CAPITAL PROCUREMENT POLICY GUIDELINES

Treasury Board
The Province of British Columbia
September 1999

Capital Procurement Policy Guidelines

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CAPITAL PROCUREMENT POLICY GUIDELINES

Executive Summary

- Treasury Board has authorized the issuance of Capital Procurement Policy Guidelines to assist agencies of the provincial government and interested parties in the private sector in the planning, assessment and approval of traditional and alternative methods for procurement of capital assets. They replace the previous Definitions and Guidelines for Alternative Financing Proposals with a broader focus on procurement of capital assets as opposed to only financing.

- These guidelines apply to government ministries, taxpayer-supported Crown corporations and agencies and the recipients of prepaid capital advances.

- The challenges posed by the Fiscal Planning Framework present opportunities for employing alternative methods of procurement and greater involvement of the private sector in projects traditionally undertaken by the public sector.

- These guidelines have been structured to: (a) encourage the use of the most economic procurement methods; (b) delineate the evaluation principles for alternative procurement methods; (c) outline the approval process; and (d) define and classify the debt component of capital projects.

- Project sponsors are required to consider innovative alternatives and, to the extent possible, employ methods which minimize the impact on taxpayer-supported debt. Nevertheless, the primary objectives of capital procurement, to minimize the risk-adjusted lifecycle cost of projects and safeguard the public interest, remain paramount.

- The traditional “buy and borrow” method of procurement involves direct ownership of the asset, financing with taxpayer-supported debt and assumption of all the risks over the asset’s life (e.g. construction, ownership, financing, operations and management).

- Alternative procurement involves any combination of acquisition of capital assets by ways other than direct purchase, financing without recourse to the province and transference of all or some of the projects’ lifecycle risks to outside parties.

- The significant benefits of alternative procurement methods include reduction of lifecycle project costs, mitigation and transfer of project risks, protection of the province’s credit rating and timely delivery of infrastructure.

- Alternative procurement methods can take multiple forms with various implications for accounting and debt reporting purposes. The basic forms presented include:

- ♦ Public Private Partnership (P3) which is a venture between the public and private sectors, built upon the expertise of each partner, in order to meet defined public needs through the appropriate allocation of resources, responsibilities, risks and rewards;

- ♦ Joint venture which is a partnership agreement in order to finance and share the risks, responsibilities and rewards of a specific project at predetermined proportions. The joint venture may be structured as a P3 or among public sector bodies without private sector involvement;

- ♦ Capital and operating leases are means of acquiring the economic use of an asset for a stated period of time. In an operating lease the lessor retains substantially all the risks and benefits incident to ownership of the property. A capital lease transfers substantially all the risks and benefits of ownership to the lessee;

- ♦ Self-supporting projects which rely on user fees or other non taxpayer-supported revenues to recover debt service payments, operating and capital maintenance costs (e.g. ancilliary services for post secondary institutions);

- ♦ Projects with internal paybacks which generate sufficient cost savings to fully cover the debt service payments without causing any increase to annual government grant or subsidy payments (e.g. energy efficiency projects for institutional buildings); and

- ♦ General purpose projects financed through non tax-supported sources by Non-Consolidated Institutions (schools, universities, colleges and health care institutions) without any increase to annual government grant or subsidy payments (e.g. financing a university campus expansion from commercial revenues or endowment funds).

- ➢ The approval of alternative procurement proposals will be based on a positive comparison to the traditional "buy and borrow" method, supported by value for money, risk and other cost benefit analyses and consideration of other public policy issues.

- ➢ All major capital procurement proposals will be reviewed by the Capital Division of Treasury Board Staff for approval of the appropriate authority. A working committee will provide support and recommend opportunities for value added use of alternative procurement methods. Projects that do not fall within the current year's capital budget may be allowed to proceed only if they can be funded by self-supporting debt or off-credit financing.

- ➢ These guidelines classify the debt component of capital projects into three distinct categories. The classifications include (a) taxpayer-supported debt, representing general obligations of the government, (b) self-supporting debt, supported by non taxpayer-supported revenues, and (c) off-credit financing, with no impact on either the taxpayer-supported or self-supporting debt categories.

CAPITAL PROCUREMENT POLICY GUIDELINES

1. *Introduction:*

The Capital Procurement Policy Guidelines are intended to assist agencies of the provincial government and interested parties in the private sector in the planning, assessment and approval of traditional and alternative methods for procurement of capital assets and any related services. They replace the Definitions and Guidelines for Alternative Financing Proposals issued by Treasury Board in November 1995.

The purpose of the guidelines is fourfold:

(i) to encourage the use of procurement methods which minimize lifecycle project costs, advance the public interest, and minimize the impact on provincial taxpayer-supported debt;
(ii) to delineate the evaluation principles required by Treasury Board to determine the value added use of alternative procurement methods;
(iii) to outline the processes prescribed by Treasury Board for approval and implementation of procurement methods; and
(iv) to define and classify the debt component of capital projects for purposes of the government's Fiscal Planning Framework and reporting in the annual Debt Statistics Report.

