The Chamber

Building The Best Business Climate in Canada, Thereby Creating a City of Opportunity

NEW APPROACHES, NEW OPPORTUNITIES, AND REDUCING RISK FOR GOVERNMENT ASSETS IN SASKATCHEWAN

March 2005

Prepared By the Greater Saskatoon Chamber of Commerce
345 3rd Avenue South
Saskatoon, SK. S7K 1M6
www.eboardoftrade.com
Phone: (306) 244-2151 Fax: (306) 244-8366

Executive Summary

This report provides an analysis and evaluation of new approaches and new opportunities for the Province of Saskatchewan to consider for reducing financial and other risks for government through changes in the approach to finance public services and assets in Saskatchewan.

Saskatchewan's economy features a high level of government intervention and the firm establishment of a wide array of crown corporations. Currently there are three publicly traded companies in Saskatchewan that were converted from pure state owned enterprises (PCS, Nexen [formerly Wascana], and Cameco). These publicly traded companies have been growing at a far faster rate than the remaining state owned entities to the extent that they are now globally competitive in their fields of endeavour. As government owned enterprises crowd out private investment, lower levels of job creation rates result. A lower job creation rate leads to a smaller tax base, thus a higher rate of taxes on the remaining tax base. This higher tax rate leads to a higher hurdle rate for investment evaluation and hence a slower rate of growth. Saskatchewan has the highest business income taxes in Canada, the highest capital taxes, the highest worker's compensation rates, the highest resource royalty taxes, and the highest business property tax rates for education when compared to the rest of Canada. High taxes and government intervention in the economy slows Saskatchewan business investment attraction and hinders job creation for citizens. High taxes limit the rates of return and therefore reduce risk tolerance for business investment, leading to less wealth being created. Changing demographics and youth exodus in Saskatchewan negatively impacts all Saskatchewan residents by further eroding its tax base. This reduces the amount of taxes collected by the government to pay for public services without tax rate increases. This vicious cycle further degrades the investment attractiveness of Saskatchewan.

Governments are continuously encountering the problem of limited debt capacity balanced with significant demands on those resources for operating expenditures causing a delay in needed capital projects. In the 1980s and 1990s the Canadian federal and provincial governments were plagued with debt due to excessive demands for operating expenditures on the revenue available while many publicly funded infrastructure projects were ignored and postponed. The impact of under-investment infrastructure has further limited investment attraction, slowed growth, limited job creation, and fueled youth exodus. The severe shortfalls in infrastructure for the Canadian public today could be addressed through Public Private Partnerships.

The government of Saskatchewan has heretofore considered only two options: sell the Crown Corporations (state owned enterprises) and use the funds to pay down debt, or have them remain completely under the provincial government's direct ownership control. Exploring as another option, Public Private Partnerships, shows that many potential benefits accrue to Saskatchewan and its publicly owned or funded services using this approach. Public-Private Partnerships are partnerships between the state sector and the market-based sector for the purpose of designing, planning, financing, constructing and/or operating projects. Traditionally, these would be regarded in Saskatchewan as falling within the remit of the state sector.

P3s would significantly speed up infrastructure improvement as compared to the traditional public sector infrastructure project phasing. P3s would provide a considerable benefit to Saskatchewan residents by providing new infrastructure, reducing public debt, improving existing facilities, improving service quality, improving working conditions, lowering project costs, lessening contingent risks, accelerating capital project execution, easing budget management, and providing sources of additional economic activity.

Any public service or government owned assets could be considered as a candidate for a P3 in Saskatchewan. This report focuses on a P3 for two business sectors. One example of a P3 would be for the Saskatchewan provincial government and SaskTel. SaskTel would remain a state owned enterprise and would create a trust unit that would focus solely on the conversion of the phone lines to a Business Trust. The most beneficial transaction to create a P3 for SaskTel's phone lines would be a sale/leaseback transaction and creating a Business Income Trust. Business Trusts are increasing in popularity with investors because of their relatively high yield and lower risk as compared to growth stock investments. Trust units have several tax advantages making this alternative attractive for investor and converter alike. This approach results in revenue from the sale of phone lines, which could help pay down provincial debt. The Trust would result in lowered interest rate risk and reduced technology risks for the province as these risks are transferred to the Trust Unit investors. A reduction of invested capital for SaskTel would decrease SaskTel's overall risk in a rapidly changing communication environment.

A second P3 could be considered as an alternative for improving the ailing Health system in Canada and Saskatchewan. Health care is a costly public service and the financial strain on the Federal and Provincial governments and taxpayers is enormous. A P3 in Medicare is a new solution that could alleviate this financial burden and improve working conditions, while reducing waiting times for service. The P3 would be designed for healthcare facilities and/or equipment, but not to the actual services. Money retained by the government could be redirected to fund other areas of public service. Other countries, such as Britain, and provinces in Canada have been adopting a P3 approach to their health care systems with good results.

This report recommends that the Province of Saskatchewan embrace alternative means to provide public services and consider alternate ownership structures for state owned enterprises that could reduce risk while retaining operating control over assets.

Introduction

For many years, Saskatchewan has been grid locked with debates over the privatization of the Crown Corporations (state owned enterprises). Presently, this debate centres on two arguments – to sell the Crown Corporations (state owned enterprises) and use the funds to pay down debt, or have them remain completely under the provincial government's direct ownership control. Despite the fact that many state owned enterprises have been converted to market based enterprises with shareholder ownership structures in Eastern Europe, Russia, China and South American countries, this approach has been subject to much debate in Saskatchewan. This paper will not be about settling this ongoing debate, but to introduce new options to consider. This paper will explore the option of Public-Private Partnerships (P3) and their potential benefits to Saskatchewan's publicly owned or funded services, such as telecommunications, education, and healthcare. A variety of examples from around the world will be used throughout this discussion to highlight the successes of other public-private partnerships and key elements needed in a P3.

What is a Private-Public Partnership?

Public-Private Partnerships are partnerships between the state sector and the market based sector.

Public-Private Partnerships are partnerships between the state sector and the market based sector for the purpose of designing, planning, financing, constructing and/or operating projects that would be traditionally regarded in Saskatchewan as falling within the remit of the state sector. P3s are relatively new forms of collaboration between the public sector and the private market resulting from their changing roles and greater demands from the general public.

The definition in a Canadian context of a Public-Private Partnership (P3) refers to the provision of public services or public infrastructure. It also refers to the transfer of risk between the partners – a necessity in any P3 agreement.

The precise definition used by the Canadian Council for Public-Private Partnerships is:

P3s are categorized according to the transfer of responsibilities, risks and rewards for service delivered to the public sector.

