Backgrounder E:
The Evolution of Alberta's Policies on Capital Financing and Accounting

Overview

For many years now, a growing Alberta population and economy have significantly increased the demand for capital spending in the province.

Although capital spending has averaged about $3 billion per year over the past two decades, it has been susceptible to the volatility of energy price cycles and the changing fiscal fortunes of the province. During the fiscal consolidation of the mid-1990s, for example, capital spending fell below $1 billion per year for a number of years.

As was pointed out by the Alberta Financial Management Commission, governments have frequently used capital funding as a cushion in the budget. Projects have been deferred when there was a budget shortfall and one-time funding has been provided when there were surpluses. This practice has often led to unpredictable 'boom and bust' capital funding cycles, exacerbating issues around infrastructure development, maintenance, and service delivery. It has also led the province to explore a variety of approaches to financing capital, in an effort to enhance stability in capital planning.

Going forward, Alberta's fundamentally positive medium- and long-term economic outlook suggests that demands on our infrastructure will continue to grow. Key infrastructure needs include the expansion and enhancement of strategic transportation corridors, infrastructure related to economic development, and deferred infrastructure maintenance as well as a variety of health, educational and social infrastructure to support the needs of Alberta's growing population. It is uncertain whether Alberta's current capital plan targets will be sufficient to address all of these needs.

Background

In recent decades, the Government of Alberta has employed a variety of approaches to the financing of capital expenditures.

Alberta Heritage Fund Capital Projects Division, 1976 to 1995

In 1976, the Capital Projects Division was established within the Alberta Heritage Savings Trust Fund to fund infrastructure projects deemed to provide long-term economic or social benefits to the people of Alberta.

Capital projects funded through the Heritage Fund were not allowed to exceed 20 per cent of the total assets of the fund (later increased to 25 per cent, in 1988). These projects did not generally yield a financial return to the Heritage Fund, but they supported the growth of Alberta's economy and the quality of life of Albertans.

Over the next twenty years, the Capital Projects Division provided nearly $3.5 billion in funding. Recipients included the Alberta Heritage Foundation for Medical Research, the Alberta Heritage Scholarship Fund, the Alberta Children's Provincial General Hospital (Calgary), the Walter C. Mackenzie Health Services Centre (Edmonton), the University of Alberta Clinical Research Building, the Tom Baker Cancer Centre, the Leduc Food Processing Centre, irrigation rehabilitation and expansion, water management system improvements, individual telephone line service in rural Alberta, the Alberta Oil Sands Technology and Research Authority (AOSTRA) for oil sands research, and the development of Kananaskis Country and Fish Creek Park.

With changes to the financial management and governance of the Heritage Fund, funding of capital projects through the Capital Projects Division was discontinued as of March 31, 1995.

Alberta Capital Fund, 1986 to 1994

With the significant downturn in Alberta's economy in the mid-1980s and its associated fiscal challenges, the Alberta Capital Fund was established in 1986 to help fund construction of major public facilities such as hospitals and post-secondary institutions.

The Alberta Capital Fund borrowed the amounts required to finance approved construction projects and then received annual departmental appropriations from the General Revenue Fund, calculated to fund projects over their useful lives. The interest costs of the borrowings were included as part of the province's debt servicing costs.

The Capital Fund represented a significant change in the financing of capital as it provided the government with a source of capital project funding that was not tied to annual appropriations.

In 1994, the Capital Fund was eliminated in accordance with the government's intention to move towards a 'pay as you go' approach to capital funding as part of fiscal consolidation, and to reduce the proliferation of regulated funds, as recommended by the Alberta Financial Review Commission.

1994 to 2002

With the fiscal consolidation of the mid-1990s, capital funding averaged just over $1 billion per year between 1994-95 and 1998-99.

During this period, the government followed a ‘pay as you go' approach to funding its capital requirements, with the cost of capital projects being expensed as the projects were constructed. This essentially meant that government revenue in the current year was the only source of funding accessed for capital construction.

