Chapter 13
Fredericton - Moncton Highway

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Background

13.1 On 22 January 1998 the Province, through the New Brunswick Highway Corporation (NBHC), entered into agreements with a private sector consortium (the Maritime Road Development Corporation) and a not-for-profit company (the New Brunswick (F-M) Project Company Inc.) to develop, design, build, operate, maintain, rehabilitate, and finance a toll highway between Longs Creek and Moncton. The most recent Department of Finance estimate of the total capital costs of the project including construction financing is $864.8 million. These capital costs include the $584.4 million fixed price contract with the Maritime Road Development Corporation, $119.9 million in Crown construction costs, $143.8 million in net interest costs, and $16.7 million in other costs.

13.2 The highway will be an approximately 195 kilometre, four-lane toll highway designated as a controlled access highway pursuant to the provisions of the Highway Act. Thirty-one kilometres of four-lane highway and nine kilometres of two-lane highway have already been constructed by the New Brunswick Department of Transportation (DOT). An additional thirty-one kilometres of two and four-lane highway sections that will form part of the highway are currently under construction by DOT. Construction costs relating to these segments of the highway are being transferred to NBHC as incurred and sold to New Brunswick (F-M) Project Company Inc.(Project Co). A total of $119.9 million in DOT construction work will have been sold to Project Co by the date of full traffic availability (i.e. the date that the highway is open for end to end use).

13.3 The highway is being built on land provided by DOT and transferred to NBHC. NBHC will lease this land to Project Co for a concession fee. Project Co will own the entire 195 kilometre highway and other improvements to these lands, including segments of the highway constructed by DOT. Project Co will sub-lease the highway to NBHC. NBHC is responsible for making the sub-lease payments to Project Co using funding provided by the Province. Under these agreements NBHC will be required to make sub-lease payments of principal and interest totalling approximately $1.514 billion. This amount will be paid through 49 equal semi-annual payments of $30.9 million, starting 30 November 2003.

13.4 We feel it is important that we look at this project because of the large commitment of public money that was made by the Province. This chapter is intended to give an overview of significant details of the project. Over the coming years, we will be looking at important aspects of the project, particularly in respect to value-for-money issues.

13.5 The following is a brief chronology of events relating to the Fredericton-Moncton Highway project.

- The project was officially announced on 14 June 1996.
- “Request for Qualifications” (RFQ) for the project was issued on 18 December 1996. The RFQ was intended to provide the Province with the opportunity to determine whether interested parties had the qualifications to undertake the project. Eighteen parties registered to obtain the RFQ.
- Five RFQ submissions were received by the 23 January 1997 deadline.
- By 25 February 1997, three of the applicants had been put on a shortlist for further consideration.
- On 27 March 1997 a Request for Proposals (RFP) was issued to the three applicants on the short list. RFP submissions were to be broken into three sections, and a deadline was set for each section. All technical submissions were received by 23 July 1997. All quality management plans were received by 6 August 1997. All financial, legal, economic and industrial benefits submissions were received by 22 September 1997.
- Seventeen evaluation teams were set up to review submissions as they were received. Members of these teams included forty-five provincial employees, two federal employees, and twenty-seven individuals from consulting firms. Consultants involved included KPMG (process), RBC Dominion Securities (financial feasibility study), Delcan (engineering), Goodman Phillips & Vineberg (legal) among others. Additionally, twenty-four individuals were called in as expert resources on an as-needed basis. More than 18,000 person hours were spent evaluating RFP submissions in a restricted-access evaluation room.
- On 20 November 1997, the Cabinet selected bidder “B”, which was later disclosed to be the Maritime Road Development Corporation. Cabinet also authorized a negotiating team to finalize the project agreements with that organization.
- On 22 January 1998 final agreements were signed with the Maritime Road Development Corporation (MRDC). Terms of those agreements were announced publicly that day.

