2:05 p.m.
[Mr. Doerksen in the chair]

THE DEPUTY CHAIRMAN: All right. Let's call the meeting to order, if we could. The package was sent out ahead, and I'm looking first of all for approval of the agenda. Could I have a motion for that?

MR. HIERATH: I'll so move.

THE DEPUTY CHAIRMAN: Any questions? All in favour? Approved.

Then we also need approval of the minutes of the June 15, 2000, meeting, which would have been circulated in your package. Could I have a motion to approve the minutes, please? Ron Stevens has moved approval. Any amendments, comments about the minutes? Seeing none, I ask for a show of hands by those approving the motion to accept the minutes. Those have been approved.

That brings us to the next item on the agenda, which is the Alberta Heritage Savings Trust Fund Business Plan.

Mr. Treasurer.

DR. WEST: Thank you very much. We're here to review with the committee the heritage fund business plan and the performance of the fund to the end of the third quarter. I have with me from the department Alex Fowlie; Paul Pugh, chief investment officer of the fund; Gisele Simard, director of investment and debt accounting. Also, Peter Orcheson, senior equity analyst, is with us.

Now, we've been looking at a review of this plan, and we've brought forth a draft plan. I'm sure you all have that. It's before you. There are some things in there – and I'm not going to go into excessive detail – and the people are here to answer questions as it relates to it. We have certain things that perhaps you would consider in recommendations to set out the objective and make sure it continues to maximize the long-term financial returns of this plan.

Remember that we set up two portfolios. One, the transition portfolio, we assumed would be shifted by 2005 through to the endowment portfolio, and the endowment portfolio was to pursue the objective of maximizing long-term financial returns through various instruments. We're now more than halfway through this transition, and I think the plan calls for a few operational adjustments.

The first change would be to raise the equity exposure in the endowment fund, specifically the exposure to foreign equity. Over a longer period equities tend to outperform bonds. Furthermore, the international investing for a Canadian pension plan is essential when constructing a diversified portfolio that will over the long term provide the highest level of return for a given level of risk. Consistent with the medical research funds, scholarship funds, and ultimate heir funds, we recommend a 5 percent increase in the weighting to foreign equity securities.

Secondly, a recommendation in the business plan is to amend the endowment portfolio benchmarks. Consistent with the above change in the equity weightings is a change in the foreign equity benchmark to reflect specific benchmark allocations to U.S. and non North American equities. Index comparisons will now be made using Standard and Poor's 500 index and the Morgan Stanley EAFE index respectively. These changes will allow for closer monitoring of the endowment portfolio's investment performance, portfolio diversification, and risk control.

The third recommendation is for an increase in the annual transfer of assets from the transition portfolio to the endowment portfolio. A range of $1.2 billion to $3.6 billion is now established for the annual transfer, up from the 2000-2001 fiscal year range of $1.2 billion to $2.4 billion. As the endowment portfolio now exceeds the transition portfolio, the transition portfolio's focus has moved to providing greater liquidity to facilitate the transfers to the endowment portfolio. This requires that the portfolio maintain short-term assets that act as a drag on the total fund performance. To maintain the heritage fund performance and reduce the cash drag, the transfers are increased so as to liquidate the transition portfolio by the year 2003 and not 2005. This would also allow flexibility to take advantage of market conditions or opportunities without compromising the discipline of dollar averaging, the systemic investing of funds over time, used in the transition.

The fourth recommendation is to consider the fund's real estate weight, and that would come back for further discussions. We have had that, and I think that when I wasn't Treasurer, I sat on one side of the discussion as it related to it. I think that will be subject to further discussion by people in the future, although Paul feels strongly that there should be a greater weighting in some of the real estate areas in the portfolio.

Finally, the business plan recommends that the maximum limit on public corporate bond issues be raised from 25 to 35 percent and to adjust the weightings on other holdings. The proposed limits will be more in line with the ScotiaMcLeod universe index, the policy benchmark for the bulk of the fund's fixed-income exposure.

Now, some of this I understand fully after visiting New York last Thursday and Friday and going to Moody's and meeting for lunch with a lot of the investment analysts and that from ScotiaMcLeod and others. I have to say that the Canadian economic environment is seen as very positive by many of these people, and I know that Paul Martin today is speaking in New York. I found that the interest in our investment moneys here is strong. An indication of that was when the leader in Quebec tendered his resignation the day that I was in New York. It didn't take them very long, when the Quebec government asked for a billion-dollar float – it was taken up instantly. So there is a lot of strength in the Canadian economy, and I think that the reflection on this right now for our investment division is to find a balance so that they can get better returns for the heritage fund and some of the dollars that they're using.