2. *Application of Guidelines:*

The Capital Procurement Policy Guidelines apply to the following organizations (collectively referred to as "Entities"):

- government ministries;
- taxpayer-supported Crown corporations and agencies (including their subsidiaries and joint ventures) defined as "Government Organizations" for the purpose of public accounting policies and fully consolidated on the Summary Financial Statements of the province; and
- entities which receive prepaid capital advances from government; these currently include schools, post-secondary institutions, health care institutions and public transit agencies.

The guidelines do not apply to self-supporting Crown corporations and agencies as determined by Treasury Board's designate, the Office of the Comptroller General (OCG). These entities do not receive government subsidies and generate sufficient external revenues through the normal course of business to fully recover costs of capital, operations and capital maintenance (e.g. British Columbia Hydro and Power Authority). They are also subject to market forces and apply different commercial benchmarks in their capital investment decisions.

3. *Fiscal Planning Framework:*

The demand for infrastructure and other capital assets has been increasing at a rapid pace. Capital expenditures for maintaining the existing asset base, replacing aging infrastructure and meeting the needs of a modern economy with a growing and changing population have increased the public debt to unprecedented levels. In order to contain the growth of taxpayer-supported debt and protect the province's credit rating, the government has presented a five-year Fiscal Planning Framework in its 1999 budget for managing the government's financial performance and debt.

The Fiscal Planning Framework is designed to balance the substantial need for operating and capital expenditures with the need to keep taxpayer-supported debt affordable. By managing the projected level of debt as a percentage of gross domestic product (GDP) and the ratio of interest costs to revenues, the government ensures that the level of debt remains affordable.

The government recognizes that the traditional approach to providing infrastructure and services is not always optimal and is receptive to new and innovative forms of delivery. The challenges posed by the Fiscal Planning Framework require Entities to be innovative in their use of capital procurement. This presents opportunities for employing alternative methods of procurement and greater involvement of the private sector in the provision of projects and services traditionally provided by the government.

4. *Capital Procurement:*

(i) Objectives

The objectives of capital procurement are process-related and results-oriented. The two objectives are integrally connected.

The process of capital procurement requires project sponsors to assess the optimal structure respecting ownership, design, construction method, pricing, revenue source(s), operation, management and the form of financing. Decisions regarding each of these key elements combine to define the lifecycle cost of the project (the present value of all capital and operating cash outlays over the economic life of the project, after netting out its terminal value), sharing of risks (if any), public policy implications and the impact on provincial taxpayer-supported debt.

Project sponsors are required to consider innovative alternatives to traditional approaches and, to the extent possible, employ methods which minimize the impact on provincial taxpayer-supported debt.

When financing of capital assets or projects will add to taxpayer-supported debt, the primary objective of capital procurement is twofold:

4. ***Capital Procurement (Continued):***

(i) Objectives (continued)

(1) minimizing the risk-adjusted cost over the project's life. This is represented by the lowest combination of capital, operating and maintenance costs over the project's life and the optimal allocation of significant project risks among those public and private sector parties best positioned to assume and manage them (e.g. design and construction, management, operation, financing and ownership); and

(2) safeguarding the public interest which will be defined by the government as a result of the issues raised by the project under consideration (e.g. transference of control and certain risks to the private sector may add disproportionate and unacceptable costs to taxpayers or erode government control over important public policy).

Procurement of capital projects which achieve lowest lifecycle cost, advance the public interest and minimize taxpayer-supported debt require innovation and co-operation on the part of public and private sector participants.

(ii) Cost Containment Strategies

In January 1997, the government concluded a review of capital expenditures to improve the planning, construction and maintenance of capital projects. The review identified over 100 potential cost containment and efficiency measures falling into the following categories:

– developing program delivery models that require less capital;
– maximizing the use of existing facilities; and
– using innovative methods to acquire capital in the most efficient and cost-effective manner possible.

Examples of cost containment strategies, which have been pursued or implemented, are documented by the Capital Division of Treasury Board Staff (Capital Division) and published in the annual Debt Statistics Report. The Capital Division is available as a resource for advice on opportunities to employ cost containment strategies.

5. ***Traditional Procurement Method:***

Traditionally, Entities employ the "buy and borrow" method to acquire capital assets. The key attributes of the "buy and borrow" method are:

– direct purchase of the asset;
– financing the purchase with taxpayer-supported debt; and
– assumption of all the risks over the asset's life (e.g. ownership, design and construction, financing, management and operations).