13.6 The projected date upon which the highway will be completed to the point of full traffic availability is 30 November 2001. There may be additional work to do after that date, but it is not expected to have any impact on the flow of traffic.

Scope

13.7 The objective of our review was to prepare an overview of the Fredericton-Moncton Highway project. The overview was to include information relating to the selection process, the organizations involved, the agreements, the toll rates, the financing arrangements, and provincial accounting for the highway project.

13.8 Our work consisted of meetings with representatives from the Department of Finance, the Department of Transportation, the Office of the Comptroller, and a private sector process consultant. We also reviewed the agreements and various other documents.

Results in brief

13.9 A toll highway will be built between Longs Creek and Moncton by the Maritime Road Development Corporation. It is scheduled to be available for end to end use by 30 November 2001.

13.10 The toll highway will be paid for and owned by New Brunswick (F-M) Project Company Inc. (Project Co). That company has issued long-term debt totalling $689.5 million to fund construction of the highway.

13.11 The land corridor on which the highway is built will be owned by the New Brunswick Highway Corporation and leased to Project Co for fifty years for a concession fee. During the first thirty years, the concession fee will be equal to toll and other revenues in excess of amounts needed to service the toll-based long-term debt issue. After year thirty, the concession fee will be $6 million per year in 1997 dollars.

13.12 The toll highway will be sub-leased from Project Co by NBHC for public use. NBHC will make forty-nine semi-annual sub-lease payments of $30.9 million starting 30 November 2003 under the highway sub-lease. These sub-lease payments will total approximately $1.514 billion and will be funded by the Province. Additionally, NBHC will be responsible for making operating and maintenance payments to Project Co over the first thirty years of the sub-lease. These payments will include $168.0 million (in 1997 dollars) in highway operating and maintenance payments over the first twenty years of the sub-lease and $39.2 million in tolling system operating and maintenance payments over the first ten years.

13.13 At the end of year thirty, and again at the end of year forty, NBHC will have the option of purchasing the toll highway from Project Co for fair market value. If NBHC does not exercise either of these options, it will purchase the highway for $1 at the end of year fifty.

13.14 We feel that the planned accounting treatment of the sub-lease had a major impact on the way in which the project was structured. The Province has accounted for the sub-lease agreement as an operating lease, which is in accordance with generally accepted accounting principles as defined by the Canadian Institute of Chartered Accountants. This allows the construction costs to be spread over the term of the lease. Had the sub-lease met the criteria for a capital lease, the full cost of construction would have been expensed when the sub-lease agreement was signed in the 1997-98 fiscal year. This would have had a significant impact on the Province's deficit or surplus over the near term, and also on the Province's compliance with its own balanced budget legislation.

Detailed findings

Selection process

13.15 The evaluation teams considered all aspects of the RFP submissions received from the three short-listed competitors. This included evaluating all technical submissions, all quality management submissions, and all submissions covering financial, legal, economic, and industrial benefits factors. The final decision was made by selecting the competitor who met all basic requirements and provided the Province with the lowest net cost. The Department of Finance also indicated that consideration was given to risk.

13.16 Exhibit 13.1 shows some of the key financial information that was evaluated in selecting the successful bidder.

13.17 Based on the RFP evaluations, MRDC (bidder "B" in the table) was selected. Reasons given for selecting that bidder included the following:

- Superior financial offer
  - lowest net cost to NBHC with consideration of risk
  - lowest guaranteed maximum price (construction)
  - excellent financing package
- Very strong financial capability
- Technically compliant
- Experienced developer/operator
- Best economic and industrial benefits package

Organizations involved

13.18 There are three main organizations that were party to one or more of the agreements for the Fredericton-Moncton Highway project. They are the New Brunswick Highway Corporation (NBHC), the New Brunswick (F-M) Project Company Inc. (Project Co), and the Maritime Road Development Corporation (MRDC). They are described in the paragraphs that follow.

