Building Strategies & Sustainability

Pension funds drawn to investable cities

Canadian infrastructure is too big and too old to survive on tax base

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Despite an abundance of investment funds spending across the globe, Canadian infrastructure continues to face a crisis. For example, the 300 biggest pension funds collectively hold about $15 trillion (U.S.), the Canadian Pension Plan (CPP) has $275 billion and the Pension Investment Association of Canada has $1.5 trillion. However, this enormous amount of money is still not benefiting Canadian municipalities like Toronto.

During the Canadian Urban Institute's 2015 Canadian Urban Forum on Investable Cities, Glen Murray, Ontario minister of environment and climate change, spoke about Toronto's rich commercial and cultural capital. The city is brimming with leading universities, scientific communities, law, planning and architecture firms, but has still not established its infrastructure to become the kind of investable city people want it to be.

"We don't have a lot of buildings in the top 100 buildings. We don't really have breakthrough technologies in our transits system yet, and we're still going back to the mid-20th century for a lot of that technology," said Murray. "For 40 years our population nearly doubled and we built almost nothing significant to deal with transportation and environmental systems. We caused the congestion we have today through decades of neglect."

In addition to this aging infrastructure and the multi-billion dollar deficit left to fix what was ignored, are climate change events, which are becoming the "new normal" and making some community infrastructures uninsurable. Such risks accelerate the need to create investable cities to support sustainable growth.

Dr. Michael Goldberg, director of the Canada Pension Plan Investment Board, said there are ways to attract capital and motivate the private sector to invest.

"Large institutions have told me repeatedly, if you make a good environment the money is going to flow," said Goldberg. "Conversely, if money doesn't flow, you can assume the conditions are not right."

Scale, certainty and profitability

First, to prepare for investment, regions need strong asset management systems so cities can understand what their specific needs are. Regions also need proper growth management systems so they can funnel growth into areas that are efficiently served, not just by transit, but other infrastructure.

Above all, said Goldberg, institutional investors increasingly need scale and political certainty, which is a main barrier to private funding. And if cities want to attract large amounts of money, the project has to be profitable.

"One of the interesting things is Canadian municipalities are not looked on favorably in terms of political certainty; there seems to be significant political risk that changes the terms of a contract after it is written," he added. "You gotta have certainty and you need scale. Most of the top five pension funds in Canada are not interested in writing a cheque for less than $300 to $500 million because it's too much work.

Meanwhile, challenges abound. Projects often involve several levels of government, making the process complex and creating even more political uncertainty. Different interests lack alignment and don't indicate interests for investors. Other challenges include the political cycle in urban governments, an ill-suited Canadian revenue model and lack of pipelines to allow cities to negotiate with sophisticated investors.

Creating investable cities

Some ideas to attract large infrastructure investments include creating a culture of dynamic road pricing in the form of tolls, which could vary on different routes according to congestion levels. Also, cities must find ways to maximize farebox revenue, suggests Goldberg. This means creating highly competitive transit that is clean and reliable, and also building density around stations. Raising prices is something Canadian governments are reluctant to do, but infrastructure won't get built if prices don't go up.

"Canada has "this absolute phobia of density," Goldberg said. "Without density it's difficult to make transit work and it's difficult to make cities work. Everyone talks about financing transit and they always overlook the customer. If you pack lots of customers in and around transit stations, you're going to get lots of customers who will pay for the stations."

Michael Sutherland, director of economic analysis and investment strategy for Metrolinx, added that the GO system proves users will pay fares if there is a high level of service. At the same time, transit can be optimized and fares don't have to be hiked in order to make revenue. For example, ridership could increase if fares were lowered for shorter trips.

Andy Manahan, executive director of the **Residential and Civil Construction Alliance of Ontario** (RCCAO), suggested that one way cities can put their "toes in the water" is through the incremental implementation of High Occupancy Tolling (HOT) lanes. In addition, the move to a cap-and-trade system could to be bolder by allowing certain municipalities to collect fuel tax, while another option would be a national infrastructure bank offering revolving funding sources where returns on a project go back into the fund and get reinvested.

Lack of resilience deters investors

Around the Greater Toronto Area, large private equity investors and pension funds often pass on investment opportunities in infrastructure, and instead, invest in Toronto's landfill, according to Tania Caceres, principal at RiskNexus.

"I had a client pass on an opportunity on the basis of gridlock and the capital funding required," says Caceres, who works directly with the private sector. "That's one million square feet of mixed use that won't get built by a particular fund."

Although she was able to overcome several due diligence hurdles, in the end, she couldn't derisk the infrastructure risk to the project in order to make the fund comfortable.

Meanwhile, money from the CPP and other funds are being invested into countries like Australia and India, while Canadians are stuck with long commutes and congested roads.

"In terms of innovation and optimization of infrastructure, we have a lot of great minds," she said. "What we don't have is a lot of connectivity between what we want to build and how we derisk the investment for those private investors we are seeking to attract."

The fact that Toronto is not the most resilient city is a main deterrent for these investors.

"We have a serious deficit in infrastructure maintenance, but we also have climate change threatening that infrastructure," Caceres added. "Globally, the world bank estimates $57 trillion of additional climate adaptability investment is required. So let's fix it, get it to good and put it to the point where it will adapt and survive and then restore."

70 per cent of Ontario-based infrastructure is not insured, so who will fund recovery efforts is a critical factor.

“We’ve got to shift away from this idea of surviving on a tax base,” she said. “We’re too big, we’re too old, we’ve been around too long, our infrastructure is at a peak in terms of use and we’re not going to generate enough tax base; it has to be investment based.”