5. *Traditional Procurement Method (Continued):*

Most Crown corporations and agencies finance their capital procurements through the Fiscal Agency Loan Program, under which the province borrows directly in the capital markets for the purpose of relending on matching terms. The Fiscal Agency Loan Program will generally provide the lowest cost financing because of the province's strong credit rating and its ability to borrow at lower interest rates. Entities may also finance capital asset purchases by borrowing directly with a government guarantee.

Schools, post secondary institutions, health care organizations and public transit agencies receive prepaid capital advances from government for much of their capital requirements with the related debt recorded as direct debt of government.

6. *Alternative Procurement Methods:*

(i) Definition

Alternative procurement in this guide refers to the acquisition and/or financing of capital assets (and any related services) by ways other than the traditional "buy and borrow" method. The key defining determinants of alternative procurement are any combination of the following:

- asset acquisition by means other than direct purchase;
- financing the acquisition by means other than fiscal agency loans or government guaranteed debt financing or pre-paid capital advances in the case of current recipients; and
- transference of some or all of the asset's lifecycle risks to parties outside of the provincial public sector.

Alternative procurement does not include the outright sale of public assets unless the terms of sale impose long term financial obligations on the seller (e.g. sale and leaseback or the sale of assets to a public-private sector joint venture).

(ii) Benefits

The potential benefits from the use of alternative procurement methods can be significant and include some of the following:

- reducing lifecycle project costs (e.g. innovative and cost-effective construction designs and methods);
- mitigation and transfer of projects risks including ownership, financing, design and construction, operation and management risks;
- reducing demand for taxpayer-supported financing and protection of the province's credit rating;
- delivery of more infrastructure sooner; and
- generating additional tax revenues.

6. *Alternative Procurement Methods (Continued):*

(iii) Basic Forms

Alternative procurement arrangements can take multiple forms, with various implications for financial accounting and debt reporting purposes. Project sponsors are advised to consult and obtain expert opinion (accountants, external auditors, OCG) with respect to the proper accounting treatment. Nevertheless, the selection of an appropriate form of alternative procurement method should be based on the economic and business merits of the project rather than its accounting treatment.

(a) Public Private Partnership (P3)

A P3 is a venture between the pubic and private sectors, built upon the expertise of each partner, in order to meet clearly defined public needs through the appropriate allocation of resources, responsibilities, risks and rewards.

More specifically, a P3 is a partnership between the public and private sectors for some combination of ownership, design, construction, financing, operation and/or maintenance of public projects. The partnership may rely on user fees or alternative sources of revenue to recover all or part of the related capital (debt servicing and return on equity if applicable), operation and capital maintenance costs.

A spectrum of partnership models exists depending on the level of public and private sector participation in risk sharing. In exchange for sharing project risks, the private partner expects to be compensated through any combination of construction contracts, user fees, government subsidies, service payments or concessionary rights. In order to participate in financing of the venture, the private partner would also expect a fair return on its investment.

Generally, P3s are most likely to be effective when a project exhibits some or all of the following characteristics:

– there is a potential for significant and cost-effective risk transfer to the private sector;
– there is a potential for government to assume or manage certain risks to facilitate private sector participation (e.g. rezoning a property);
– there is substantial scope for lowering lifecycle costs through innovation in design, construction, operation and/or use;
– there is an opportunity to generate project revenue from non taxpayer-supported sources sufficient to cover some or all of lifecycle costs;
– the P3 nature of the project is supported by the public; and
– there are successful P3 precedents for similar projects in other jurisdictions.

6. ***Alternative Procurement Methods (Continued):***

(a) Public Private Partnership (P3) (continued)

P3 partnership models range from low to extensive private sector participation. Some examples include:

- contracting for asset maintenance services;
- fixed-price design and build construction;
- build-own-transfer to the public sector (BOT);
- build-own-operate-transfer to the public sector (BOOT); and
- build-own-operate (BOO).

Interested parties should refer to the publication entitled “Best Practices Guide to Public-Private Partnerships” for guidance on ways to plan and implement P3s including business case development, Requests for Proposals, evaluation and selection of a proponent, negotiation and contract award, and project implementation. Copies of the publication are available from the Capital Division.

(b) Joint Ventures

A joint venture is a partnership whereby two or more parties enter into an agreement in order to finance and share the risks, responsibilities and rewards of a specific project at proportions set down in the joint venture agreement. The joint venture may be structured as a P3 or among public sector bodies without private sector involvement.

A joint venture project may be self-supporting, relying on user fees and other non taxpayer-supported revenues to recover its operating costs, debt service payments and return on equity. Furthermore, the joint venture may be funded through the province’s Fiscal Agency Loan Program (or government guaranteed debt) or non guaranteed financing with recourse limited only to the project and/or the joint venture partners.