A collaborative venture between the public and private sectors, built on the expertise of each partner, that best meets clearly defined public needs through the appropriation of resources, risks and rewards.

The Canadian Council for Public-Private Partnerships identifies a spectrum of P3s beginning with the lowest form of government control up to the highest P3 – complete outsourcing. Within this spectrum, P3s are categorized according to the transfer of responsibilities, risks, and rewards for service delivered to the public sector. (Appendix A)

Virtually any public service could be a candidate for a P3 in Saskatchewan. Candidates include schools, hospitals, land registry, payroll/accounting, highway design, construction, or maintenance and water and waste management. Public-private partnerships can encompass a project completely or part of a process or entity.[1]

Why P3?

Governments are continuously encountering the problem of limited debt capacity for capital projects balanced with significant demands on those resources for operating expenditures. In the 1980s and 1990s Canadian federal and provincial governments found themselves plagued with debt due to excessive demands for operating expenditures on the revenue available. This made needed public infrastructure construction or improvements take a backseat to other initiatives such as social spending.[2] As a result, many publicly funded infrastructure projects were postponed. This has caused a severe shortfall in infrastructure for the Canadian public today. Examples of shortfalls in infrastructure investments include roads, water and sewer infrastructure, institutional building problems, outdated power transmission lines, outdated generation stations, and limited transborder electrical switching stations. P3 approaches provide an opportunity to address this infrastructure shortfall. In a properly constructed P3, the investor group is able to make a return on its investment, and participate in the project, while a government is able to satisfy the demands of building needed infrastructure in an accelerated fashion without substantially increasing its debt load.[3]

Governments are continuously encountering the problem of limited debt capacity for capital projects…

This has caused a severe shortfall in infrastructure for the Canadian public today.

[1] Canadian Council for Public-Private Partnerships – website at www.pppcouncil.ca
[2] "Government Policy in Canada". 2003.
[3] Poschmann, Finn. "Private Means to Public Ends: The Futures of Public-Private Partnerships." C.D. Howe Institute, Commentary. No. 183, June 2003, p.2-5.

From a taxpayer perspective, the advantages of a P3 are numerous. Firstly, the process provides funded debt for capital projects immediately provided by individual investors rather than through economic contraction inducing tax increases or the limited debt capacity of the government. A P3 may also place the development (and perhaps management of the project) into hands that hold the most expertise – either the investor partner or the public entity thereby reducing the capital cost or the ongoing operating costs of projects. The tendering process of the P3 contract invites innovative and creative approaches to service delivery. The investor is likely to observe the costs of the project closely since it is their money being spent and their returns at risk. Lastly, the approach allows the government to construct infrastructure, invest in technology or provide/improve access to public services in a more timely fashion.[4] The question that often arises is: Why would an investor enter into a P3 when they are to assume the majority of the risk? The answer is quite simple – the investor gains a relatively stable investment partner and a stream of revenues that may be secure for as long as 50 years.[5] This type of investment is likely to fit for at least a portion of any diversified individual portfolio.

The investor gains a relatively stable investment partner and a stream of revenues that may be secure for as long as 50 years.

[4] Poschmann, Finn. "Private Means to Public Ends: The Futures of Public-Private Partnerships." C.D. Howe Institute, Commentary. No. 183, June 2003, p.6.
[5] Canadian Council for Public-Private Partnerships – website at www.pppcouncil.ca

Saskatchewan Environment

P3s will provide a considerable benefit to Saskatchewan residents by providing new infrastructure, reducing public debt, improving upon existing facilities, and positively affecting the provincial economy. Being a 'have not' province for several decades has resulted in years of needed infrastructure being put off due to lack of available funds as funds were directed to social spending. These factors are limiting investment attraction, slowing growth, limiting job creation, and fostering youth exodus. The impact of under-investment infrastructure may approach that of regulatory overburden or tax uncompetitiveness in terms of impact on investment attraction.

Is Change Necessary?

P3s will provide a considerable benefit to Saskatchewan residents by providing new infrastructure, reducing public debt, improving upon existing facilities, and positively affecting the provincial economy.

In 1944, Saskatchewan people elected the CCF Party to form the first socialist government in Canada. Under the CCF Government, government-run businesses grew dramatically including bowling alleys, box factories, state-run farms, gas stations, and bakeries. Medicare was also legislated under the CCF Government in the 1960's. Medicare later expanded across Canada and remains popular among people across the political spectrum. Saskatchewan's economy features a high level of government intervention and the firm establishment of a wide array of crown corporations. Exceptions did occur however. In the 1980's, when Saskatchewan saw high interest rates and declining commodity prices, the provincial government of the day was forced to realize that high government intervention in the market place was displacing rather than augmenting the investment by other actors in the provincial economy. As a result, the provincial government declared they were open for business and brought the Potash Corporation of Saskatchewan, SaskOil (now Nexen) and Saskatchewan Mining and Development Corporation (now Cameco) to the public markets. A decade later, free market attitudes were becoming even more apparent and there was increasing support for de-regulation and market based service delivery systems. It is interesting to note that in 2004 the three converted companies now represent over $25 billion in market capitalization, are globally recognized as leaders in their respective fields. In addition, these companies have grown their revenue by more than a factor of 20. These three companies employ several thousand people in Saskatchewan and around the world. Over the same period, revenue in real dollar terms, employment, and market value of other crown corporations have remained constant in size or have shrunk in scale and value. According to the Financial Post 500 Largest companies in Canada (June 2004)[6], the Potash Corporation ranks 79, Nexen ranks 77, and Cameco ranks 275. There are only a few provincial government owned entities (known elsewhere as state enterprises) from Saskatchewan on the FP500 list. SaskPower is ranked at 200. Saskatchewan Telecommunications is ranked at 254. The Saskatchewan Auto Fund is ranked at 370. Entry into the public markets allowed these publicly traded firms (PCS, Nexen, and Cameco) more access to capital and markets than state owned enterprises in Saskatchewan. These now publicly traded

These now publicly traded entities (PCS, Nexen, and Cameco) grew at a far faster rate than the crown-owned entities and are now globally competitive in their fields of endeavour.

[6] "Canada's 500 Largest Corporations." National Post Business – The FP 500. 40th Edition, June 2004. p.78-102.

entities (PCS, Nexen, and Cameco) grew at a far faster rate than the crown-owned entities and are now globally competitive in their fields of endeavour.

The policy of high taxes, regulatory overburden, and high levels of government sponsored business activity have negatively affected the Canadian and most particularly the Saskatchewan economy.