I just found the interest almost renewed in the Canadian context and not just from a provincial level. They said: you're paying off your notes; we're more interested in lending you money than your paying them off. Nonetheless, there are ongoing operational funds required in all governments. As well, the security at the base of our economy attracts people for other reasons, making investments in our companies that operate here and strengthening all the portfolios that exist.

Nonetheless, I'll quit there for fear that I say something that I don't know. New York is quite a place, and that Mercantile Exchange is just as crazy as it looks on television. They actually fight down there. They actually push and shove. When I was down there, when they started off the NYMEX on the oil and gas that morning – it's just unbelievable if you've never been there. You can see it on television, but you have to be there to believe it. I don't know what the life span of some of these people on that floor is, but it's about 24 hours for some of them. They have these pits. They're like these pits you see in South America where they put fighting chickens in the middle. They put the runners in the middle, and then of course the essence of the dogs fighting or whatever it is will be what commodity they're on that day. These people just go berserk in their bids.

THE DEPUTY CHAIRMAN: So perhaps they should be introduced to the concept of three swords' length.

DR. WEST: Well, they're not. They're not. That's right. But it's a little like this.

THE DEPUTY CHAIRMAN: Nevertheless, you digress Mr. Treasurer. We want to move on to the questions addressed to the business plan.

DR. WEST: I was just trying to get off the discussion so that then you'd say, "All in favour," and we'd move on.

THE DEPUTY CHAIRMAN: Ron Hierath has a question.

MR. HIERATH: Steve, with some of the changes in the business plan that, you know, you're recommending, do you see any increased risk for taxpayers in the changes being proposed?

DR. WEST: Do you want to answer that?

MR. PUGH: The major change in the business plan is to increase the equity weighting in the endowment portfolio. Part of the move is to the foreign markets. If you look at the Canadian market, the U.S. market, and the foreign markets, they move in most cases counter-cyclically; i.e., they don't always move together. So the movement into the foreign market will mitigate some of the risk by taking on a higher equity exposure. Granted, because we've got a higher weighting in equities and because the portfolio is moving from the transition to pure endowment, there is an added risk, but I don't think there's, quote, a real risk to the taxpayers.

I think your risk is that there's going to be greater volatility in the returns as we go forward, but over the long term, because of the greater equity exposure, you're going to have increased returns vis-a-vis having a very large portion of the portfolio in fixed income and currently a large portfolio in very short-term securities; i.e., the transition portfolio, which is roughly $5 billion, with the endowment portfolio of $7 billion. Having those very short-dated bonds has some risk in that you're not going to have the returns that you couldn't get out of equities.

I hope that covers that off.

2:15

MR. HIERATH: All right.

Just another follow-up question, Mr. Chairman, if I could. The transition fund was to be completely phased out by '05. Now you're proposing to phase it out two years earlier. Explain a little bit more to me what the reason for that is.

MR. PUGH: When the two portfolios were set up, the transition portfolio was meant to support the government's income needs, if you will, and the endowment portfolio was, if you will, the long-term portfolio. It was felt that over time we'd transition to a portfolio that was a more typical balanced fund with equities, bonds, real estate and that it would provide the long-term appreciation in growth in revenues.

Last year, when we were looking at the portfolio, we realized that the structure we'd put in place was working very well. We were getting the increased returns from the endowment portfolio, and we were getting income from the transition portfolio. At the same time, the government's finances were improving dramatically and have improved dramatically. We looked at that and said: "Well, this is working well. Why not accelerate it and get to where we want to be quicker so that we can get those increased returns coming in faster than they normally would have?" This is just a continuation of it.

I think the way to look at it is that the process that was put in place in '96-97 has, we realized, matured, and we can move to the next step. That is helped dramatically by government revenues and the government's fiscal position, and we think we should get to that. There are some opportunities with the lower equity markets now that we'll be buying low and selling high, hopefully, down the road.

MR. HIERATH: Thank you.

THE DEPUTY CHAIRMAN: Debby Carlson, then Glen Clegg.

MS CARLSON: Thank you, Mr. Chairman. First, my questions are on the second-quarter update.

THE DEPUTY CHAIRMAN: I think that's coming at a different point in our agenda.

MS CARLSON: Oh, I'm sorry. Okay. I'll just go to the business plan.

THE DEPUTY CHAIRMAN: If you don't mind.

MS CARLSON: Sure. A follow-up to Ron's question first of all. Do you have an estimated market rate of return on completing the transactions two years early? Do you have any anticipation as to what the increase is going to be?