Exhibit 13.1
Evaluation of bids
(all figures in millions of dollars)

	Bidder "A"	Bidder "B"	Bidder "C"	Department of Transportation Estimate
Construction price	$ 779	$585	$ 755	$ 758
Crown completed work	130	130	130	130
Interest costs	183	158	208	191
Other	30	19	37	14
Total capital cost of highway	$1,122	$892	$1,130	$1,093
Various net present value figures (1997 dollars)				
Net cost to Province of project	$870	$681	$852	$807
Revenue				
Tolling	$224	$206	$220	$210
Other	6	2	3	-
Total	$230	$208	$223	$210
Operating and maintenance costs				
Highway	$143	$100	$101	$114
Tolling infrastructure	31	30	24	22
Total	$174	$130	$125	$136
Economic benefit to New Brunswick (Wages and Salaries)	$270	$305	$275	-

13.19 The New Brunswick Highway Corporation (NBHC) is the Province of New Brunswick's direct representative in the Fredericton-Moncton Highway project. It is a provincial Crown agency that is the signatory for the Province in all agreements relating to the Fredericton-Moncton Highway project. As such, the Corporation is responsible for monitoring, controlling and administering those agreements to ensure that agreement terms are respected by other signatories and that provincial commitments are met. This includes ensuring that the construction of the highway and any required refurbishments are completed as required in those agreements. It also includes ensuring that the ongoing operation, management, and maintenance of the Fredericton-Moncton Highway are conducted in accordance with the agreement terms.

13.20 All monies owing to Project Co for sub-lease or maintenance payments will be paid through NBHC. NBHC will also own the land corridor on which the highway is being built and lease it to Project Co. Additionally, NBHC will collect all concession fees owed by Project Co. The Province is in the process of transferring all required land to NBHC.

Approximately seventy percent of the necessary land has been transferred to date.

13.21 The New Brunswick (F-M) Project Company Inc. (Project Co) is a not-for-profit corporation. Project Co will ensure that the highway is developed, designed, constructed, operated, maintained and rehabilitated according to the terms of the signed agreements. It will own the improvements, including the highway, constructed on NBHC's land and will lease the completed highway back to NBHC for public usage. Additionally, Project Co will collect tolls on the highway and pursue other highway-related revenue such as concession fees from restaurants and gas stations, utility right of way fees, and advertising revenues. It will also oversee the financing for the highway, issue debt and make payments to the toll and lease-based lenders, MRDC and the operator.

13.22 Project Co is directed by a Board of five members, two of whom were nominated by the Province, two by MRDC and one of whom was selected by the first four. The fifth member serves as Chair, under a renewable three-year term of service. The Chair may not be an employee of either the Province or the MRDC. Project Co has no direct reporting or accountability relationship with any provincial Minister. Any residual interest in Project Co will accrue to a charity selected by Project Co from a list provided by NBHC.

13.23 The Maritime Road Development Corporation (MRDC) is the consortium of thirty-seven companies that was the successful bidder on the project. Dragados FCC Internacional de Construccion, S.A., of Spain, Miller Paving of Ontario, and GTMI (Canada) of Quebec are the principal companies involved in this consortium. MRDC is responsible for building the highway in conformance with technical and other specifications included in the agreements. It will also be the operator of the highway for the first thirty years of the agreement.

Agreements

13.24 There are four key project agreements that were signed relating to the Fredericton-Moncton Highway. Exhibit 13.2 shows those agreements and illustrates the organizations who were signatories to them. The remainder of this section gives a summary of each agreement.