Illustrative examples of joint ventures include:

- Brilliant Power Funding Corporation, a joint venture involving Columbia Power Corporation and Columbia Basin Trust for the acquisition of Brilliant Dam from Cominco Ltd. based on a long-term power supply contract with West Kootenay Power; and
- A non-share capital corporation wherein public and private sector entities contribute assets to form a not-for-profit organization, mandated to undertake a purpose of mutual interest and benefit. No single partner or member owns or holds a controlling interest in the corporation. As such non-share capital corporations are not included as Government Organizations in the province’s Summary Financial Statements.

6. *Alternative Procurement Methods (Continued):*

(c) Capital and Operating Leases

A lease is a means by which the public sector (lessee) can acquire the economic use of an asset for a stated period of time.

An operating lease is a lease in which the lessor retains substantially all the risks and benefits incident to ownership of the property. A lessee may be attracted to operating lease structures by the transfer of ownership risk to the lessor and the flexibility afforded by being able to walk away from the asset at the end of the lease term. For example, the lessee may be concerned about functional or technological obsolescence of the asset or that the asset may become surplus to future (and possibly uncertain) business needs.

A capital lease transfers substantially all the risks and benefits of ownership to the lessee. A capital lease is in essence an alternative method of debt financing for the acquisition of assets, which at the same time, provides a security interest in the property to the lessor.

A lease transaction is currently examined and accounted for in accordance with generally accepted accounting principles, as established by the Canadian Institute of Chartered Accountants (CICA).

According to CICA Accounting Recommendations (Section 3065), the risks and benefits of ownership are transferred to the lessee (and therefore classified as a capital lease) when, at the inception of the lease, one or more of the following conditions are present:

- the ownership of the asset is transferred to the lessee by the end of the lease term, or the lease provides for a bargain purchase option;
- the lease term represents a major portion of the economic life of the leased asset (usually 75% or more); and
- the present value of the lease payments represents a substantial portion of the fair market value of the property (90% or more).

It should be noted that the Public Sector Accounting Board (PSAB) has recently proposed guidelines which present additional criteria in determining whether substantially all the risks and benefits of ownership have been transferred to the public sector lessee, thereby resulting in a capital lease classification. These guidelines, which may be applied retroactively, consider the economic substance of the lease transaction, including government intent, use of the assets, financing elements, construction risk, operating risk, specialized nature of the asset, obsolescence, and other risks such as environmental liability. Lease transactions may be examined and accounted for in accordance with these guidelines pending their final approval by PSAB and adoption by Treasury Board.

6. ***Alternative Procurement Methods (Continued):***

(c) Capital and Operating Leases (continued)

Under both operating and capital lease agreements, the lessor has full recourse to the lessee in the event of default by the lessee under the lease agreement. The government may also guarantee the lessee's obligations under the lease agreement. Further, leases may be structured as a sale and leaseback of an existing asset, in which the seller would receive the purchase price of the asset at closing and agree to make lease payments over the term of the lease.

(d) Self Supporting Projects

Another form of alternative procurement is to structure projects as fully or partially self-supporting, relying on user fees or other non taxpayer-supported revenues to recover all or some debt servicing, operational and capital maintenance costs.

Self-supporting projects can be structured as P3s or without partnership components. Further, these projects may receive financing from the province's Fiscal Agency Loan Program (or government guaranteed debt) or non government guaranteed financing with recourse limited only to the project and/or the sponsoring Crown agency or institution.

Illustrative examples of these projects may include:

- ancilliary services for post-secondary institutions, e.g. student residences, parking lots; and
- transportation infrastructure for which user tolls are charged, e.g. bridges, roads.

(e) Projects with Internal Paybacks

A further form of alternative procurement is to structure projects which generate sufficient cost savings to fully pay for any associated operating and debt service costs (i.e. principal and interest) without causing any increase to the government's annual grant or subsidy payments.

These projects can be structured with or without P3 components and may receive financing from the province's Fiscal Agency Loan Program or non government guaranteed financing with recourse limited only to the project and/or project sponsors.

Illustrative examples of projects with internal paybacks may include:

- capital expenditure on energy efficiency projects for institutional buildings; and
- installation of a more efficient patient care system in a hospital.

6. ***Alternative Procurement Methods (Continued):***

(f) General Purpose Projects Supported by Non Tax-Supported Sources

Schools, post-secondary institutions and health care organizations (Non-Consolidated Institutions) may finance general purpose projects through non tax-supported sources provided that there is no increase to the entity's annual grant or subsidy payments from the government.

These projects can be structured with or without P3 components and may receive financing from the province's Fiscal Agency Loan Program or non government guaranteed financing with recourse limited only to the non tax-supported sources and/or the Non-Consolidated Institution.

An illustrative example of a project supported by non tax-supported sources may include:

– financing a university campus expansion from non tax-supported sources (e.g. endowment proceeds, commercial revenues).