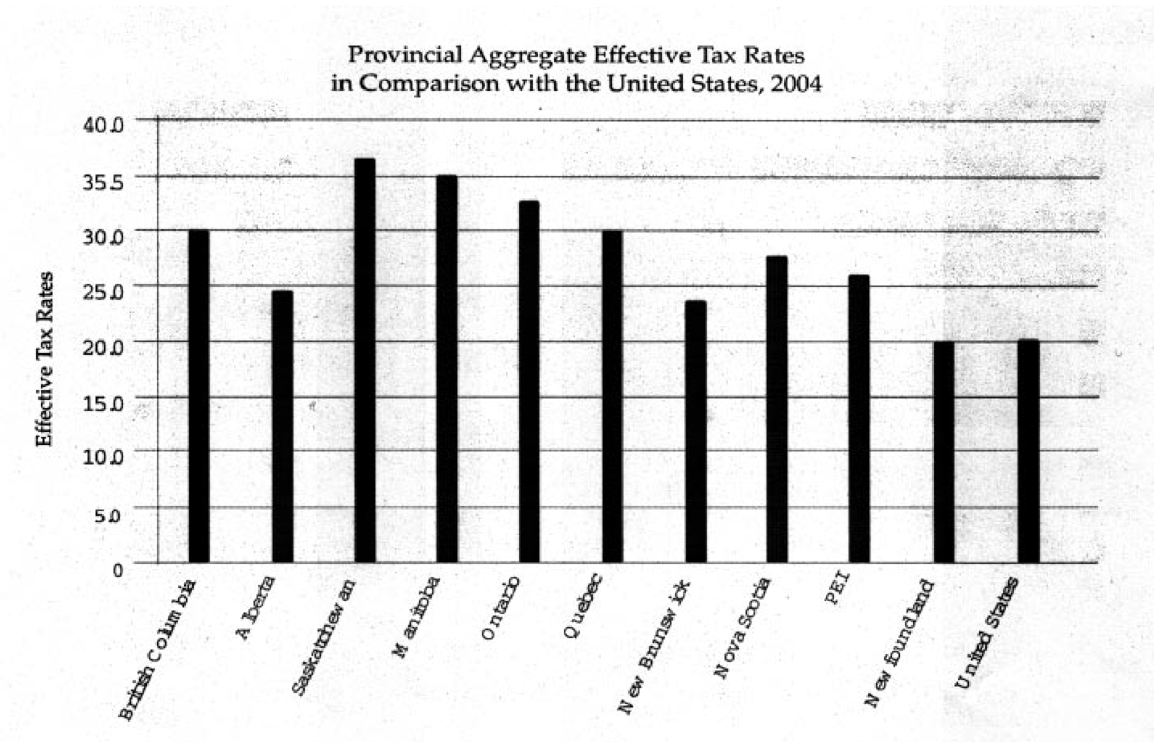
In the early 2000's, it was obvious that Canada and especially Saskatchewan had fallen behind our major competing jurisdiction (the United States) in productivity and standards of living. High taxes and government intervention in the economy was slowing Saskatchewan business investment and hindered job creation for citizens.[7] The policy of high taxes, regulatory overburden, and high levels of government sponsored business activity have negatively affected the Canadian and most particularly the Saskatchewan economy. In terms of the impact of high taxes, they limit rates of return and therefore reduce risk tolerance, cause disincentive to work, and lead to less wealth being created. This cycle lowers the GDP/GPP growth and productivity growth, which consequently lowers the standards of living of Saskatchewan citizens. All business investments need to exceed a required "hurdle" rate of return to justify the investment. The hurdle rate is defined as the projected rate of return on a pro forma basis for project evaluation below which the project will not justify investment for the investor and therefore will not proceed. In any given economic circumstance, the higher the hurdle rate, the fewer the number of projects that will proceed. This in turn causes a lower job creation rate. The risk of government enterprise competition also causes a higher hurdle rate for investment analysis in Saskatchewan. Low investment attraction rates and job growth causes higher tax rates which in turn further raise the hurdle rate.

This cycle lowers the GDP/GPP growth and productivity growth, which consequently lowers the standards of living of Saskatchewan citizens.

[7] "Government Policy in Canada". 2003. p. 87-93.

Saskatchewan has the highest business taxes in Canada (refer to graph below[8]), among the highest capital taxes, and the highest business property tax rate in Canada. From this policy regime it is not surprising that the job creation rate in Saskatchewan has lagged virtually every other province in Canada even though Saskatchewan is home to what may be the richest resource base in the world.

Saskatchewan has the highest business taxes in Canada and the highest business property tax rate in Canada.



As government owned enterprises "crowd out" private investment, lower levels of job creation rates are also the result. The lower the job creation rate, the smaller the tax base. The smaller the tax base, the higher the rate of taxes on investment for a given set of tax-funded services under a balanced budget constraint. The higher the tax rate, the higher the hurdle rate. The higher the hurdle rate, the slower the growth. This vicious cycle along with high taxes also causes a larger underground economy, since many people will use tax

As government owned enterprises "crowd out" private investment, lower levels of job creation rates are also the result.

[8] Chen, Duanjie and Jack Mintz. "The 2004 Business Tax Outlook: Lowering Business Taxes Would Spur Investment." C.D. Howe Institute, March 3, 2004.

evasion techniques including leaving the province as a tax evasion strategy. In Saskatchewan, due to its proximity to Canada's lowest taxed jurisdiction, tax avoidance losses may be very high. This tax avoidance further fuels higher taxes. These factors combine in a classic vicious cycle. These circumstances are sometimes identified as a Laffer's Curve in economic study where higher taxes and regulatory overburden result in progressively lower tax capture rates and slower growth.

Another major issue facing Saskatchewan will be the severe demographic changes encountered in Saskatchewan over the next 10 years.