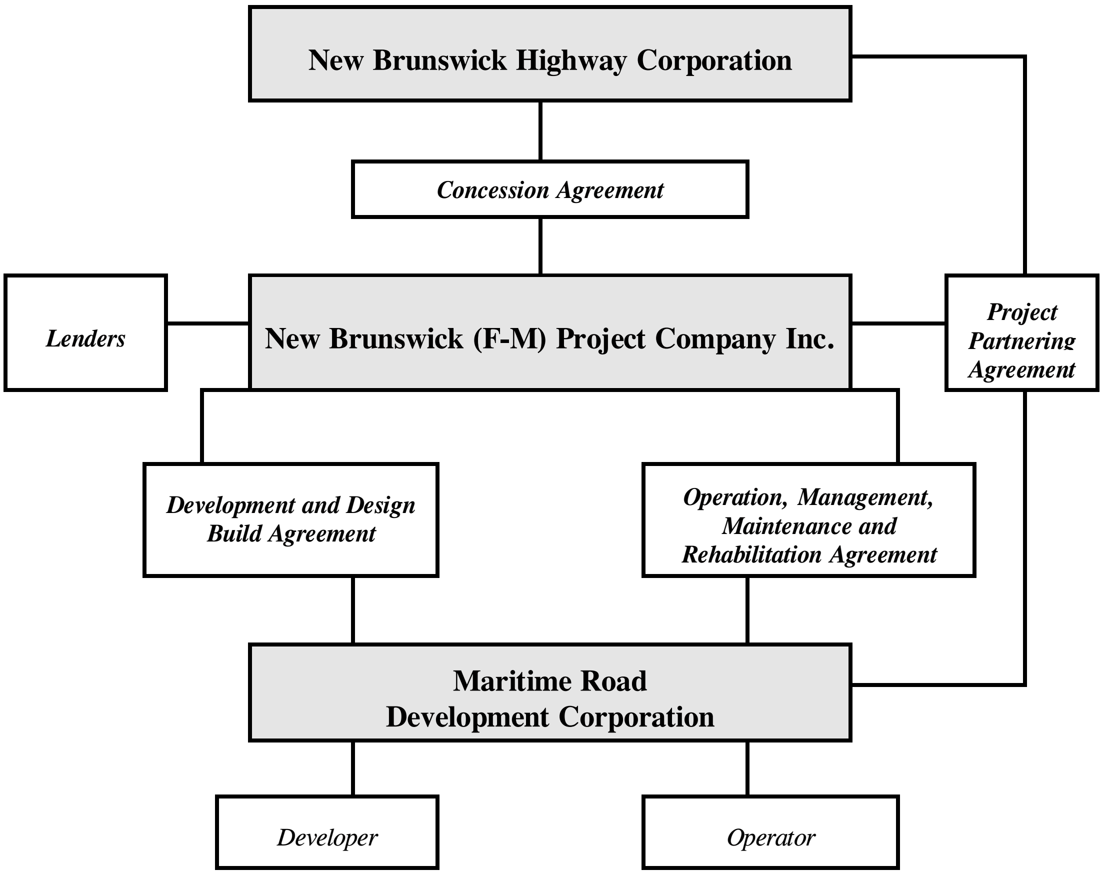
Project Partnering Agreement

13.25 The Project Partnering Agreement was signed by NBHC, Project Co and MRDC. It is a global agreement that covers such general areas as relationships and dealings between the parties, what constitutes acceptable contractual performance, allocation of risk between the parties, the expected level of quality of the project, costs and timing, law and regulations, the environment, and economic and industrial benefits.

Concession Agreement

13.26 The Concession Agreement was signed by NBHC and the Project Co. From the provincial perspective, it is the most important agreement. It covers a fifty-year period. However, upon completion of the initial thirty-year period, and again at the end of year forty, NBHC will have the option to cancel the agreement by acquiring the highway from Project Co for fair market value. Fair market value is defined as the present value of Project Co's projected net cash flows for the remaining years of the concession agreement. If NBHC does not exercise its right to buy the completed highway after year thirty or year forty, ownership reverts to the Province for $1 in year fifty.

Exhibit 13.2
Overall project organizational structure



13.27 The agreement covers, but is not limited to, the following areas:

- NBHC grants to the Project Co a concession to develop, design, build, finance, operate, toll, manage, maintain and rehabilitate a four-lane highway between Longs Creek and Moncton. The concession commences on 22 January 1998 and continues throughout the term of this agreement.

