



# Can Ontario Municipalities Borrow More to Make Needed Investments?

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# Overview

- Introduction: motivating questions and definitions
- Analyses and comparison: US, Canadian, and Ontario municipal credit markets
- Financing alternatives: green bonds, credit enhancement facilities, and pooled issuance entities
- Conclusion

# Introduction

## Orienting questions:

- Can Ontario municipalities borrow more?
- Which debt financing tools are available to Toronto and other municipalities in Ontario?
- What are the current limitations to borrowing?
- What is the experience with debt financing in other jurisdictions?
- Which instruments could be adapted to Ontario and Toronto?

# Definitions

Municipalities can borrow directly from banks (loans) or issue securities (bonds or debentures). These can be classified by:

- Maturity: short term (notes) or long term (bonds and debentures)
- Interest rate: fixed or variable
- Amortization: “bullet” or “serial” bonds
- Security: general obligation (GO) or revenue bonds

# Pros and Cons of Borrowing

Pros	Cons
Easier than raising taxes.	Undemocratic or unaccountable form of financing.
Low interest rates currently prevailing in capital markets.	“Market discipline” is problematic: the interests of the creditors may not align with community interests.
Fairer from an intergenerational point of view.	Current taxpayers also benefit from infrastructure investment.
Aligns the spending and repayment requirements with the asset’s lifecycle (“spend-as-you-use”).	Taxes and fees (“pay-as-you-go”) may be better at enforcing fiscal discipline.

# US-Canada Muni Market (bonds)

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US	Canada
89,004 “local governments”.	3,750 “local governments”.
States, municipalities, local public authorities, school districts, etc.	Municipalities and other local public administrations/authorities.
Local Governments are “creatures of the states”. Borrowing powers must be prescribed in state constitutions/laws.	Local Governments are “creatures of the provinces”. Borrowing powers must be prescribed in provincial law.
Municipalities can apply for bankruptcy (Chapter 9, US Code, Title 11).	Municipalities cannot apply for bankruptcy.
Most US Muni bonds are exempt from income tax (federal and state).	Canadian Muni bonds are not exempt from federal or provincial income tax.

# US-Canada Muni Market (bonds)

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US	Canada
Individual investors predominate (42%-67% of the total). Over-the-counter (OTC) market.	Institutional investors predominate; private placements are the rule.
Approx. US\$3.2 trillion of principal outstanding (2016Q2).	Approx. C\$76.6 billion of principal outstanding (2014).
New bond issues in 2015: 9,696, approx. US\$370 billion.	New bond issues in 2014: approx. C\$7 billion.

Source: SIFMA, US Federal Reserve Bank, Stats Canada

# US – Tax Exemptions (bonds)

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Interest payments are tax-exempt if bonds are issued for public purposes (US IRC).

Tax exemption is costly (in terms of tax revenue) and also potentially regressive. However, it lowers borrowing costs for local governments.



# US – Borrowing Limits

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“Soft” limits: “public purpose doctrine” – expenditure must benefit the public

“Hard” limits to municipal borrowing vary:

- Fixed indicators (e.g. percentage of taxable property or revenues)
- Referenda or council majority
- Authorization from a state authority
- Different rules depending on city size

Revenue and TIF bonds usually exempt from limits

# Canada –Borrowing Limits

Hard limits to municipal borrowing (financial obligations in general) vary:

- Fixed indicators (e.g. percentage of assessed property or own-source revenues)
- Referenda or public consultation
- Mandatory approval from ministry, provincial board or agency
- Approval if borrowing exceeds an indicator
- Separate rules for bigger cities, regions

# Ontario – Borrowing Limits

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Legal limits to all municipalities (York Region and Toronto benefit from special rules):

- For “municipal purposes” only (exceptions)
- Municipalities can issue GO bonds (bullet or serial); Toronto can issue revenue bonds
- Long-term borrowing is restricted to capital investments (short term borrowing is allowed)
- Maximum maturity - lifetime of the asset/work or 40 years, whatever is lower