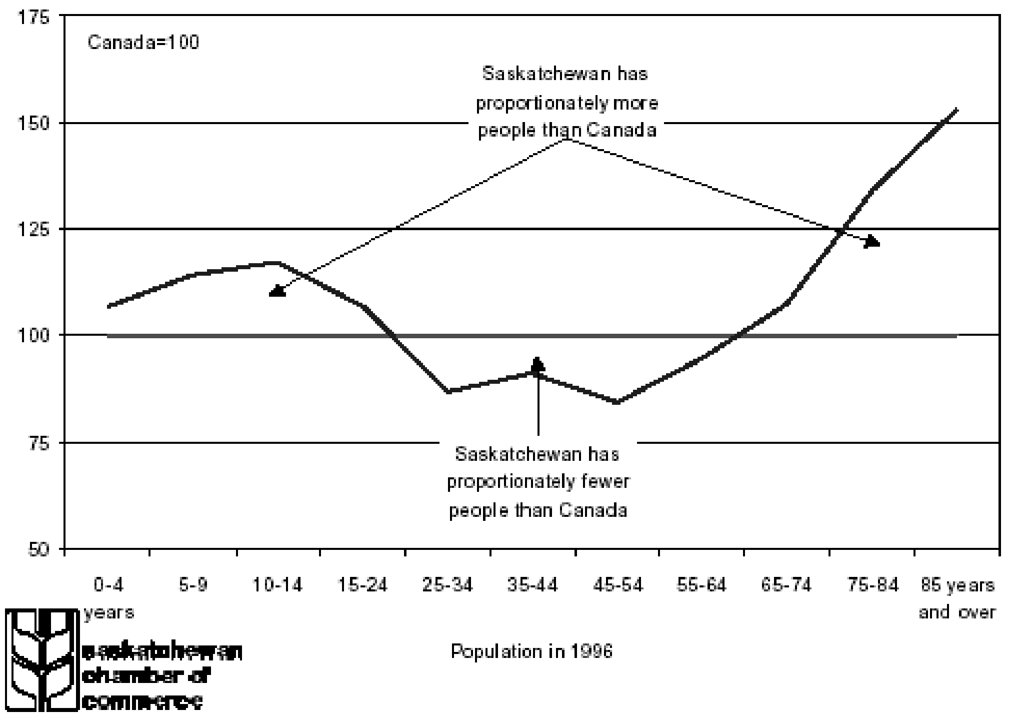
Another major issue facing Saskatchewan will be the severe demographic changes encountered in Saskatchewan over the next 10 years. From the end of World War II to the mid 1960's, the average Saskatchewan woman had over 3 children. Children born in this period are generally considered as the 'baby boom' generation. The first of the baby boomers are now in their early 50's; the last of them are in their late 30's.[9] Over the next ten years, the number of people aged 45 – 64 will increase as the population 35 – 44 declines in the wake – meaning the number of retirees will dramatically increase over this time period while reducing the amount of taxes collected by the government and reduced economic activity per resident. This Canadian demographic trend is magnified in Saskatchewan, as the demographic profile of the province is older than the Canadian average and there is a significant "hollowing out" of young people (18-35) and younger workers (25-45) due to exodus. Approximately 6000 people per year have been leaving Saskatchewan on average for the past 15 years. Those leaving are largely in the younger demographic age profile

[9] Statistics from Stats Can – website www.statscan.ca

thereby aggravating the “hollowing out” phenomenon. Presented below is an Action Saskatchewan (Saskatchewan Chamber of Commerce) graph to illustrate this point.

Population Age Groups, Canada and Saskatchewan

Saskatchewan’s Youth Exodus haunts the education community. Over 85,000 people left Saskatchewan since 1990. Over 80% of those leaving were between the ages of 15 and 29.



The hollowing out of the Saskatchewan population is the greatest threat to quality health care in Saskatchewan.

Saskatchewan’s Youth Exodus haunts the education community. Over 85,000 people left Saskatchewan since 1990. Over 80% of those leaving were between the ages of 15 and 29. Providing health care to a person over 70 is five times as costly as those between the ages of 1 and 49. For someone over 90 it is 14 times as costly as those between the ages of 1 and 49. The hollowing out of the Saskatchewan population is the greatest threat to quality health care in Saskatchewan.

Benefits of P3

Improved Infrastructure

With a public-private partnership there could be improved service quality, lower project costs, lesser risk, more rapid project execution, easier budget management, and provide sources of additional economic activity.

PPP's can significantly speed up infrastructure improvement as compared to the traditional public sector infrastructure with separate project (i.e., design and construction) phasing. Integrating the project phases into the PPP further allows optimization of design, material and construction costs, and operational considerations, often resulting in significantly lower procurement and life-cycle and operating costs. Furthermore, private sector companies owning or operating several systems in one region can centralize activities such as customer service, emergency repairs and billing to achieve improved service and cost savings. The need for more investment in public infrastructure coupled with strained financial resources is promoting a search for new ways to develop capital projects in the province. With a public-private partnership there could be improved service quality, lower project costs, lesser risk, more rapid project execution, easier budget management, and provide sources of additional economic activity. Productivity gains in non-state owned enterprises occur at a far greater rate than in state owned enterprises. For example, in Alberta where there are multiple suppliers of electricity, the market has benefited from declining rates over the past two years (See Appendix C). Productivity enhancement is fundamental to improving the standard of living for citizens.

Through PPP's, delayed bridges, highway improvements, water and sewer projects, and aging electrical transmission could be rectified. For example, the bridge that spans the North Saskatchewan River between Battleford and North

Productivity gains in non-state owned enterprises occur at a far greater rate than in state owned enterprises.

Battleford and supports regional economic and social development could have been a capital project that was completed with fewer costs in a more reasonable time frame. As well, public buildings, such as schools and universities, could provide services and be upgraded. For example, the collapsed roof of the University of Saskatchewan Gymnasium might have been dealt with earlier and the outdated life science and laboratory facilities in Saskatchewan could be updated in a more timely fashion.

“Without basic infrastructure, we could lose some of the success stories in the province,” stated one business owner in a newspaper article.

Operating in rural Saskatchewan, while competing in an international market, has been challenging for growing businesses. For example, rural based manufacturers face many challenges operating their businesses. It is hard to retain a sufficient supply of labour as it is not easy to attract new people to a rural job. More rapid infrastructure enhancement could partially address this situation. Infrastructure has also been an ongoing challenge as cellphone coverage, high-speed Internet access, poorly maintained roads, and poor water and sanitary systems have been a significant barrier in some areas. “Without basic infrastructure, we could lose some of the success stories in the province,” stated one business owner in a newspaper article entitled “*Infrastructure to support rural industrial firms lacking.*”[10]

[10] Hursh, Kevin. “*Infrastructure to support rural industrial firms lacking*.” Saskatoon Star Phoenix, September 1, 2004.

Arresting Youth Exodus

Youth Exodus is directly attributable to slow job growth, which in turn is the result of the limited new business investment needed to spur job creation.