- It establishes the terms under which Project Co is to lease the necessary land corridor from NBHC. It also restricts use of these lands to the development, design, construction, operation, tolling, management, maintenance and rehabilitation of the four-lane highway.

- It establishes the concession fee that Project Co must pay to NBHC for use of the land. This fee is monthly excess revenues during the first thirty years of the concession agreement. Monthly excess revenues are the sum of toll and ancillary revenues received by the Project Co less the cost of servicing the toll-based debt. The Province has projected that these excess revenues will total $321 million over the initial 30 years of the agreement. Almost all of this excess will come from toll revenue. After year 30, providing NBHC does not exercise its option to buy the toll highway at fair market value, all toll revenue will be retained by Project Co. From that point until the end of the agreement term in year 50, a concession fee of $500,000 per month in 1997 dollars will be paid by Project Co to NBHC.

- It sets guidelines for the initial toll rates, the start of tolling, and increases in toll rates.

- It transfers highway segments already completed by DOT from NBHC to Project Co and establishes transfer pricing for uncompleted DOT work.

- It establishes Project Co as the owner of the toll highway.

- It establishes terms for the sub-lease under which NBHC leases the toll highway from Project Co for use as a public highway. It also establishes terms of sub-lease payments during the first 30 years of the concession agreement. Lease payments will commence after the highway is fully open and available for use.

- It establishes the requirement for NBHC to make monthly payments for highway operations, maintenance and rehabilitation costs during the first thirty years of the agreement. After year thirty, assuming NBHC does not exercise its option to buy the toll highway at fair market value, these expenditures will be borne exclusively by Project Co. Payments for operations, tolling and maintenance commence during the 1998-99 fiscal year.

Development and Design-Build (DDB) Agreement

13.28 NBHC signed the Development and Design-Build Agreement with Project Co and the principal companies involved in the MRDC consortium. The agreement requires the toll highway to be developed, designed and built by MRDC in accordance with specific guidelines, and for the Guaranteed Maximum Price of $584.4 million. It covers technical specifications, construction standards, environmental matters, timing of work, audit and inspection of work, and other areas.

Operation, Management, Maintenance and Rehabilitation (OMM) Agreement

13.29 The Operation, Management, Maintenance and Rehabilitation (OMM) Agreement was signed by NBHC, Project Co, the MRDC Operations Corporation, and the principal companies involved in the MRDC consortium.

13.30 The agreement covers the appointment of an independent agent, the work to be handled by the operator, reporting requirements and rights and duties of NBHC and the Project Co. It also covers the collection and disbursement of gross revenues, dispute resolution, and other areas related to the ongoing operations of the toll highway.

13.31 MRDC is responsible for the operations, maintenance and rehabilitation of the highway for the first thirty years of the agreement. During the first twenty years of the agreement NBHC is reponsible for making operating, maintenance and rehabilitation payments to Project Co based on a pre-set schedule attached to the agreement. Payments for the first twenty years of the agreement will total $168.0 million in 1997 dollars. Amounts to be paid for operations, maintenance and rehabilitation during years twenty-one to thirty will either be mutually agreed upon by the parties to the agreement or determined by binding arbitration.

13.32 MRDC is also responsible for operations, maintenance and rehabilitation of the tolling system for the first ten years of the agreement. Payments of $39.2 million in 1997 dollars will be made by NBHC to Project Co based on a pre-set schedule attached to the agreement. After year ten, Project Co will be responsible for renewing the tolling system operations, maintenance and rehabilitation agreement for five-year periods with either MRDC or another organization at an agreed upon fixed price.

13.33 Project Co has appointed Delcan Corporation to be the Independent Agent for the project. The independent agent's role, as specified in the Independent Agent Agreement (IAA), is to provide such services as progress measurement and certification of payments, quality auditing, and change management. The independent agent must regularly report to NBHC and Project Co with respect to its activities and findings. Independent Agent services will be paid on an hourly basis at rates established in the IAA to a maximum of $10.0 million, adjusted for inflation. The Independent Agent's contract ends on 30 November 2002.