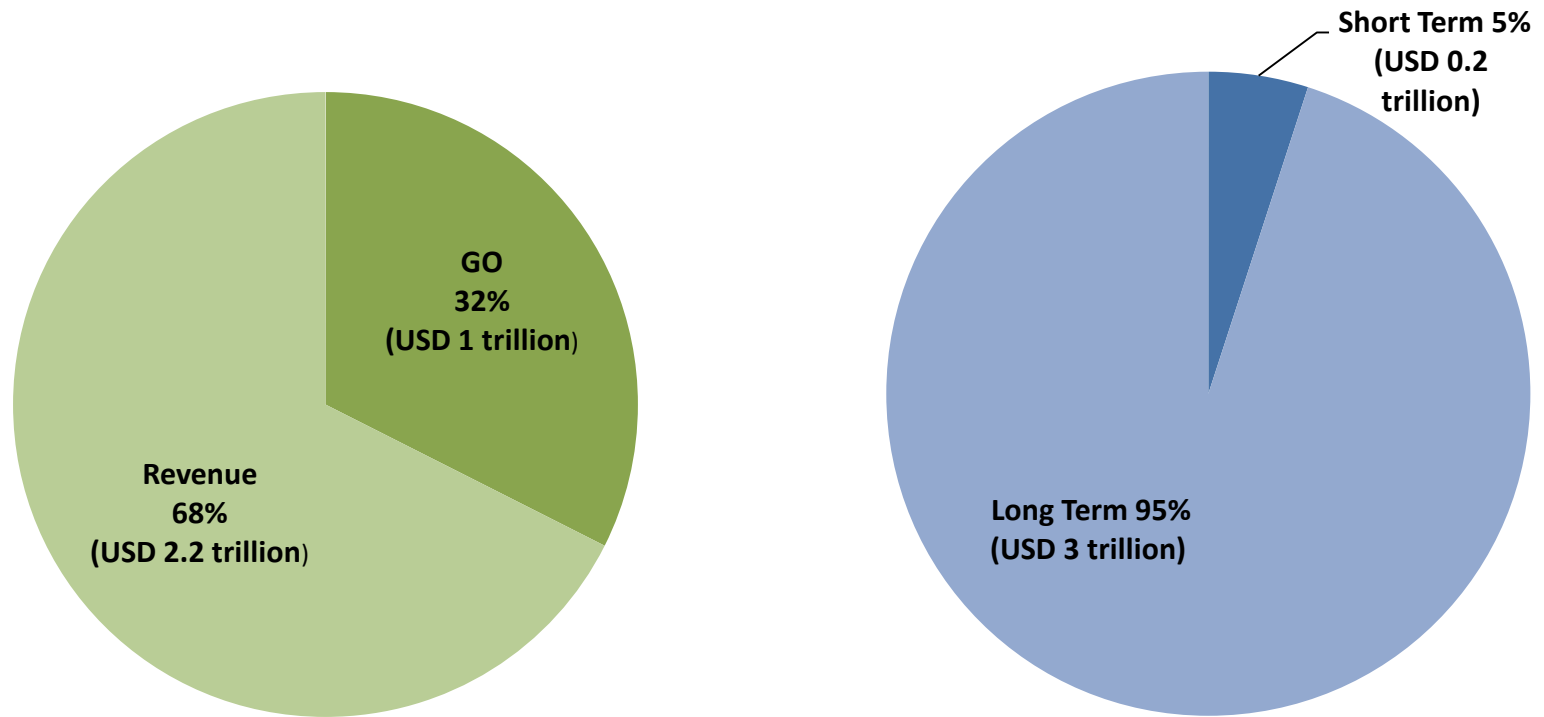
# Ontario – Borrowing Limits

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- Limited to fixed rate borrowing; variable rate and foreign currency borrowing restricted
- “Annual Repayment Limit” (ARL) for financial obligations - 25% of own-source revenues, net of financial payments; above that, Ontario Municipal Board approval is required
- York can add 80% of the revenue with development charges to ARL (until 2021)
- Toronto has no ARL – “soft” limit of 15% of property tax revenues (other limitations)