Youth Exodus negatively impacts all Saskatchewan residents by eroding its tax base. This compounds the older demographic profile of Saskatchewan. The term 'Youth Exodus' refers to young people leaving Saskatchewan to pursue employment opportunities elsewhere. Youth Exodus is directly attributable to slow job growth, which in turn is the result of the limited new business investment needed to spur job creation. High taxes for business investment, regulatory overburden, and state owned competition underlie the lagging investment.[11] Insufficient job prospects are the exact opposite of what is needed to keep young people in Saskatchewan. With a high portion of young people leaving the province, and a retirement-age demographic population remaining, Saskatchewan's tax base risks becoming severely eroded.[12] As a result, Saskatchewan will be struggling to maintain, let alone create, public infrastructure funded from a depleting tax base. Our province must therefore identify, pursue and secure many new opportunities, such as public-private partnerships, to maximize investment activity in order to stop and reverse youth out-migration.

With a high portion of young people leaving the province, and a retirement-age demographic population remaining, Saskatchewan's tax base risks becoming severely eroded.

Risk Transfer

Interest rate risk, technology risk, liability risk, and environmental compliance risk.

[11] "Saskatchewan Check Up." Chartered Accountants of Saskatchewan. 2004.
[12] "Investment Attraction, Growth Stimulation, and Job Creation Through Effective Labour Legislation." Saskatoon & District Chamber of Commerce, 2002.

Reduced risk for government finance is a compelling reason to pursue P3.

Another dimension to the benefit of P3 approaches is to reduce contingent risks to government through partial risk transference. These contingent risks include: interest rate risk on debt, unfunded pension liability, technology, building obsolescence, regulatory compliance, and environmental compliance. To elaborate on one of these risks the paper will examine interest rate risk. Interest rates in Canada are currently (2004) at historically low levels. The General Revenue Fund in Saskatchewan has seen a decline in interest costs over the past number of years from $700 million to $800 million per year in the mid 1990's to approximately $600 million in 2004. Should interest risk rise, the growing interest expense will be funded through increased taxes, service cutbacks, deficit financing, or delayed infrastructure development. By engaging in Public Private Partnership activities, the governments in Saskatchewan could pay down debt, thereby reducing its significant interest rate risk. Reduced risk for government finance is a compelling reason to pursue P3.

Opportunities for P3's In Saskatchewan

SaskTel Communications is a sole provider of "land line" telecommunications in Saskatchewan. This paper will use this company as a model for entering into one kind of Public-Private Partnership that would be beneficial to taxpayers, the Saskatchewan provincial government and SaskTel employees. This example is used because a similar comparative directly is available for illustration (Bell Nordiq). SaskTel's primary capital asset, its land based phone lines, would be the asset of focus in a P3 in this example because of its clearly defined revenue generating capabilities. According to SaskTel's 2002 annual report, the net book value of their plant and equipment, which would include the value of their phone lines, is approximately $609 million dollars, and the net present value for SaskTel phone lines is estimated to be between $2-5 billion dollars. The net present value of these assets may be eroding much more quickly than identified simply because of evolving technology and emerging competition. (See Technology Risk)

Less capital invested can potentially reduce SaskTel's overall risk and therefore increase SaskTel's risk adjusted rate of return on employed capital.

In choosing the most beneficial transaction to create a P3 for SaskTel's phone lines, a sale/leaseback transaction and creating an Income Trust Fund will be considered as the example. A sale/leaseback transaction entails the sale of the phone lines to investors through a Trust vehicle and SaskTel leasing the use of the phone lines back from the investors.[13] This approach results in revenue from the sale of phone lines, which could, for example, be used to pay down debt in the General Revenue Fund. This paydown results in lowered interest rate and reduced technology risks being born by the province as these risks are transferred to the Trust Unit investors. When looking solely at the impact of a sale/leaseback transaction for the phone lines, this type of transaction would also result in a reduction of the invested capital for SaskTel. SaskTel would also incur a lease expense, resulting in a lower net income. However, SaskTel would have substantially less capital invested in physical assets at risk of technological change. With less capital invested, SaskTel's overall risk would

[13] Kieso. Weygandt, Warfield, Young, Wiecek. **Intermediate Accounting**, (7th Canadian Edition) John Wiley & Sons Canada, Vol. 1 and Vol. 2.

Income trusts function by holding business assets that generate operating income that then flows directly to unit holders typically distributed monthly or quarterly.

be reduced. This would therefore increase SaskTel's risk adjusted rate of return on employed capital.

The creation from SaskTel's phone lines of the SaskTel Income Trust Fund would be based on the revenue generating capability of the phone lines. SaskTel was selected as the sample crown asset for conversion as there are market comparatives available such as Bell Nordiq. Income trusts have recently seen a surge in popularity in investor markets in Canada and around the world because of their relatively high yields (median 10.1 per cent), and their relatively lower risk as compared to growth stocks. Income trusts function by holding business assets that generate operating income that then flows directly to unit holders typically distributed monthly or quarterly. This periodic payment consists of a taxable and non-taxable portion, the latter representing a return of capital. Income trusts tend to have stable cash flows and distributions to unit holders; unlike a bond, there is no maturation date for income trusts. There are numerous types of income trusts including oil and gas, real estate, business, and utilities.[14]

Utility income trusts are a common and successful manner in which corporations raise capital to fund expansions or acquisitions. A market comparable is the Bell Nordiq Income fund listed on the Toronto Stock Exchange (BNQ.UN_T). Typically, resource income trusts, such as oil, tend to have higher yields than utility trusts, as resource income trusts are of higher risk

[14] Information from www.investcom.com

Investing in trust units is attractive to investors for two reasons. Firstly, trust units offer substantially higher yields seen in dividend distributions, and secondly, they have several tax advantages.

due to the finite life of the resource and their fluctuating commodity prices. Traditional utility trusts, tend to be asset intensive, comparatively low maintenance and offer stable cash flows. Consequently, utility trusts offer lower yields relative to other varieties of income trust funds for the investor. This lower yield results in a relatively higher cash receipt to the asset converter – in this case the government of Saskatchewan.

The examined income trust fund for SaskTel focuses solely on the conversion of the phone lines into a trust unit.[15] This is a key point to note, as the remaining SaskTel Corporation would remain a state owned enterprise, and continue to function in its current fashion with Head Office and administrative functions staying in Saskatchewan. The SaskTel Phone Line Income Trust Fund would be managed and overseen by SaskTel Corporation, but would report to the Trust's Board of Directors who in turn would be accountable to the Trust Unit holders.