7. ***Treasury Board Evaluation of Alternative Procurement Proposals:***

The assessment of alternative procurement proposals will be guided by a positive comparison to the traditional "buy and borrow" method with regard to risk-adjusted, lifecycle cost, the public interest and the impact on provincial taxpayer-supported debt. The Capital Division should be consulted regarding the appropriate comparative benchmarks to be used for each project.

Approval of alternative procurement proposals will be based on value for money analysis and other criteria which test for additional costs and benefits, and any public policy concerns.

(i) Value for Money

Project sponsors are required to provide value for money analysis and benchmark the results against the traditional "buy and borrow" method.

Value for money analysis is an evaluation technique which requires an assessment of all the project components to determine the best design, construction, management, financing and operation system for creating the most cost-effective method of delivering and operating the project.

Risk analysis is an integral part of value for money assessments. The objective is to identify and allocate all major risks, evaluate their expected impact on the project, mitigate their impact where possible or cost effective and determine whether risk transfer is optimal and appropriately reflected in the project costs.

7. *Treasury Board Evaluation of Alternative Procurement Proposals (Continued):*

(i) Value for Money (continued)

There are different methodologies for assessing risk including multiple account evaluation and cost-benefit analysis. The Capital Division should be consulted when choosing a method of risk assessment.

(ii) Other Evaluation Criteria

Alternative procurement proposals will also be assessed with regard to criteria which may not be explicitly factored into value for money analysis including:

- protection of the public interest and if required, evidence of public consultation;
- impact on taxpayer-supported debt;
- operating budget implications for government;
- net additions to the province's tax base;
- risk of transaction completion;
- value added use of open, transparent and competitive tendering processes;
- compliance with the spirit and intent of the Income Tax Act and provincial tax policy objectives; and
- compliance with applicable legislation and legal and liability considerations.

(iii) Self-Supporting Project Analysis

For self-supporting projects, approval will be based on comprehensive business plans, including operating and financial projections (cash flow, income statement and balance sheet) for a minimum period of five years and the cost impact on users. Project sponsors should also provide the projected rate of return on their equity participation (if any). The project analysis should demonstrate the economic feasibility and financial viability of the project on a self-supporting basis.

Given competing program demands, extending Fiscal Agency Loans to fund self-supporting projects may not always be the optimal use of the province's credit. Accordingly, sponsors of projects which are currently self-supporting or are projected to become so in the near future may be directed to obtain non government guaranteed financing (i.e. secured by the project and/or the sponsoring institution).

(iv) Analysis of Projects with Internal Payback

For projects with internal paybacks, approval will be based on satisfaction that the expected cost savings will be sufficient to fully pay the related operating and debt service costs (principal and interest) commencing at project completion and without any incremental increase in the government's annual grant or subsidy payments. Project sponsors will be required to work with the Capital Division on submission of a satisfactory business plan and financial projections to substantiate that expected savings are sufficient.

7. *Treasury Board Evaluation of Alternative Procurement Proposals (Continued):*

(iv) Analysis of Projects with Internal Payback (continued)

Given competing program demands for a limited capital budget, extending prepaid capital advances to Non-Consolidated Institutions to fund these projects may not always best advance the government's capital budget priorities, e.g. to the extent that doing so adds to taxpayer-supported debt it may preclude another highly-valued project (without the attributes of an internal payback) from proceeding in the current year. Accordingly, Non-Consolidated Institutions which sponsor these projects may be directed to finance with non-government guaranteed debt with recourse limited to the project and/or the sponsoring institution.

(v) Analysis of General Purpose Projects Supported by Non Tax-Supported Sources

For these projects, approval will be based on satisfaction that the non tax-supported sources will fully support the debt service payments without impacting the government's annual grant or subsidy payments to the Non-Consolidated Institution for the period during which the debt is outstanding. Project sponsors will be required to work with the Capital Division on submission of a satisfactory business plan including the historical performance of non tax-supported sources and financial projections to substantiate a sustaining source of funds which may be increased by the entity as required to fully pay debt service costs.

For similar reasons as noted directly above under Internal Payback Projects, Non-Consolidated Institutions may be directed to finance these projects with non-government guaranteed debt with recourse limited to the project and/or the sponsoring institution.

(vi) Leases

For operating and capital leases, the present value of lease and operating payments (discounted at the province's cost of funds), and adjusted for any impact on provincial tax revenues and assuming purchase option exercise (if any), should not exceed the comparable cost under the traditional "buy and borrow" method. Alternatively, the economic justification in favour of transferring ownership risk through lease transactions must provide sufficient benefits to offset the higher cost. The transaction costs, risks associated with transaction completion and indemnities typically required from the lessee will also be factored into the business case analysis.

8. ***Approval Process:***

Treasury Board requires that Entities adhere to the annual Budget/Estimates and Consolidated Capital Planning (CCP) processes. The Budget/Estimates process provides the overall appropriation authority for government programs including capital expenditures. The CCP is the mechanism by which the government identifies and priorizes its multi-year capital needs and approves capital projects by traditional or alternative procurement methods. Further information regarding the CCP process may be obtained from the Capital Division.