# US – Types of Bonds and Maturity

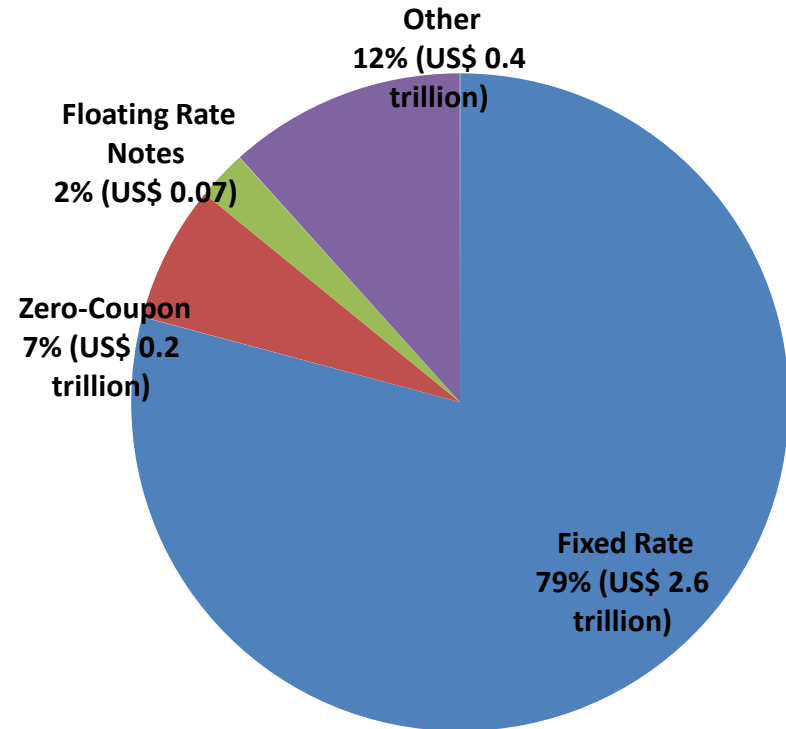
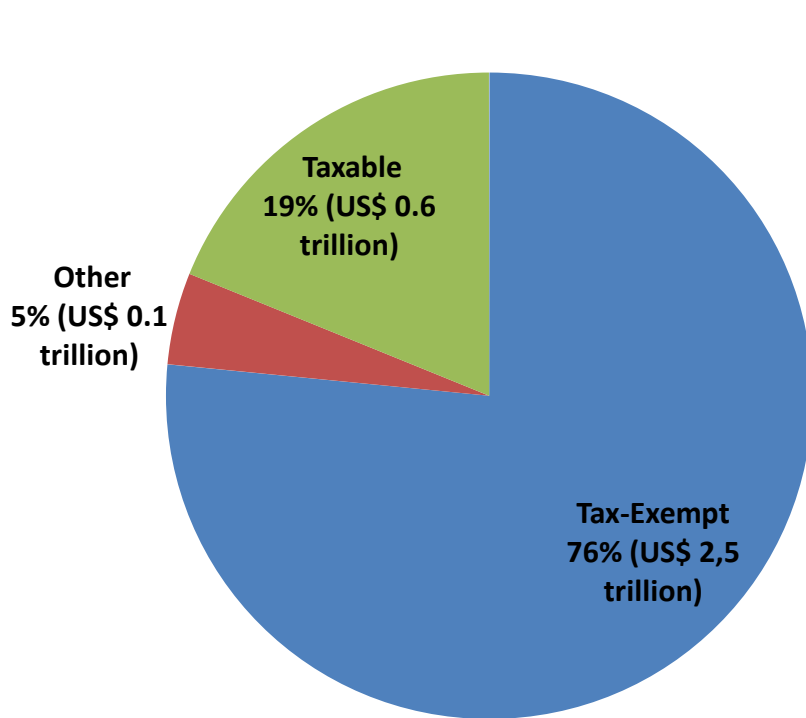
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Source: SIFMA.