Investing in trust units is attractive to investors for two reasons. Firstly, trust units offer substantially higher yields through distributions, and secondly, they have several tax advantages. Tax benefits for asset-intensive trusts include a deduction for capital cost allowance (return of capital). The trust units may be held to compound tax free in a sheltered RRSP, RIF, or DPSP plan.[16] In the future these assets will be exposed to tax at the personal level upon withdrawal

[15] Information from www.investcom.com
[16] "Introduction to Federal Income Tax in Canada." 2003-2004. Chapter 5 and 9.

from the tax vehicle. Due to the asset-intensive nature of the trust and depreciation of these assets, there would be a tax impact for the trust investor at the point of selling the trust units. The recapture on the capital cost allowance resulting from amounts deducted during the holding period of the income trust unit would be subject to taxation in the hands of the trust unitholder. In the case of a state owned asset (such as SaskTel), the tax impact to the seller (the province of Saskatchewan) regarding the sale of the asset to the trust is slightly positive. Future tax revenues for the province would be enhanced as individuals owning the assets will be exposed to income tax on their investment returns. Investors may also face capital gains tax exposure and capital cost recovery at a future liquidation of the trust unit. All of theses investment returns are taxable at the personal level. While SaskTel was chosen as the example in this report, there are many provincial government owned assets that would be well suited for consideration. Examples include: electricity generation, electricity distribution, gas distribution, government buildings, liquor distribution, gaming operations, property and liability insurance, and land title operations.

Future tax revenues for the province would be enhanced as individuals owning the assets will be exposed to income tax on their investment returns.

P3s and Health

Public-private partnerships are also an attractive alternative for improving the ailing Health system in Canada. Over recent years, the cost of the Canadian Health system has substantially increased, thus placing a considerable financial strain on both the federal and provincial governments, as well on Canadian citizens who continue to suffer while on lengthy waiting lists (Saskatchewan

A public-private partnership in Medicare is a relatively new solution that could alleviate this financial burden on both the federal and provincial governments, while reducing waiting times for service.

has the longest waiting lists in Canada).[17] Bringing the matter of a strained Health system to light has been done by numerous reports and commissions such as Kirby and Romanow commissions nationally. These reports contain suggestions on how to improve the quality of healthcare in Canada. Regardless of the outcomes of any of these commissions, healthcare is a costly public service. These costs increase each year at a rate higher than the economic growth of the province. The budget for healthcare in Saskatchewan is now over $2.5 billion in 2003/2004 and grows by approximately 6 per cent each year.[18] The financial strain on both the Federal and Provincial governments as well as the taxpayers is enormous. With a population base aging relatively faster than most of Canada, Saskatchewan will face even greater challenges to fund health care in the future than much of the rest of Canada.

Freed up funds could also be directed to prevention initiatives to reduce the burden on the health system.

Both provincial and federal governments and healthcare professionals are now trying to work to improve the Health system in Canada while remaining within the confines of the Canada Health Act and maintaining a high standard of care for patients. A public-private partnership in Medicare is a relatively new solution that could alleviate this financial burden on both the federal and provincial governments, while reducing waiting times for service. Improving working conditions through upgrading equipment and facilities for health workers could also be an outcome making it easier to retain and attract health workers. To clarify, the public-private partnership contemplated for healthcare

[17] "Waiting Your Turn, Hospital Waiting Lists in Canada (14th Edition)." Fraser Institute, October 2004 – See www.fraserinstitute.ca
[18] Saskatchewan Provincial Budget, 2003/04.

A P3 also assists in creating a better economy in the community in terms of new direct and indirect employment opportunities, better working environments for healthcare employees, and a higher quality of service delivered to the users.

services relates to healthcare facilities, and/or equipment, but not to the services themselves. Simply, rather than owning, financing the construction, and maintaining the facilities, the provincial government would lease the healthcare facilities, and/or equipment. [19] This partnership saves the government millions of dollars by not being responsible for the cost of administration of construction and the maintenance of the healthcare facilities or the purchase, maintenance and disposal of costly medical equipment.[20] Rather, the money retained by the government could be redirected to fund other areas of public service, such as hiring more healthcare professionals, including doctors, nurses, and specialists, or increasing the funding for medical research. Freed up funds could also be directed to prevention initiatives to reduce the burden on the health system. A P3 also assists in creating a better economy in the community in terms of new direct and indirect employment opportunities, better working environments for healthcare employees, and a higher quality of service delivered to the users of the P3 hospital. By pursuing this option the provincial government would also be reducing technological and obsolescence risk for equipment in the rapidly evolving field of health technology.

P3s in Britain have revived its healthcare system and have made public money invested go further.[21] Today, P3's account for about 11 per cent of investment in public services in Britain. This policy approach has resulted in thousands of

[19] Poschmann, Finn. "Private Means to Public Ends: The Futures of Public-Private Partnerships." C.D. Howe Institute, Commentary. No. 183, June 2003.
[20] Canadian Council for Public-Private Partnerships – website at www.pppcouncil.ca
[21] Hutton, John. "PPPs revive British health care system." Reprinted from the Financial Post, November 25, 2003.

Public-private partnerships saved the British healthcare system by shortening long wait times for patients, replacing outdated healthcare buildings, replacing outdated equipment, improving working conditions, and reversing the trend of declining capacity in available health services.

new jobs in construction and related industries, while improving health services, shortening waiting lists, and maintaining economic growth. Public-private partnerships saved the British healthcare system by shortening long wait times for patients, replacing outdated healthcare buildings, replacing outdated equipment, improving working conditions, and reversing the trend of declining capacity in available health services. Several years ago, the concept of P3s working with the public sector was ridiculed by critics in the United Kingdom who claimed that such a concept would never work within a public healthcare system. Conversely, since P3s have been implemented within the British National Health Services (NHS), more patients can be seen more quickly, as waiting times for treatment are falling. By 2010, 40 per cent of British hospital real estate will be less than 15 years old. For the first time in over 50 years, patients and staff will be able to work and be treated in modern, purpose built facilities that have been tailored to the modern needs of healthcare professionals. In the United Kingdom, overall capacity for acute care has recently increased after 30 years of decline. The new contract in the British National Health Service has committed itself to improving primary care, which is most commonly used by patients. Currently in Britain, most primary care facilities are inappropriate for the delivery of modern medicine, and one quarter of these facilities are over 25 years old. P3s will modernize these facilities. The new initiative involves P3s includes establishing a long-term trust fund while improving primary care services.[22]

[22] Hutton, John. "PPPs revive British health care system." Reprinted from the Financial Post, November 25, 2003.

Several years ago, the concept of P3s working with the public sector was ridiculed by critics in the United Kingdom who claimed that such a concept would never work within a public healthcare system.

Canada has also successfully implemented P3s in the healthcare industry in Ontario and British Columbia. For example, the Royal Ottawa Hospital (ROH) secured a public-private partnership in the construction, operation, and maintenance of the ROH hospital. This innovative partnership saved the hospital and taxpayers over $6 million dollars, built the facility faster, and saved 4 per cent on annual operating costs. To manage the project on behalf of the hospital, a diverse P3 team was appointed to oversee the construction, maintenance, and operation of the hospital. The P3 team is also the liaison between all unionized and non-unionized staff to listen, and communicate issues that arose during the various stages of construction, operation, and maintenance of the hospital.[23]

Canada has also successfully implemented P3s in the healthcare industry in Ontario and British Columbia.