Project sponsors must forward all major capital procurement proposals which have not been previously approved by the appropriate authority to the Capital Division for review (where the estimated present value of acquisition cost exceeds $1.5 million or higher as may be agreed to by Treasury Board for specific Entities). The Capital Division will evaluate proposals with support from the Alternative Capital Procurement Committee, consisting of representatives from the Capital Division, Office of the Comptroller General and the Debt Management Branch of Provincial Treasury. This committee will review all alternative procurement proposals and recommend value added use of these methods where appropriate. The Capital Division will be responsible for co-ordinating and/or securing approval of the appropriate authority(ies) for major capital projects.

Projects that do not fall within the current year's capital budget may be allowed to proceed only if they can be funded by self-supporting debt or off-credit financing (as defined below).

The Debt Management Branch of Provincial Treasury, acting on behalf of the Minister of Finance and Corporate Relations as the province's fiscal agent, will assist sponsoring agencies in the structuring and implementation of financing arrangements. The branch will also lead and coordinate all enquiries and engagement of financial advisors, rating agencies and investors. Project sponsors are required to contact the branch before initiating enquiries of the financial community; the branch will consider alternative arrangements for Entities which have an ongoing requirement to work with the financial community on capital procurement matters.

9. ***Classification of Debt under the Fiscal Planning Framework:***

The Fiscal Planning Framework distinguishes between taxpayer-supported and non taxpayer-supported debt. The annual Debt Statistics Report classifies financings into these two debt categories.

This section of the guidelines reviews criteria applied by Treasury Board in classifying financings including those which fall into neither debt category (i.e. those which are off-credit). The criteria parallel those currently applied by one of the major U.S. credit rating agencies.

9. ***Classification of Debt under the Fiscal Planning Framework (Continued):***

(i) Taxpayer-Supported Debt

Taxpayer-Supported debt includes the direct debt of government, and the government-guaranteed and non-guaranteed debt of those taxpayer-supported Crown corporations and agencies which are fully consolidated on the province's Summary Financial Statements (i.e. excluding schools, universities, colleges and health care institutions). These entities receive government contributions to fully or partly cover their debt service, operational and/or capital maintenance costs.

Debt of subsidiaries or joint ventures of taxpayer-supported Crown corporations and agencies (in proportion to their interest) which receive subsidy payments, loans or guarantees from the parent entity is classified as taxpayer-supported. Government subsidies to these subsidiaries or joint ventures also result in their debt being classified as taxpayer-supported.

Debt of Non-Consolidated Institutions is generally classified as taxpayer-supported debt (notwithstanding accounting treatment). Exceptions to this general classification rule are noted in the next sections under Self-Supporting Debt and Off-Credit Financing.

The categories of taxpayer-supported debt currently include:

– **Direct debt** funds government operations and capital advances for education, health care and public transit infrastructure;

– **Fiscal agency and government guaranteed loans to social and government services Crown corporations and agencies** finance construction of justice facilities, and government and other accommodation requirements;

– **Fiscal agency and government guaranteed loans to economic development Crown corporations and agencies** finance ferry terminal and fleet expansions, certain public transit and highway construction projects;

– **Other fiscal agency loans** finance the construction and maintenance of post-secondary residences, parking facilities and other ancilliary services. These projects are supported by user fees which are not sufficient to fully recover all debt service requirements, operational and capital maintenance costs. Loans are also provided to local improvement districts to finance infrastructure;

– **Loan guarantees** to private sector firms and individuals are provided by the government through various programs. The government obligation is contingent upon default of the primary debtor; and

– **Non-guaranteed debt** incurred directly by a taxpayer-supported Crown corporation or agency (excluding Non-Consolidated Institutions).

9. ***Classification of Debt under the Fiscal Planning Framework (Continued):***

(ii) Self-Supporting Debt

There are two pre-conditions which must be met before the debt of either an entity or (in limited cases) a capital project could be considered for designation as self-supporting:

– user fees and/or other non taxpayer-supported revenue fully cover all debt service, operations and capital maintenance costs. At minimum, this requires positive net income (after deducting depreciation) and a debt service coverage ratio[1] of one-to-one ("Fully Self-supporting Performance"); and

– five-year financial projections show that Fully Self-Supporting Performance is sustainable. Treasury Board may further require that Fully Self-Supporting Performance to be achieved for as many as each of the three fiscal years prior to such designation.