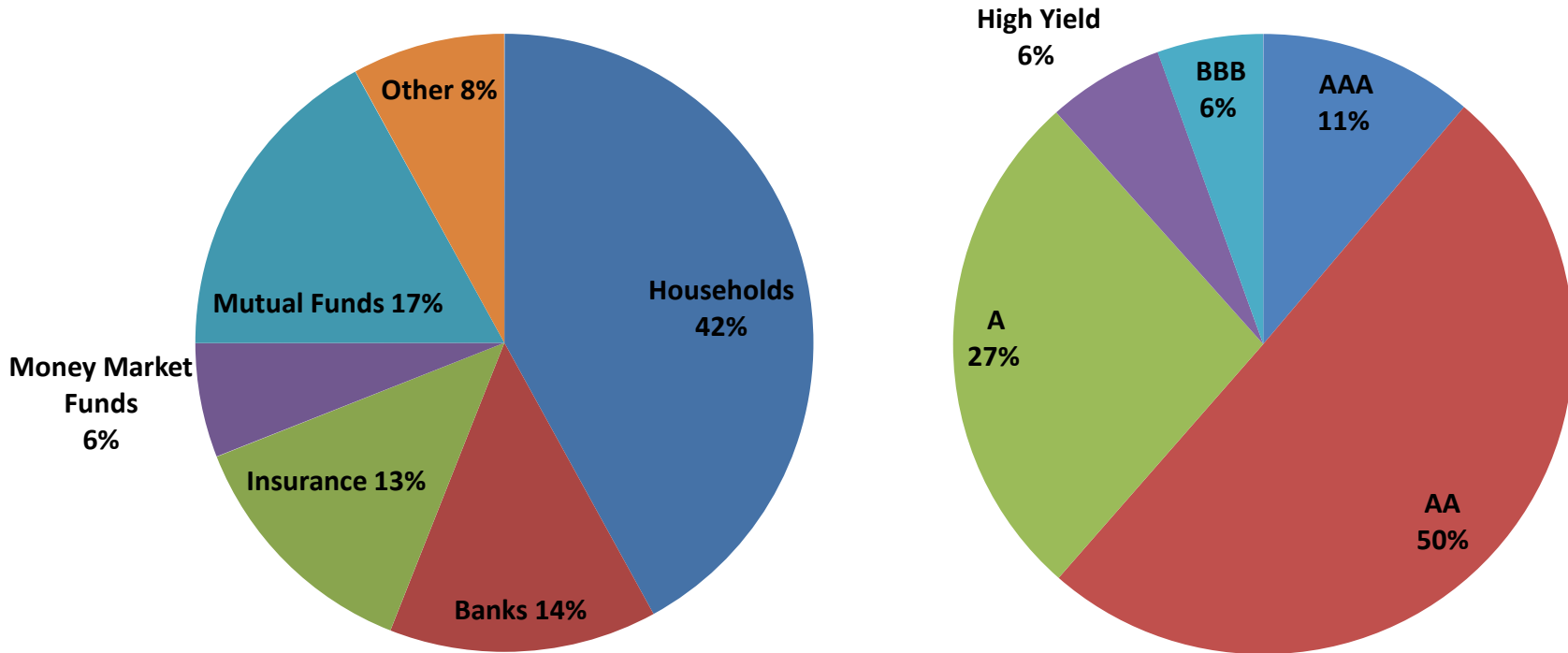
# US – Tax Status and Interest Rates

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Source: SIFMA.

# US – Ownership and Ratings



Source: SIFMA and US Federal Reserve Bank.

# US – Use of Proceeds (2016Q2)

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Airport	88,459	2.72%
Development	106,306	3.27%
Education	687,123	21.11%
General Government	650,133	19.98%
Healthcare	252,569	7.76%
Housing	127,041	3.90%
Other	663,065	20.37%
Public Facilities	13,386	0.41%
Student Loan	29,245	0.90%
Transportation	213,963	6.57%
Utilities	423,177	13.00%
total	3,254,492	100.00%

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Source: SIFMA.



# Canada – Municipal Governments and Authorities, Stock (2014)

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	Rev.	Tax Rev.	Liabil.	Bonds	Loans	% Rev. (Bonds)	% Tax Rev. (Bonds)	% Liabil. (Bonds)	% Rev. (Loans)	% Tax Rev. (Loans)	% Liabil. (Loans)
NL	826	403	1,072	581	253	70.34	144.17	54.20	30.63	62.78	23.60
PEI	121	46	223	11	186	9.09	23.91	4.93	153.72	404.35	83.41
NS	1,841	1,277	3,159	891	57	48.40	69.77	28.21	3.10	4.46	1.80
NB	1,180	685	1,287	893	174	75.68	130.36	69.39	14.75	25.40	13.52
QU	18,932	12,086	32,654	28,292	1,435	149.44	234.09	86.64	7.58	11.87	4.39
ON	42,100	22,425	45,988	20,309	6,366	48.24	90.56	44.16	15.12	28.39	13.84
MB	2,328	1,159	2,320	1,258	444	54.04	108.54	54.22	19.07	38.31	19.14
SK	2,727	1,325	1,866	514	375	18.85	38.79	27.55	13.75	28.30	20.10
AB	14,618	8,038	19,149	11,884	755	81.30	147.85	62.06	5.16	9.39	3.94
BC	10,252	5,994	17,506	9,894	1,180	96.51	165.07	56.52	11.51	19.69	6.74
YK	100	43	27	9	2	9.00	20.93	33.33	2.00	4.65	7.41
NT	221	45	125	1	54	0.45	2.22	0.80	24.43	120.00	43.20
NU	232	16	55	0	20	0.00	0.00	0.00	8.62	125.00	36.36

Source: Statistics Canada (in million C\$).