MR. PUGH: If I really could answer that definitively, I wouldn't be working. What we do in our projections is we use long-term averages. The long-term average for equity markets is roughly 8 percent and for bond markets roughly 5 percent, 6 percent. So we would expect to increase the value of the portfolio by 2 to 3 percent per annum over the long term. Now, the markets as we see them over the next year or two will be volatile, and we may not see that, but over the long term I think we'll see those types of returns.

MS CARLSON: Okay. That's good. Will we see a date specified in the business plan for when the gross debt will be eliminated?

MR. PUGH: At the moment we've put it in as bullets because it depends on the budgeting process. We people in the investment operation aren't privy to some of that knowledge, so we've just put it in as bullets now. They're still working on the budget for next year, and that should come out in due course.

MS CARLSON: Okay.

Anything to add?

DR. WEST: No. I mean, the only thing we can do in our projection at this time is, in the future, bring out the financial report on the province as well as the third-quarter report as it relates to the province, and that will be forthcoming. So I'm not privy to give you that information today.

MS CARLSON: Okay. The projected investment income for the next six months or so is lower than anticipated in the 2002-03 and 2003-04 years. Do you want to comment on that?

MR. PUGH: There are two things that are at work there. In the last 18 months, because the heritage fund and the endowment portfolio in particular have gone through some restructuring – to refresh people's memory, the heritage fund did until mid-2000 own some equities directly in the portfolio rather than in our pools. They were partly in our pools and partly directly held equities. We found that the structure was moving away from our desired pools, so we restructured the portfolio, and by doing that, our turnover was greater and we were turning the portfolio over at relatively high values in the Canadian market. So we were generating more income.

For '99 and 2000 our income was, if you will, a little higher than it normally would be. With the transfer, as well, increasing the transfer transition to the endowment portfolio, there'll be more turnover from the point of view of going to equities, and until that's firmly in place, the income will drop.

So there are two forces there: the restructuring and the increase in the endowment fund transfers.

MS CARLSON: Okay. We've seen a significant increase in administrative costs. Could you comment on that?

MR. PUGH: Yeah. The increase in the administrative costs is mainly due to the transfer from bonds to equities. Because we use external managers and our external managers aren't as cheap as we are, we pay them more. So with the increase in the equity exposure, we're increasing our costs, and that's the reason for the increased expenses.

MS CARLSON: Okay. Finally, it looks like on page 8 there's a typo. I think it's supposed to be December 31, 2000. At the top there, the breakdown at December 31, 2001, I think has got to be 2000; right?

MR. PUGH: Yes.

MS CARLSON: Just before it goes to print.

THE DEPUTY CHAIRMAN: I don't think we need a formal amendment on that. I think you'll just take note of that.

MR. PUGH: Yes. Definitely. Thank you.

MS CARLSON: Good. That's it on the business plan. Thanks.

MR. CLEGG: Just one question. Unless I'm not reading this chart right, I think the hon. Dr. West said that we're looking at putting 10 percent more into foreign investment.

DR. WEST: Five percent.

MR. CLEGG: Five percent. Well, then I believe, in reading this, that we did better on our Canadian equities than we did on our foreign equities. Now, maybe I'm reading it wrong, but certainly if we're going to have a strong economy, then why would we be doing that 5 percent more?

MR. PUGH: We feel that our total equity exposure should be increased, and there are going to be advantages in dealing with foreign markets. Currently the Canadian market shows value, and we're, as we call it, neutrally weighted in Canada. We want to build for the future, and that's why we're moving up the equity exposure in the foreign markets.

The other reason we want to do that is because the Canadian market is very concentrated. You've all heard about the Nortel effect, representing now only 20 percent of the market. It was 30 percent of the market. By going to the foreign markets, we can reduce our exposure to stock-specific risks; i.e., one stock such as Nortel. That's a risk-control mechanism as well, going to the foreign markets. We don't disagree that the Canadian market is good value at the moment, but we think there's probably going to be better value in the foreign markets because they have not performed as well as the Canadian market over the last couple of years.

2:25

MR. CLEGG: Just one other question then. If you've followed that foreign market and the Canadian market, say, in the last five years, you must feel that the foreign market is better in the long term with less risk, if I read you right.

MR. PUGH: We do adjust our weightings between the different markets from time to time based on our view. Currently we're slightly overweighted in the foreign markets because they have not done as well as the Canadian and U.S. markets. Last year we were overweighted in the Canadian market. We took profits, mainly because Nortel was very high, and put that money into both the U.S. and the foreign markets. So from time to time we will adjust those weightings, depending on what our tactical views of the markets are.

MR. CLEGG: Well, just one more question then. Steve mentioned the fact that it's not necessarily that you're going to take that 5 percent more, but you're going to have the ability to take that 5 percent.

MR. PUGH: Yes. Correct.

MR. CLEGG: Okay.