Self-supporting debt includes the following categories:

– debt held by commercial Crown corporations, which do not receive grants or subsidies to pay debt service, operations and capital maintenance costs. The debt of British Columbia Hydro and Power Authority, Columbia Power Corporation, British Columbia Railway Company and Skeena Cellulose currently fall into this category;

– debt held by a self-supporting subsidiary or joint venture of a taxpayer-supported Crown corporation and agency, provided that the subsidiary or joint venture is treated on a modified equity basis on the statements of the parent Crown corporation;

– fiscal agency loans to and any other government guaranteed debt of Non-Consolidated Institutions for the purposes of financing self-supporting ancilliary service projects, e.g. student residences, parking lots[2]; and

– the warehouse borrowing program which takes advantage of capital market opportunities to borrow money in advance of the actual requirements of government or its Crown corporations and agencies. Proceeds from the borrowing are invested pending eventual off lending.

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[1] Calculated as a ratio of annual cash flow to annual principal, interest and lease payments.
[2] Non government guaranteed financing of these projects, with recourse limited only to the project and/or the sponsoring institution, is treated as off-credit because these entities are not consolidated on the province's financial statements.

9. ***Classification of Debt under the Fiscal Planning Framework (Continued):***

(iii) Off-Credit Financing

Off-credit financing does not appear in either the taxpayer-supported or self-supporting debt categories. Classification of financing as off-credit is not solely subject to the accounting rules and conventions for off-balance sheet treatment.

Examples of off-credit financing include the following categories:

– operating leases as designated by the auditor of the lessee (whether or not government-guaranteed);

– debt of internal paybacks projects sponsored by Non-Consolidated Institutions provided that:

  (a) the entities remain non-consolidated;
  (b) the debt recourse is limited to the project and/or the Non-Consolidated Institution;
  (c) there are no dedicated grants or subsidy payments from the government to the Non-Consolidated Institution for servicing the debt (i.e. principal and interest);
  (d) grants or subsidy payments from the government to the Non-Consolidated Institution are not incrementally augmented to accommodate debt servicing for the project; and
  (e) cost savings generated by the project fully cover debt servicing, starting on the completion date as evidenced by five-year financial projections and pro-forma statements;

– debt of self-supporting projects, sponsored by Non-Consolidated Institutions provided that:

  (a) the entity remains non-consolidated; and
  (b) the debt recourse is limited to the project and/or the Non-Consolidated Institutions; and

9. *Classification of Debt under the Fiscal Planning Framework (Continued):*

(iii) Off-Credit Financing (continued)

- debt of general purpose projects, sponsored by Non-Consolidated Institutions and the debt service costs of which are fully covered by non tax-supported sources provided that:

  (a) the entities remain non-consolidated;
  (b) the debt recourse is limited to the non tax-supported sources and/or the Non-Consolidated Institution;
  (c) there are no dedicated grants or subsidy payments from the government to the Non-Consolidated Institution for servicing the debt (i.e. principal and interest);
  (d) grants or subsidy payments from the government to the Non-Consolidated Institution are not incrementally augmented to accommodate debt servicing for the project; and
  (e) the historical performance of non tax-supported sources and five-year financial projections substantiate a sustaining source of funds which may be increased by the entity as required to fully pay debt service costs without impacting the government's annual capital or operating grant or subsidy payments for the period during which the debt is outstanding.

APPENDIX A

Impact of Financing Methods on Provincial Debt

	Taxpayer-supported	Self-supporting	Off-Credit
Direct debt of government for purposes of:			
• Operations	✔		
• Schools	✔		
• post-secondary education	✔		
• health care	✔		
• public transit[1]	✔		
Fiscal agency loans to:			
• Tax-Supported Entity[2]	✔		
• Tax-Supported Venture[3]	✔		
• Self-Supporting Venture[4]		✔	
• Non-Consolidated Institution for:			
– Self-Supporting Project[5]		✔	
– Internal Payback Project[6]	✔[10]		
– Projects Supported by Non Tax-Supported Sources[7]	✔		
– General Purpose[8]	✔[10]		
• Self-Supporting Entity[9]		✔	
Gov't Guaranteed Debt/Capital Lease of:			
• Tax-Supported Entity[2]	✔		
• Tax-Supported Venture[3]	✔		
• Self-Supporting Venture[4]		✔	
• Non-Consolidated Institution for:			
– Self-Supporting Project[5]		✔	
– Internal Payback Project[6]	✔		
– Projects Supported by Non Tax-Supported Sources[7]	✔		
– General Purpose[8]	✔		
• Self-Supporting Entity[9]		✔	
Non Gov't-Guaranteed Debt[11]/Capital Lease of:			
• Tax-Supported Entity[2]	✔		
• Tax-Supported Venture[3]	✔		
• Self-Supporting Venture[4]		✔	
• Non-Consolidated Institution for:			
– Self-Supporting Project[5]			✔
– Internal Payback Project[6]			✔
– Projects Supported by Non Tax-Supported Sources[7]			✔
– General Purpose[8]	✔		
• Self-Supporting Entity[9]		✔	
Operating Lease:			
• Government Guaranteed			✔
• Non-guaranteed			✔