Toll rates

13.34 Initial toll rates and the mechanism and limits on increases were set in the OMM and Concession agreements. Tolling of segments of the highway will commence as those segments are opened. Tolling of the Riverglade to Moncton section of the highway was to have been started effective 1 July 1998.

13.35 Initial maximum tolls at the date of full traffic availability are to be as shown in Exhibit 13.3. Annual increases after that date are to be no more than ninety percent of the increase in the consumer price index starting at December 2002 (i.e. one year after the full traffic availability date of 30 November 2001).

13.36 MRDC is responsible for tolling the highway in return for a fixed amount for the first ten years of its operation. After this initial ten-year term, Project Co has no obligation to renew the tolling arrangement with MRDC but it has an obligation to enter into an agreement with an alternate toll operator if it does not renew the tolling agreement with MRDC. Project Co will collect tolls on the highway and pursue other highway-related revenue such as concession fees from restaurants and gas stations, utility right of way fees, and advertising revenues.

Exhibit 13.3
Maximum tolls to first year after full traffic availability date

	Fredericton – Moncton	Longs Creek - Moncton
Passenger Car	$ 6.00	$ 7.00
Recreational Vehicle	$ 8.25	$ 9.75
Commercial Vehicle		
2-axle	$ 7.75	$ 9.25
3-axle	$ 11.50	$13.50
4-axle	$ 15.50	$18.25
5-axle	$ 19.25	$22.75
6-axle	$ 23.25	$27.50

Financing arrangements

13.37 Project Co issued debt to cover the long-term financing of project expenditures. The debt has been divided into two parts.

13.38 Part “A” debt (the toll-based debt) is repayable over a twenty-nine year period and will be repaid from the gross tolls collected from users of the highway and ancillary revenues. Toll-based debt totalling $149.5 million was issued on 22 January 1998 at interest rates of 6.74% and 7.14%. Toll and ancillary revenues have been assigned as security on the toll-based debt. The interest rates are between 0.58% and 1.00% above the 22 January 1998 provincial borrowing rate of 6.14%.

13.39 Part “B” debt (the lease-based debt) will be repaid from the payments made by NBHC under the toll highway sub-lease. Security for the Part “B” debt will comprise a pledge of the Province’s covenant to make the semi-annual lease payments under the sub-lease agreement, supported by legislation which makes these payments statutory appropriations. Lease-based debt was issued on 5 March 1998 giving proceeds of $540.0 million. The debt was issued at an interest rate of 6.47%. Principal and interest payments will commence on the lease-based debt in November 2003. The interest rate on this debt is 0.31% above the provincial borrowing rate of 6.16% that was in effect at the time the lease-based debt was priced.

13.40 All debt will have been repaid by the time the first thirty years of the concession agreement have been completed.

Provincial accounting for highway project

13.41 The sub-lease agreement is the agreement under which Project Co will lease the toll highway to NBHC for public use. The Province has determined that the sub-lease is an operating lease for accounting purposes rather than a capital lease. In completing our audit of the financial statements of the Province of New Brunswick for the year ended 31 March 1998, we evaluated the accounting treatment of the sub-lease agreement. The Canadian Institute of Chartered Accountants requires capitalization of a lease if one of the following statements apply.

13.42 *There is reasonable assurance that the lessee will obtain ownership of the leased property by the end of the lease term. Reasonable assurance that the lessee will obtain ownership of the leased property would be present when the terms of the lease would result in ownership being transferred to the lessee by the end of the lease term or when the lease provides for a bargain purchase option.*

13.43 The sub-lease term for the toll highway is thirty years. At the end of that term, NBHC may purchase the toll highway from Project Co at fair market value. Therefore, there is no bargain purchase option or other guarantee that NBHC will acquire the toll highway after the thirty year sub-lease period. The sub-lease is not a capital lease by this measure.