DR. WEST: Just so you're aware, even on the Canada pension fund the administrative board is asking for a change, too, of the risk weightings so that they cannot use as much of the TSE 300. They'd like the flexibility to move in other directions when needed. I mean, there was an education on the TSE 300 when over 40 percent of it was between two stocks, BCE and Nortel. At one time Nortel was 35 percent of that market. Two stocks made up 40 percent of your index. That's high risk, folks. I mean, you've got to give some of these people credit. They bailed out before it hit $44.

THE DEPUTY CHAIRMAN: If I may ask a few questions. Staying on that particular theme, under your goal 2, page 12, is that where these changes are reflected? So the 35 percent foreign equity reflects the change from 30 percent to 35 percent.

MR. PUGH: That's correct.

THE DEPUTY CHAIRMAN: That's correct.

On the bond side, where you've got 33 percent, can you tell us also: is that all Canadian bonds?

MR. PUGH: Yes.

THE DEPUTY CHAIRMAN: No foreign content?

MR. PUGH: No. At the moment we don't have any foreign content, and we haven't really looked at putting any foreign content into the Canadian bond portfolio.

THE DEPUTY CHAIRMAN: Okay. Is there a particular reason for that?

MR. PUGH: We're of the view that you can't add a lot of value by buying foreign bonds, and you're taking relatively more risk than you would by exposing yourself to the equity markets, where you get more returns for the risk you're taking.

THE DEPUTY CHAIRMAN: So it's an exchange rate risk?

MR. PUGH: Well, there is some of that in there as well.

THE DEPUTY CHAIRMAN: Okay.
In the foreign equity you've got it broken down between the U.S. at 17.5 percent and EAFE, which stands for . . .

MR. PUGH: Europe, Australia, and the Far East.

THE DEPUTY CHAIRMAN: Okay. Did you increase each of those by 2 and a half percent?

MR. PUGH: That's correct.

THE DEPUTY CHAIRMAN: So we're going to have equal weighting between the European and U.S. markets.

MR. PUGH: Yeah. That's what we call our benchmark weight. We will over time vary that plus or minus on either side.

THE DEPUTY CHAIRMAN: Okay. Then if you could turn to page 15, under your Income Forecasts and Underlying Assumptions, what's missing from here – and I didn't have the opportunity to compare. Can you tell me how this compared to our forecast of last year's business plan?

MR. PUGH: These numbers are slightly lower, if I remember correctly.

DR. WEST: They're lower.

THE DEPUTY CHAIRMAN: Okay.

MR. PUGH: We could get you the actual numbers and bring them back to you.

THE DEPUTY CHAIRMAN: More in terms of presentation, I think, in the future it would be useful to know what was forecast in the past and what's been changed. We're looking at these figures here, and they look wonderful, but obviously some changes have occurred since last year. Sometimes that leads to better questions.

DR. WEST: We had an average over 8 last year, so, I mean, 8.3 rings a bell. At one point we were at 9.2. We use that as a good example of why we were borrowing money at 6.8 and the heritage fund was generating money at 8.3 plus. But this has got to be lower. To anybody that's following the equity market and that, it has to be lower. I mean, all of it's lower. I think it's about 2 percent.

MR. PUGH: Yeah.

DR. WEST: Okay. That's the answer.

THE DEPUTY CHAIRMAN: Yeah. But you have to remember that this forecast goes out over four years and that stock markets are volatile. Equity markets in particular are volatile.

DR. WEST: Everybody is discounting out right now, at the present time.

THE DEPUTY CHAIRMAN: Okay. We do need a motion from the members if you wish to accept the business plan or if anybody has suggested amendments.

MR. CLEGG: I make a motion that we accept it.

THE DEPUTY CHAIRMAN: Okay. Mr. Clegg has moved that we accept the draft Alberta heritage savings trust fund business plan. Any questions on that motion? Okay. All in favour? Opposed? Approved. Thank you.
Now we'll move on to the next item on the agenda, which is the First Quarter Update. You know, we probably can handle both the first-quarter and second-quarter updates at the same time on our agenda. Are the members okay with that? Then at the end we'll have a motion. Do we have to accept that? It's just a report.

DR. WEST: Well, this is here for more information, Mr. Chairman, to show you how the first and second quarters performed. I'll give you a little update on the third quarter so you can see the whole snapshot. If you want some questions on the first two quarters, you can do that. I don't know where we're at. Have they had the third-quarter snapshot?

MR. PUGH: On page 2 there are some comments on the third-quarter snapshot.

DR. WEST: That will demonstrate to you the volatility, what's going on right at the present time, because the first two quarters performed a lot differently than the third quarter performed.

THE DEPUTY CHAIRMAN: Just before you proceed, can I ask you where you got that third-quarter information?