[1] Excluding debt of British Columbia Transit Authority.
[2] Includes taxpayer-supported Crown corporations and agencies; excludes schools, universities, colleges and health care institutions.
[3] Includes subsidiaries and joint ventures of a Tax-Supported Entity.
[4] Includes subsidiaries and joint ventures of a Tax-Supported Entity which are treated on a modified equity basis on the statements of the parent.
[5] Includes self-supporting subsidiaries, joint ventures and capital projects of schools, universities, colleges and health care institutions.
[6] Includes qualified capital projects of schools, universities, colleges and health care institutions (see section 6(iii) (e) of Guidelines).
[7] Includes qualified projects of schools, universities, colleges and health care institutions (see section 6(iii) (f) of Guidelines)
[8] Includes all capital projects of schools, universities, colleges and health care institutions save for projects referenced under footnotes 5, 6 and 7.
[9] Includes self-supporting Crown corporations and agencies, their subsidiaries and joint ventures (e.g. B.C. Hydro).
[10] Treated as pre-paid capital advance and government direct debt.
[11] Debt recourse limited to the project and/or the Crown agency, school, university, college or health care institution.

APPENDIX B

Glossary of Terms

Acquisition: The process of obtaining goods and services to meet material needs by way of purchasing, leasing or contracting.

Alternative Procurement Method: Any non-traditional procurement method (refer to Traditional Procurement Method).

Appropriations: The authority granted by the Legislative Assembly to discharge money out of the Consolidated Revenue Fund.

Bargain Purchase Option: A provision allowing the lessee, at its option, to purchase the leased property at a price substantially lower than the expected fair value of the property.

Capital Assets: Tangible long-term fixed assets.

Capital Lease: A lease that, from the point of view of the lessee, transfers substantially all the risks and benefits incident to ownership of property to the lessee.

Commercial Crown Corporations: Provincial corporations which undertake business-like activities and generate sufficient revenues from the sale of services to pay their own operating and capital expenses including debt service charges.

Direct Debt: Funds borrowed directly by the government for financing of its operations, capital advances, refinancing of maturing debt and other financing transactions.

Economic Life: Estimated balance of useful life of property for the intended purpose.

Entity: Government ministries, taxpayer-supported Crown corporations and agencies and recipients of prepaid capital advances.

Fair Value: The amount of consideration in an arm's length transaction between willing and knowledgeable parties.

Fiscal Agency Loan Program: A program under which the provincial government borrows directly in the capital markets and re-lends the funds to Crown corporations and agencies, usually on matching terms.

Guaranteed Debt: Debt incurred by Entities, private sector firms and individuals with a provincial government guarantee as to the payment of principal and interest.

Lease: A conveyance by a lessor to the lessee of the right to use a tangible asset usually for a specified period of time in return for rent.

Lifecycle Cost: The aggregate present value of all capital and operating cash outlays over the economic life of the capital asset, after netting out the terminal value of the asset.

Modified Equity Basis: An accounting method which reports investments in commercial enterprises on a net equity basis (after deducting liabilities) on the books of the investing entity.

Non Consolidated Institutions: Schools, post secondary institutions and health care organizations which are excluded from consolidation on the Summary Financial Statements of the province.

Non Guaranteed Debt: Debt which is incurred by Entities without the guarantee of the provincial government.

Off-Credit Financing: Financing with no impact on taxpayer-supported or self-supporting debt classifications.

Operating Lease: A lease in which the lessor does not transfer substantially all the risks and benefits incident to ownership of property.

Prepaid Capital Advances: Funding provided to schools, universities, colleges, health care institutions, public transit agencies and any other organization designated by the Order of the Lieutenant Governor in Council for the acquisition of capital assets. Prepaid capital advances are amortized over the useful life of the asset funded.

Procurement: Acquisition.

Project: An undertaking of defined scope and structure intended to develop, maintain or acquire capital assets and/or related services.

Recourse: The right of recovery by the lender in the event of the borrower's default in payment of its obligations under a financing agreement.

Self-supporting Crown Corporations: Commercial Crown Corporations.

Self-supporting Debt: Debt of entities which generate sufficient revenues from external sources to cover their operating and capital expenses including debt service payments and may include self-supporting project debt of Non Consolidated Institutions (refer to Appendix A). It also includes the warehouse borrowing program.

Taxpayer-Supported Debt: Generally, debt incurred for government operations and capital purposes, and debt of Crown corporations and agencies which undertake capital projects that provide essential services to the province, but require an operating or debt service subsidy from the provincial government (for exceptions to this general definition refer to Appendix A).

Traditional Procurement Method: The "buy and borrow" method of acquiring capital assets by financing the purchase with taxpayer-supported debt and assuming all risks over the asset's life.

Warehouse Borrowing Program: A borrowing program under which the government borrows directly in the capital markets in advance of requirements in order to take advantage of financial market conditions.