It is important to emphasize that the ROH, although designed, built, and maintained by a private-sector partner, is still a public hospital, available free of charge to all citizens and fully complies with the Canada Health Act. The actual funding to operate the hospital is still provided by the government, annually, in exactly the same manner, as it would be for a non-P3 hospital.

The Minister of Health Services for British Columbia, recently stated that the British Columbia provincial government is fully committed to public-private partnerships. They have created ‘Partnerships B.C.’ to promote P3s to the private sector. Partnerships BC was created in 2002 and is owned by the BC

[23] Information from www.royalottawahospital.com

provincial government. The mandate for this company is to promote, stimulate and help implement P3 projects by working with and supporting public agencies as they develop partnerships with non-government. Non-government partners are chosen through a fair and competitive bidding process. The interested non-government party is invited to submit proposals containing details on how they will meet service delivery needs. They are evaluated to ensure they deliver value for money for taxpayers and protect the public. Minister Hansen also identified a number of applications for P3s to the healthcare sector. Issues identified in British Columbia regarding challenges facing the provincial government are very analogous to those issues facing the Saskatchewan provincial government such as ever-increasing costs the health budget faces for Acute Care services, being unable to invest in high-tech innovations in health care, and long wait times. Healthcare P3 projects underway in British Columbia include the Academic Ambulatory Care Centre, to be built on the Vancouver General Hospital site and the Abbotsford hospital and cancer centre. This organization has made considerable headway with P3s in other sectors as well, including water treatment, education, and various areas of transportation. Partnerships BC is a model for other provinces in what can be accomplished when the public and private agencies come together.[24]

[24] *Information Bulletin*. Partnerships British Columbia. July 18, 2003.

Given the political history of the province of Saskatchewan, educating Saskatchewan citizens that believe in government ownership of the means of production about the benefits of a P3 may seem like a daunting, lengthy task. However, if the P3 meets the following criteria, the efforts embodied in the task are substantially lessened. The criteria are recommended as derived from those involved in past P3 where the cooperation of a staff team is required. The criteria generally required are:

- Job security
- Protection of conditions i.e. pensions, holidays
- Equal conditions for existing and new employees so wages and benefits are not unbalanced
- Good governance – where everyone is treated openly, honestly, and on board - Partnerships UK (www.partnershipsuk.org.uk)

The Romanow Commission, which was released in late November of 2002, specifically outlined that P3's would likely result in costing more to the taxpayers in the long run compared to the government constructing, maintaining, and operating the hospital itself from the project's inception. However, the Romanow commission did not recommend against P3's, and explicitly states that ancillary medical services such as laundry or food preparation are appropriate services to be delivered by the private sector.
- Romanow Commission

There is little to suggest in the Romanow Report that the identified opinion of higher cost was based on anything other than speculation by the commission.

Pursuit of different alternatives such as P3 or Crown Asset conversion to Trust Units may yield significant new opportunities for:

1. The development of the relatively immature capital markets of Saskatchewan.
2. Reduced exposure to interest rate risk exposure for the Government of Saskatchewan’s $12 billion in debt, not including the Province’s unfunded pension liability.
3. New non-government sources of capital to deal with technology upgrade or environmental law compliance thereby reducing these risks to the citizens of Saskatchewan.
4. Signals to all sides of the political spectrum that new ideas can be embraced in Saskatchewan.
5. Potential new tax revenues to various levels of government as the result of Trust Unit holders taxable returns and potential future capital gains.
6. Reduced exposure to other risk factors such as technological, environmental, or regulatory risk.

From this analysis, it can be seen that:

1. Changes in Financial structure in Saskatchewan need not lead to the loss of local jobs or taxes.
2. Risks born by the taxpayers can be reduced.
3. Improved services, facilities, and infrastructure can occur more quickly than would otherwise be the case.

4. These improvements would assist the province in improving its youth retention performance.
5. The standard of living of Saskatchewan citizens could be enhanced through accelerated productivity gains.

Recommendation:

That the Province of Saskatchewan embrace alternative means to provide public services and consider alternate ownership structures for state owned enterprises that could reduce risk while retaining operating control over assets.

Other Sources

Confederation Bridge, New Brunswick/PEI

Legislative Assembly, Iqluit, Nunavut

Skyreach Place, Kelowna BC

Central North Correctional Centre, Penetanguishine, ONT

Highway 407, Toronto, ONT

John Labatt Centre, London ONT

Highway 104, Nova Scotia

Water Treatment Facility, Moncton NB

Teranet, Toronto ONT

Bay of Fundy Ferry Services, Atlantic Canada

Five Corners Project, Chilliwack, BC

Collicutt Centre, Red Deer AB

Websites:

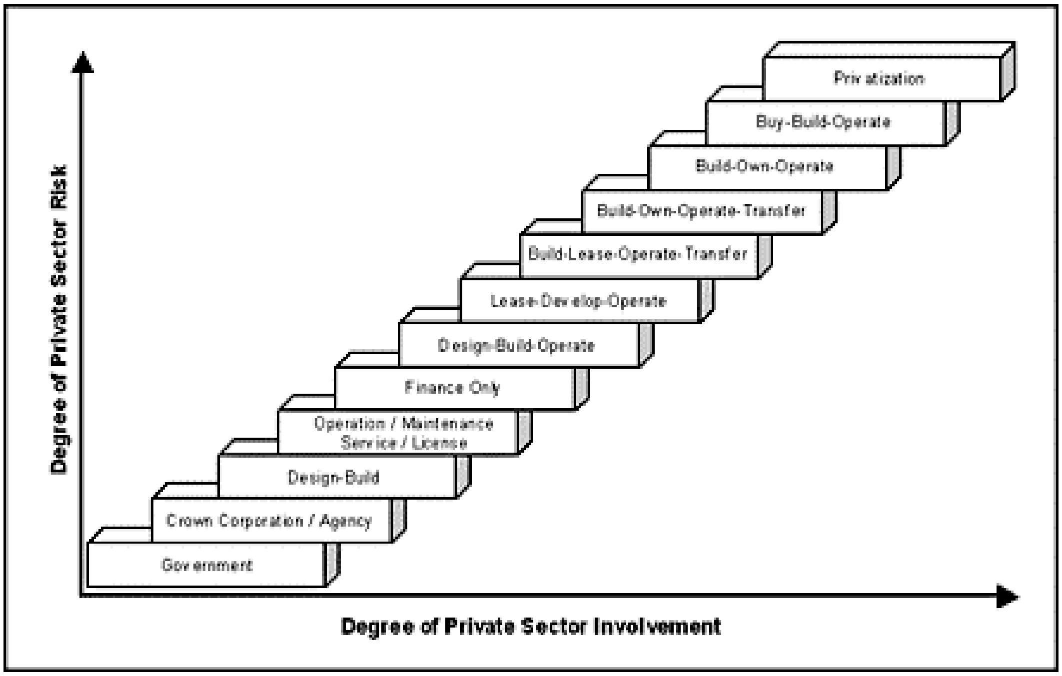
www.partnershipsuk.org.uk

www.partnerships.vic.gov.au

www.ppp.gov.ie

www.pppcouncil.ca

Appendix A



Privatization
Buy-Build-Operate
Build-Own-Operate
Build-Own-Operate-Transfer
Build-Lease-Operate-Transfer
Lease-Develop-Operate
Design-Build-Operate
Finance Only
Operation / Maintenance Service / License
Design-Build
Crown Corporation / Agency
Government
Degree of Private Sector Risk
Degree of Private Sector Involvement

Appendix B
EXAMPLE OFFERING

Offering: 200,000,000 units of the Fund
Price: $10.00 per Unit, payable at closing date

Use of Proceeds:
The gross proceeds of the Fund will be used to acquire certain assets from SaskTel Corp.

Retained Interest: SaskTel – 5%

Distribution Policy of the Fund:
The Fund intends to distribute all of its distributable cash to the maximum extent possible to Unitholders by equal monthly cash distributions. The distributable cash of the Fund will be comprised of all cash received from its indirect interest in the Company less administrative expenses and other obligations of the Fund and amounts which may be paid by the Fund in connection with any cash redemptions or repurchases of Units and reasonable reserved established by the Trustees, which reserves are currently expected to be nominal.

Distribution Policy of the Trust:
The distributable cash of the Trust will be derived primarily from the performance of SaskTel Corporation. The Trust intends to make monthly distributions to holders of Trust Units of its distributable cash after satisfaction of any administrative expenses.

Risk Factors:
An investment in Units is subject to a number of risk factors. The risks associated with the Company's business include the execution by the Company of its growth and development strategy, the Company's dependence of key personnel, technology advances in the telecommunications industry, commoditiy price and supply, laws governing labour and employment, potential litigation, class actions and other complaints, environmental liability and risks, shortage of labour, employee strike, employee benefit costs and other risks.

Cash distributions are not guaranteed and, subject to required regulatory approvals, the Fund may in certain circumstances distribute to Unitholders additional units in lieu of cash distributions on account of income.

Tax Considerations:
Each Unitholder will be required to include in computing income for Canadian tax purposes for a particular taxation year the Unitholder's *pro rata* share of the Fund's income that was paid or payable in that year by the Fund to the Unitholder and that was deducted by the Fund in computing its income. Generally all other amounts received by Unitholders will not be included in income, but will reduce the adjusted cost base of the Unitholder's Units, for Canadian income tax purposes. No amount should be reported on a Unitholder's individual income tax return in respect to trust units held in a Registered Retirement Savings Plan, Registered Retirement Income Fund, or a Deferred Profit Sharing Plan.

Appendix C

Publication: Edmonton Journal; Date:2004 Sep 28; Section:Business; Page Number: F1

ActivePaper

HOT NEWS HEADING INTO WINTER

Power deregulation poised to pay off

Lower electricity prices on the way, power producers promise

GORDON JAREMKO Journal Business Writer

EDMONTON

Consumers can count on electricity prices to stay steady or even drop because provincial deregulation policy is at last generating benefits, the Independent Power Producers Society of Alberta said Monday. "It's a buyer's market right now, " IPPSA chairman Bob Williams said. "There's a definite downward pressure on price, " agreed Evan Bahry, the society 's executive director.

At the wholesale level, the supplier group expects the Alberta cost of electricity to average about $53 per megawatt hour this year —down16per cent from $63 in 2003, and 25 per cent less than the 2001 peak of $71.

The market shows the trend will continue. Big industrial and commercial consumers can currently buy ahead for 2005, '06 and '07 at prices averaging in the range of $43 -to-$50-per-megawatt hour in the Alberta Power Pool.

A technical review will be released soon that proves Alberta's power deregulationpolicy is reachinga turningpoint for the better, Williams and Bahry told TheJournal' s editorial board. The study — done for IPPSA by Tabors Caramanis & Associates, a Massachusetts-based international engineering and economics consulting firm — paints a flattering portrait of the provincial experiment in a free market for electricity.

"A remarkable transformation has been achieved within a relatively short period of time," the report concludes after reviewing deregulation since its onset in the late 1990s.

"Alberta's customers would not have been better off under continued regulation, and indeed are poised to reap the benefits of lower prices as early as 2004 or 2005. "

At the same time as surcharges to cover transition costs are coming off consumers' power bills, a healthy electricity surplus is at hand thanks to generating projects encouraged by deregulation, Williams and Bahry said.

Since 1999, the provincial grid's capacity jumped 3,300 megawatts or about 40 per cent to11,800 MW.The Alberta surge also accounted for 40 per cent of total Canadian power station construction since 1999, IPPSA estimates.

Maximum generating capacity tops the province' s estimated 2004 average consumption of 7,000 MW by nearly 70 per cent.

Power station construction shows strong signs of continuing despite the surplus because oilsands projects include electricity generators built with excess capacity to sellintotheprovincial grid, Bahry said.

A dozen "co -generation" plants, makingheat andelectricity for oilsands complexes, account for about one-third of the capacity added to the Alberta power grid since the onset of deregulation, IPPSA estimates.

A recent survey of oilsands developers by a Fort McMurray regional planning agency found theyplan tobuild15more co -generation plants by 2013. Additional surplus power available for sale outside the oilsands region will be up to1,343 megawatts, the surveyshowed.

The next big step for power deregulation willbeencouragingconstructionof new transmission lines to make the added generating capacity available across Alberta and eventually make the provinceanexporter ofelectricity,Bahry and Williams said.

A $99-million line that Atco Electric completed in August to relay 250 megawatts from Fort McMurray to the Edmonton region was the first significant improvement of the Alberta transmission grid in 17 years.

The next transmission project, a new power line between Edmonton and Calgary to serve the provincial electricity market, is under review by the Alberta Energy and Utilities Board. The project remains in a preliminary stage.