MR. PUGH: That's in the briefing book only.

DR. WEST: Yeah. You don't have that. I just have it as an update because we haven't tabled the full third-quarter report yet, but I'll give you a snapshot of that. You've got the first two quarters.

THE DEPUTY CHAIRMAN: Okay. Then why don't you give us a snapshot of where we're at today, and the committee can ask questions on that or on either the first-quarter or second-quarter updates.

DR. WEST: Well, I think that you have the first and second quarters, and they performed fairly well. If you look at the total returns, the first quarter returned $450 million from the transition portfolio to the endowment portfolio. The second quarter went through and even strengthened a little bit and returned $535 million. All of the returns were, I think, pretty respectable from a marketplace point of view, but then as we went into the third quarter, they weakened considerably, especially the equity market returns.
The Canadian and U.S. equity markets fell 13.7 percent and 8 percent respectively in the third quarter, the European and Far East markets were down about 2.9 percent, and the bond returns for the quarter were at 2.9 percent. They did perform quite well, but you know what's happening. The investors are seeking safety in fixed-income securities. I think that was one of the questions that was asked here, why we would stay in the Canadian bond market. As I indicated in my first comments, people will be running to the Canadian bond market for security for awhile.
So the combined heritage fund return in the third quarter was minus .9 percent over the quarter and 5.6 percent over a one-year period on a market-value basis, which is down. The endowment portfolio declined 3.7 percent over the quarter on a market-value basis, bringing the one-year return to 3.6 percent, which is down from the forecast that we have. I think that if you go back and you

look at what that forecast was in the business plan, it was closer to 5.6. So the quarterly and one-year returns are ahead of the policy benchmark returns of minus 3.8 percent and 3.3 respectively, but the technology stocks have damaged the returns in this quarter.

I'll leave it to Paul and some of the rest that are on this daily on the phones. They could give a comment, going into the fourth quarter, on what damage they think this is going to have on our forecasting and the performance of the first and second quarters. Paul, could you comment on that?

2:35

MR. PUGH: I think that for the first quarter of 2001, or the fourth quarter of the fiscal year, we're going to have a very volatile period in the markets. We've seen that already. At the beginning of the year we were surprised by the feds' move of reducing rates by 50 basis points. That was not anticipated, although as we started the new year, there was a growing view that the economy was softening worldwide and that there would be some rate relief as we looked forward. I think the jury is out on how hard the landing will be, and that's going to create a lot of volatility in the marketplace. I believe Nasdaq is already up this year 10, 12 percent. It had a very strong day today; it's up 4, 5 percent.

We're going to see this volatility as we go through the year. I don't think we're going to see the returns that we've seen through the '90s; i.e. double-digit returns. I think we're going to be back to more historic returns, single-digit returns, and that will impact some of the returns that we have and the income that we have in the heritage portfolio. Volatile times are ahead. Until we find out or we become quite convinced that the landing will not be hard or we start moving back into, shall we say, stronger economic times, we will see a reduction in economic growth worldwide. The U.S., I think, is going to be hit the most. Canada will be relatively immune. That does not mean we're not going to see reduced economic activity, but volatility will be the word as we go forward.

DR. WEST: Paul, going back just to a couple of questions by the committee which intrigued me. One, of course, was that when we made the decisions to make some of the recommendation changes, somebody asked: what's the risk of doing that right now, at the present? Because if you don't have long-range focus, many of us get nervous faster than others do. So if you took page 15, plus the question of what these changes would do to developing risk in foreign markets and what have you, what would the third-quarter forecast, that I just gave a snapshot of, do or have the potential of doing to these underlying assumptions? Is this page 15 on solid ground now that the third quarter has come forward? What are many of the investment people saying now on giving out these four-year assumptions?

MR. PUGH: We use historic returns in most cases here to project out, but I would think that people would be looking at some of these returns and saying that they'll probably be slightly lower, that you would probably have equity returns in the 6 to 8 percent versus the 9 percent returns. But we focus on the longer term historic returns in our projections as we go forward.

DR. WEST: The interesting thing is that as it gets down, if we can get an upgrade on our rating and these rates hold consistent, would you say then that provincial borrowing would track this so that if we were only bringing in 6 and a half percent on the heritage fund, we would only be paying 5 and three-quarters on the money markets?

MR. PUGH: In all likelihood, probably.

DR. WEST: The question will come as we move to a debt-free province: what is the prudence of running a portfolio that generates 4 and a half percent when you're paying 6 and a half percent?

MR. PUGH: Well, I would think that over the longer period we will earn more than the cost of debt, especially with a strong economy and that fiscal position . . .

