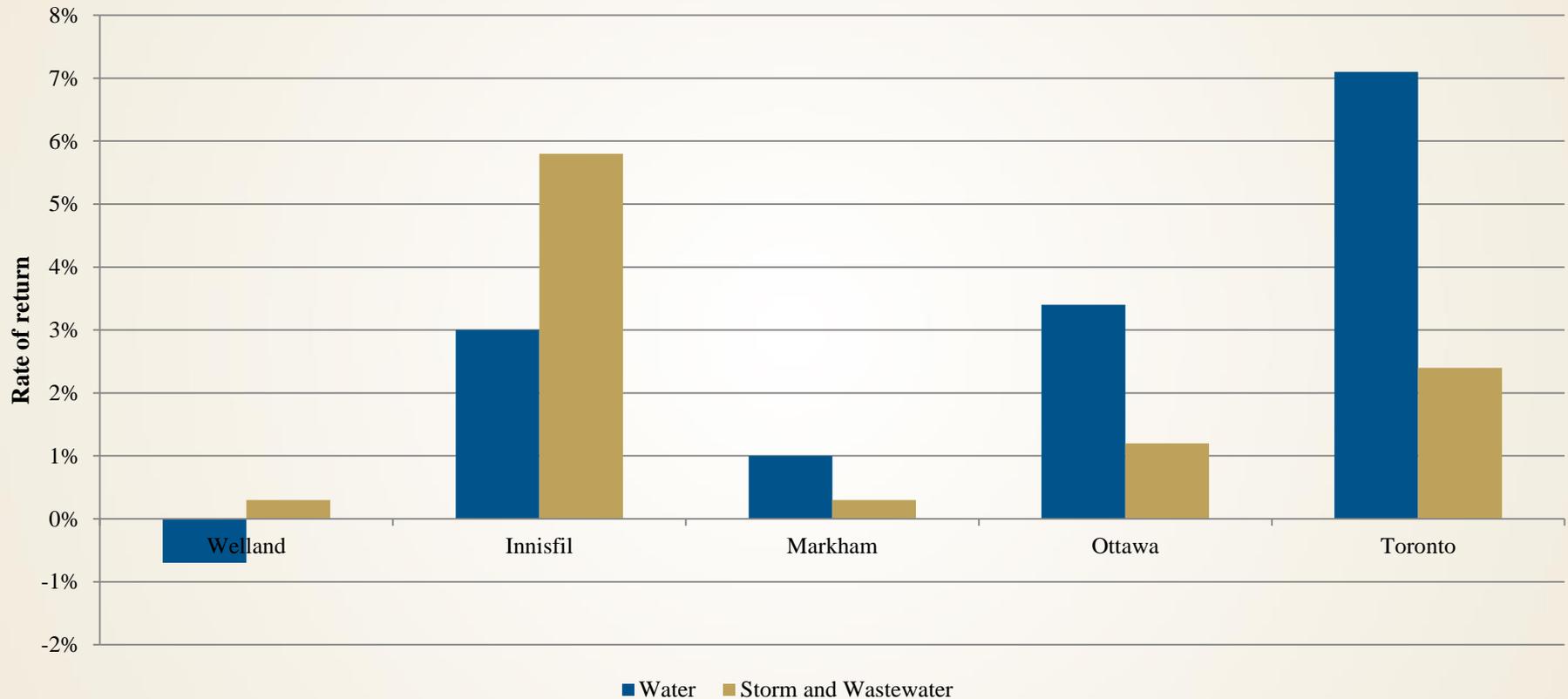


### Development charges for a single detached house (2015/16)



Higher development charges = more expensive homes

## Return on Asset for Municipal Water and Wastewater Services (2014)



Low rate of return = why are cities in this business?  
Can other operators manage better?

## What will it take to spur municipal asset recycling and consolidation?

### ❖ Cities should put water and wastewater utilities into separate corporations, not integrated departments

- Allows for clear understanding of utility finances – less support from property taxes
- Allows corporation to finance with debt without same municipal burden: matches long-term benefit with long-term cost
- Less reliance on development charges to finance infrastructure

### ❖ Province should put in place independent economic regulator to oversee private and public water and wastewater utilities

- When operator and regulator, governments have an inherent conflict of interest
- No independent economic regulator, unlike gas + electricity to ensure quality, safety and set water and wastewater rates
- Can put in place rate-of-return regulation to ensure both sufficient pricing and discourage excess price increase

**May the Fourth  
be with you!**



Thank you!