13.44 *The lease term is of such a duration that the lessee will receive substantially all of the economic benefits expected to be derived from the use of the leased property over its life span. Although the lease term may not be equal to the economic life of the leased property in terms of years, the lessee would normally be expected to receive substantially all of the economic benefits to be derived from the leased property when the lease term is equal to a major portion (usually 75% or more) of the economic life of the leased property.*

13.45 The estimated useful life of the highway has been estimated to be fifty years. The sub-lease term is only thirty years, or sixty percent of the total useful life. The sub-lease is not a capital lease by this measure.

13.46 *The lessor would be assured of recovering the investment in the leased property and of earning a return on the investment as a result of the lease agreement. This condition would exist if the present value, at the beginning Mof the lease term, of the minimum lease payments, excluding any portion thereof relating to executory costs, is equal to substantially all (usually 90% or more) of the fair value of the leased property, at the inception of the lease.*

13.47 We reviewed and agree with Department of Finance calculations showing the present value of lease payments to be in the range of eighty to eighty-five percent of the cost of construction. The sub-lease is not a capital lease by this measure.

13.48 It is obvious that the toll highway is being built for public use during the next fifty years and for no other purpose. We also feel that the Province's commitment to make lease payments over a thirty-year period is not substantially different from a commitment to make debt payments to bondholders for thirty years.

13.49 Because the sub-lease has been accounted for as an operating lease, the Province is only required to show current year lease payments as an expense. Since there were no lease payments during the 1997- 98 fiscal year, no expenditure amount was shown. Additionally, the Province is not required to show the committed amount as a liability on its balance sheet. Total lease expenses will be spread over the thirty-year term of the sub-lease. On the other hand, had the sub-lease met the criteria for a capital lease, the Province would have been required to show the entire expenditure, recorded at the discounted value of future lease payments, in the year in which the sub-lease commitment was made. This would have meant an additional $709.8 million in expenditures being shown in the 1997-98 financial statements of the Province. It would also have had to show a liability for the same amount. Obviously then, the accounting classification of the sub-lease has a large impact on the ability of the Province to meet its balanced budget legislation.

13.50 We feel that the planned accounting treatment of the sub-lease had a major impact on the way in which the project was structured. Regardless, our primary concern is whether the way in which the project was structured gave the best value for money to the taxpayers of New Brunswick. We will be looking at this and other issues related to the toll highway project in the years ahead.

Future work

13.51 The stated objectives of the government of the Province of New Brunswick for the Fredericton-Moncton Highway are as follows:

- to improve safety for the travelling public;
- to ensure the development, design, construction, operation, management, maintenance and rehabilitation of the Fredericton-Moncton Highway meets or exceeds current Provincial standards;
- to ensure the development, design, construction, operation, management, maintenance and rehabilitation of the F-M highway is done in an environmentally responsible manner;
- to share the risks of the project between the private and public sectors;
- to obtain optimal value for money for the Province;
- to minimize the financial contribution of the Province to the project;

- to open the entire highway for safe operation by 30 November 2001 and to fully complete the highway by 30 June 2002;
- to defer payments by the Province for the project (other than on account of highway operations and maintenance) until after the opening of the completed highway;
- to maximize the economic and industrial benefits to the citizens and industries of the Province; and
- to provide a high level of service to the highway users at a low cost.

13.52 In the coming months we will be addressing many of these goals to determine if they have been accomplished, or are likely to be, within the parameters established by the agreements. Additionally, we will be pursuing answers to the following questions.

- Have substantial risks been transferred from the Province to private sector entities and, if so, was the consideration paid for those transfers reasonable?

- Did the issuance of long-term debt well in advance of the commencement of the bulk of the construction work have any positive or negative consequences on the Province's cost?

- Is it reasonable that, in an arrangement where all lease-based and toll-based debt will be paid off by the end of year thirty, the Province is still required to pay fair market value to purchase the highway at the end of year thirty?