DR. WEST: Good. Now, I want you to pay attention to that for some of the notes we're carrying. It's always a question. I mean, to the simple-minded person they have to – it's straight arithmetic; isn't it?

MR. PUGH: Right.

DR. WEST: I just ask that. I don't have a right to question, but I just thought it was interesting that we had these assumptions when a year from now we'd be looking at different ones, and you're going to say yes and maybe.

MR. PUGH: Maybe we will, but we try and focus on the long run and long-run returns rather than changing them from quarter to quarter, because we have very volatile projections.

THE DEPUTY CHAIRMAN: Those are good questions, Mr. Treasurer, but since you brought us back to page 15, even though it's part of the business plan, I'm going to take the liberty of asking one more question. Your assumptions on that page are consistent across the board, yet your investment income varies considerably. What would cause that?

MR. PUGH: It's the volatility in the markets and the trading in the marketplace as we shift from a pure fixed income, which has a lower return and less volatility or turnover, to the equity markets, which have the higher return but also the higher turnover. I mean, we turn the portfolio over if we take profits. Every time you take a profit, that creates an income item. So as we have more equities, we generally have greater turnover with the equities, and that's part of the generation of greater income.

THE DEPUTY CHAIRMAN: Mr. Treasurer, were you finished with your presentation?

DR. WEST: I'm done.

THE DEPUTY CHAIRMAN: Okay. I'd like to then turn the floor over to the members for questions they might have.
Debby.

MS CARLSON: Thank you, Mr. Chairman. Ridley: Mr. Treasurer, if you could update us on that a bit. As I understand it, the yearly principal payments have been deferred and added to the accrued interest on the loan. Would that be correct? Page 17, Ridley Grain.

THE DEPUTY CHAIRMAN: Ridley Grain? You're on page 17 of the second-quarter report?

DR. WEST: Prince Rupert.

MS CARLSON: Yeah.

DR. WEST: The question again?

MS CARLSON: The payments have been deferred and added to the interest owing – would that be correct? – for the time period December 31, 2000.

DR. WEST: Well, there was no principal payment last year. Is that what you're saying? That's correct for the crop year July 31, 1999.

MS CARLSON: What happened to that principal payment?

DR. WEST: Alex?

MR. FOWLIE: We understand that under the terms of the loan – the Ridley Grain deal is that they pay us from their income. They pay the interest on the loan first, and then if they're able to, if they have sufficient income, they also repay the principal. Payments that aren't received that are due are just sort of added onto the books. They're still owing; they're not written off. However, we normally don't record the outstanding.

MS SIMARD: Yeah. We don't record the accrued interest. We don't increase the balance of the loan, but we track it, basically increasing it and deducting it. We're tracking it. That's where it's disclosed: on page 17 under (d), $55 million.

MS CARLSON: Is the expectation that that money will never be recovered?

DR. WEST: Well, in essence the policy is to capitalize the interest, and then in 2015 there's a true-up, but over the years we've been hopeful that they would pick that up. The answer to your question is that the performance of this grain terminal is suspect at the present time, and as a result we are working with our partners, the owners of the grain companies that ship through it, to find a solution so that we can put them in as the holders of these loans and respective of the long-term debt that has to be paid. What discount we have to do on that is still subject to negotiations. I don't think it's any myth that these terminals right today, their throughput and what's being diverted to Vancouver rather than Prince Rupert makes the economics of this terminal very difficult.

2:45

So it's not a question of whether we'll get the interest or that. It's a question of negotiating a financial turnover to these companies – as an owner they'll utilize it better than they will putting us in first position – and seeing what discount would have to be taken. I can say right now that the initial talks aren't that financially hard on the province, but again, we have to see what their bankers say.

It's been difficult. Nobody is making any ifs, ands, or buts. They have got an advantage going through Vancouver of $4.25 a tonne. The amount of grain going through this terminal last year was an embarrassment to the volume that should be handled. I'm not beating around; I'm being as direct as I can on this account. It's not a matter of where the interest goes or that. It's a matter of financially making this terminal work for Alberta farmers.

MS CARLSON: So, Mr. Treasurer, is there any consideration being given to the consortium members' proposals to buy out the Alberta government interest?

DR. WEST: We're in consideration of all proposals, but because some of the individuals are in different positions – you're aware of the consortium's position in these terminals and their position in western Canada in some of their own operations. They have difficulty right now with the grain prices and the high cost of operating terminals on the prairies, and they've built a lot of high throughput terminals. So I can't sit here and disclose any information that's subject to their financial positions that they're taking with their banks at the present time. But all are not in the same position. I think there are five in there. I think it would be unfair of me to disclose any further discussions.

MS CARLSON: Sure. I appreciate that. Any time lines on when we may have some information?