The ‘pay as you go’ approach differed from the private sector, where capital spending was treated as the addition of an asset that was then expensed (or ‘amortized’) over time according to its useful life.

Alberta Capital Account, 2003 to 2008

In 2002, the government established the Alberta Financial Management Commission (AFMC) to recommend changes to the fiscal framework. One of the most frequent messages the commission heard from stakeholders was a desire to find new ways of funding important infrastructure.

Among its recommendations, the AFMC suggested that the government prepare a three- to five-year plan for capital and infrastructure projects and include that plan as part of its annual budget. It also proposed that existing legislation be changed to allow funding for specific approved projects to be carried over from one fiscal year to the next, and that consideration be given to alternative funding arrangements for capital projects.

Beginning in *Budget 2003*, the government presented three-year capital plans in its budget documents, including infrastructure projects and purchases of equipment by school boards, post-secondary institutions, health authorities, municipalities, and other local authorities and organizations; as well as capital investment in government-owned infrastructure, equipment and inventories.

The Alberta Capital Account was created to provide an additional source of financing to support capital infrastructure projects. Funds allocated to the Capital Account in one year could be used for projects in future years to help ensure that capital plan commitments were met. Previously, those dollars could be reinstated only if there was room within the next year's fiscal plan. For projects being constructed by local authorities, the government's capital grants were often fully advanced in the year the grants were budgeted even if there were construction delays.

In *Budget 2003*, the government also moved to the new Public Sector Accounting Board standard of amortizing capital for fiscal reporting, similar to the standard that had been used for many years by the private sector. Government-owned capital assets were added to the government's balance sheet and charged to the bottom line over their useful lives through an annual amortization expense. This change affected only government-owned capital assets, as capital grants to local authorities continued to be fully charged to expense on the income statement.

The *Fiscal Responsibility Act* was also amended in 2003 to permit borrowing for capital purposes. The government could now borrow for capital investment in government-owned assets, to support infrastructure owned by school boards, post-secondary institutions and health authorities, and as required by self-supporting corporations such as the Agriculture Financial Services Corporation, Alberta Treasury Branches and the Alberta Capital Finance Authority. Debt incurred for capital purposes after April 1, 2003 was excluded from the accumulated debt that was required by law to be eliminated by 2025.

This legislative change facilitated the development of alternative financing arrangements for capital, such as public-private partnerships (P3s). The use of alternative financing is assessed on a project-by-project basis. A business case is required to demonstrate that alternatively financing a project makes sense, and considers all costs. All proposals are reviewed and approved by the government.

These various changes coincided with a dramatic rise in capital spending. The province's capital spending grew from $1.7 billion in 2003-04 to $7.6 billion in 2008-09.

2009 to the present

The severe global recession, which began in 2008, forced a re-examination of the way the province funded its capital expenses. Among the changes announced by the government in *Budget 2009,* the Capital Account was abolished and its financial assets were rolled into a new Sustainability Fund. A cash-based fund, the Sustainability Fund financed the difference between annual expenditures on government-owned assets and amortization.

With the substantial growth of the Capital Plan over the past decade, the capital being funded by the Sustainability Fund each year far exceeds the amortization of capital assets. Growing annual cash draws have left the Sustainability Fund vulnerable to depletion in the event of a prolonged economic downturn.

Budget 2009 also set out a plan to directly borrow $3.3 billion over three years to support capital spending. Subsequent improvements in the fiscal situation resulted in only $1.5 billion actually being borrowed.

In 2011-12, the Government of Alberta began to borrow directly from financial markets and then lend the proceeds to the Alberta Treasury Branches and the Alberta Capital Finance Authority, as has been the practice with the Alberta Financial Services Corporation. This practice, known as on-lending, results in lower borrowing costs for provincial corporations (as it allows these entities to take advantage of the Government of Alberta's AAA credit rating). These entities then pay the province back, with interest. The Government of Alberta expects to borrow approximately $3.5 billion for the purpose of on-lending to provincial corporations in 2012-13.