DR. WEST: No, I can't. I might have had six months ago or four months ago. The initial discussions continue. As I say, even this fall the economy of the western grain basin has changed. It had better strengthen, folks.

MS SIMARD: One thing that these statements, because they're dated September 30, don't reflect: there was an October payment made.

MS CARLSON: One last question on this. Can you tell me what the estimate for throughput was from August of 2000 to July 31, 2001?

DR. WEST: How many tonnes?

MS CARLSON: Yeah.

DR. WEST: My mind is good, but it's getting older. Roughly 3 and half million tonnes.

MR. FOWLIE: For the '99-00 crop year.

MS CARLSON: Right. That's what I'm asking.

MR. FOWLIE: The year that's over, not the one that we're in the middle of.

DR. WEST: Yeah. It's somewhere in there, but that's a far cry from what this terminal can turn: 16, 20, you know.

MR. CLEGG: Just a follow-up. If I understand this perfectly, what's happening – and you're right, Steve. The $4.25 is that it costs that much more to get it to Prince Rupert. But there are two things happening: $4.25 to get it to Prince Rupert, but to the overseas market it's $5 a tonne cheaper from Prince Rupert than it is from Vancouver. The Canadian Wheat Board or the grain companies never consider that at all. We're just paying as producers that $4.25 more.

A second point. If you took everything into consideration, Vancouver and the St. Lawrence, it's political. It's a lot political here because they want to keep all the jobs in Vancouver and in the St. Lawrence. There's where your problem is. If they took everything into consideration, this would be a money-making thing. But if we can't convince the federal government and all the grain companies to use Prince Rupert, then we'll have difficulty in ever getting our dollars back.

DR. WEST: Well, that's a 50-year discussion.

MR. CLEGG: Yes.

DR. WEST: What we've been dealing with is the business case, and we have to deal with the facts of the business case and on behalf of Albertans do the right thing.

You're right, historically, Glen, but if you were owning port facilities in Vancouver and you had them paid for on your books or in a good equity position and then you had a deal with somebody else that was in first position, not you, in Prince Rupert, you would ship your grain through Vancouver albeit discounted marginally. But they're still making more money by doing it that way without a deal with the port authority, the railway companies, and the Canadian Wheat Board. That is to be solved by Canadians with the federal government over the next decade.

Historically it's been as far wide a discussion as I've ever seen. So you're right, but I think from a heritage fund point of view and from a going-forward basis, we have to deal with it in a business case sense as to what equity we can get out of it and how we can marginalize the losses to Albertans.

MR. CLEGG: One more point on this. Another cost that's never considered when we talk about these freight rates from the overseas market is the dredging cost, which is fabulous, but that comes out of another fund.

I was at the port in Prince Rupert, and you can get the boat within the length of this building. From the port you just load. In Vancouver there are millions of dollars spent in dredging to get those ships in to load. Those are all factors that unless they get straightened out, this is going to be a very difficult situation to resolve.

THE DEPUTY CHAIRMAN: In fact we have been enlightened this afternoon by the hon. member. Thank you.

Are there any other questions? Debby.

MS CARLSON: The real estate portfolio underperformed. Can you give us some comments on that?

MR. PUGH: The real estate portfolio we treat more as a bond portfolio in that there's steady income. We only value some of the properties on a quarterly basis. We rotate some of the properties by realtor evaluations with appreciation, and some of that appreciation won't come forward until next year as rental rates increase. So our performance looks, if you will, poor vis-a-vis the equity markets, but we think we're going to get some fairly strong performance as we go forward.

If you look at the markets that were in Toronto, if you go back five years, rental rates that were net effective at maybe $5 to $10 are now $32 plus. Calgary was in a similar situation. There's not a lot of large space around. Rents are now going for $20 plus, and we're starting to see some turnover in the rentals for the leases that we have in our portfolio, so we should see that coming through in the portfolio in the next year or so. In the interim we're still earning a good fixed income in terms of the portfolio.

MS CARLSON: Okay. Is the expectation, Mr. Treasurer, to inflation-proof the fund this year, and if so, what estimate are you thinking of using?

DR. WEST: The simple answer?

MS CARLSON: I'll take the simple one and the long one.

DR. WEST: We're putting it all on debt, consistent with what a lot of Albertans have to do.

MS CARLSON: Okay. That's it.

THE DEPUTY CHAIRMAN: Are there any other questions from the committee members?

If I could just ask a couple of clarification questions. On page 11 of the second-quarter update where it shows our net incomes, in view of your comments on the third quarter, can you give me an idea of how those numbers would be impacted?

DR. WEST: I can't directly, but maybe Paul can. We haven't done a full true-up of the third quarter and balanced it through the first two quarters. Unfortunately I can't. Now, whether Paul or the money managers can . . .

MR. PUGH: We wouldn't have that information yet. As I said previously, it depends a lot on how our managers have traded the portfolio in the quarter, and we haven't seen their statements yet. They would just be flowing into Gisele's area now.

2:55

THE DEPUTY CHAIRMAN: Well, maybe some of these questions are for the record, because I think in your comments about the third quarter, you indicated there are some negative returns on some of the equity markets. How does that kind of negative return impact on that dollar figure? Will we show in fact a loss in the net income figure?

DR. WEST: It'll be lower.

MR. PUGH: We won't show a loss on that income. Let me go back to first principles, and the accountant can help me out. Income for the heritage fund is dividends, rental income, mortgage payments, interest income, plus capital gains. So you will always have that positive flow. The only time you'd have a negative flow is if we folded up a whole portfolio at a loss and took a huge pile of realized capital losses. So as we go forward, so long as we generate that base revenue plus some capital gains – in most cases you take your capital gains, not your capital losses – there should be a positive income.

THE DEPUTY CHAIRMAN: Okay. That's the reason I asked the question. Even though there are negative returns in the stock market, in fact there is still a net income which flows through the general revenue fund.

DR. WEST: Oh, yes, everything from ADC, financial services, to AOC. There are all types of other flow-throughs.

MS SIMARD: The returns are based on market value, and the accounting is done on cost. That's the difference.

MR. FOWLIE: So the income that the government of Alberta takes, in a sense, from it all is basically based on the cost and not the short-term fluctuations in the market value of the equities. It's based on the income we actually get and the stocks we actually sell rather than whether the market was up or down today. So it may show benchmark returns in the negative because the whole market is down, but the actual income that the government of Alberta will receive will be positive.

MR. PUGH: There might be a circumstance where income might spike up because managers are trading the portfolio to reposition it for what their view of the economy might be. That might generate more capital gains than you would otherwise have, and you might get a spike.

MS SIMARD: Also, I'd also like to caution that those returns even for the third quarter are still not finalized.

DR. WEST: I talked about the third quarter. We're nervous about talking – they change by the hour, by the way, or maybe every two hours. I mean, there are dynamics to preparing quarterly reports throughout that you have to keep your eye on the horizon. It changes so very fast. Look at how oil revenues have changed 30-some percent in 20 days. We were down to under 25 from a 37 high, nearly 38. Now we're back to 29. The volatility: gas goes down; gas goes up.

THE DEPUTY CHAIRMAN: Okay. Well, then, that also begs the question of why we are accelerating the movement to the endowment portfolio from the income portfolio.

MR. PUGH: Again I'll reiterate. One, I think we've got a mature structure here, and we should move to that mature structure and focus on the long-term growth of the portfolio. Two, I think there are some opportunities in the marketplace where markets have come off their highs. The TSE last year was up over 11,000; we're just under 9,000 now. Some of the foreign markets are off over last year. These are opportunities. Don't forget that the endowment portfolio still has roughly 35 percent of its assets in fixed income, so you're still protected on the income side there as well.

The other issue is that with a very large portion of the total portfolio of the heritage fund in very short-term assets you're running the risk that you miss opportunities in the marketplace and you're stuck with short-term assets that are yielding 4 percent, when you may be able to get 8 or 9 percent. You are building for the long term.

THE DEPUTY CHAIRMAN: Yeah, but that's also the reason why we deliberately did a 10-year move of the portfolio from the transition to the endowment.

MR. PUGH: I think the other thing, too, is that when that move was made, the province wasn't benefiting from $30 oil and $8 gas. I think that's another thing that we shouldn't forget. You're in the throes, if you will, of riches, and it might be the best time to do it.

THE DEPUTY CHAIRMAN: Okay. I don't see any further questions.

I need a motion to receive the first- and second-quarter updates as distributed. Mr. Lougheed. Any questions on the motion? All in favour? It's carried.

Other Business. Are there any other items of business that anybody wishes to bring forward at this time?

The next meeting. We need to talk about that. Okay. We'll just talk about that. I just want to point out one thing to the committee members. You'll note that in the business plan on page 13 under goal 3 we continue to have a strategy of holding public accountability meetings around Alberta. That particular strategy has to stay in place until the legislation gets changed. Even though it has been recommended by this committee to adopt a different way of doing that, until it gets changed in the legislation, we have to abide by it. So that will remain in the business plans. That's just a little bit of an afterthought.

A motion to adjourn? Mr. Stevens. All in favour?

Thank you very much, ladies and gentlemen. We are adjourned.

[The committee adjourned at 3:02 p.m.]