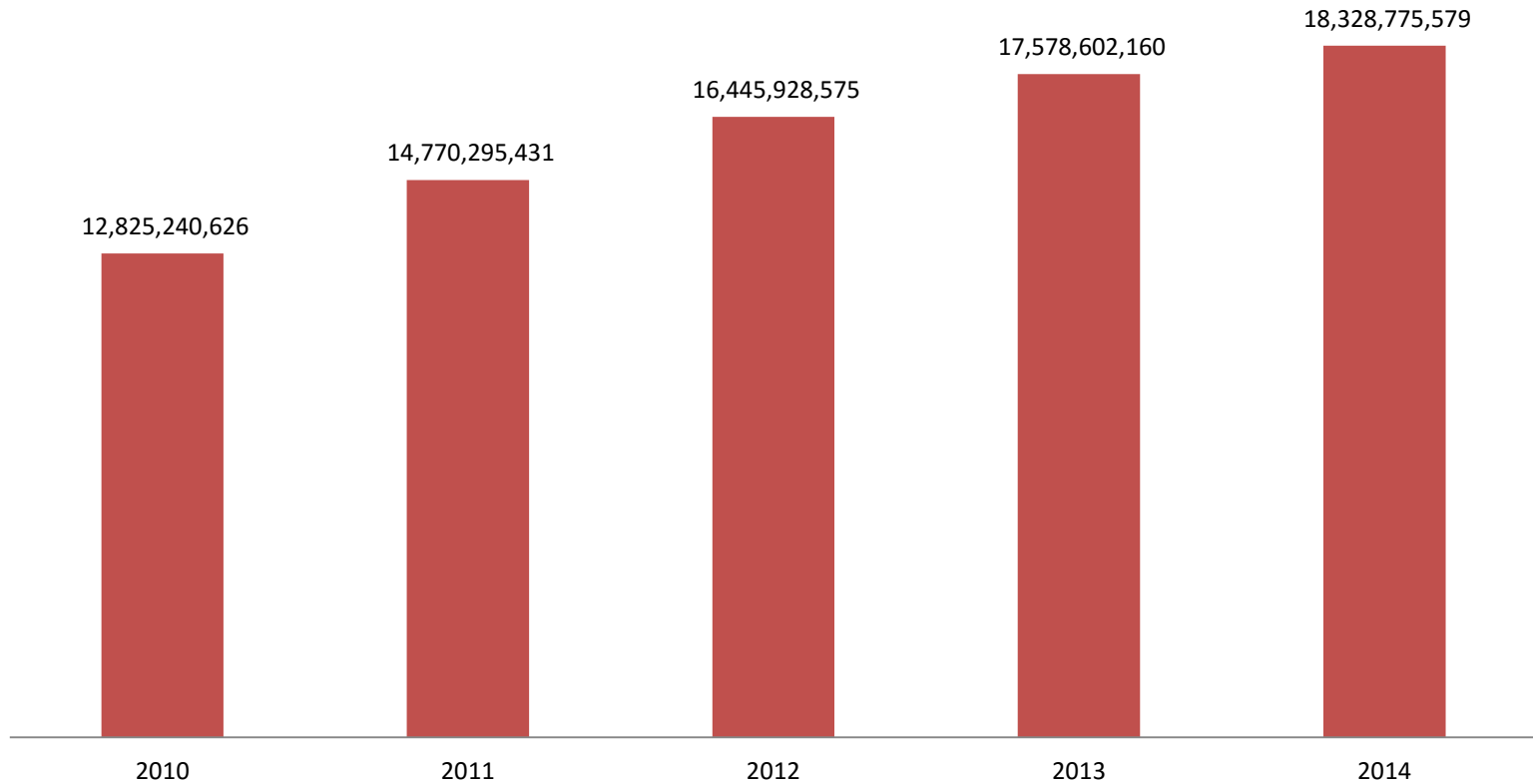
# Canada – Municipal Governments and Authorities, Flows (2014)

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	Revenue	Tax Rev.	Liabil.	Bonds	Loans
NL	826	403	182	187	-18
PEI	121	46	-5	3	-5
NS	1,841	1,277	224	35	-9
NB	1,180	685	77	23	35
QU	18,932	12,086	2,251	2,953	-846
ON	42,100	22,425	1,998	2,736	-696
MB	2,328	1,159	201	213	-23
SK	2,727	1,325	157	52	41
AB	14,618	8,038	735	225	-13
BC	10,252	5,994	917	637	28
YK	100	43	1	-1	1
NT	221	45	-1	0	2
NU	232	16	-2	0	-3

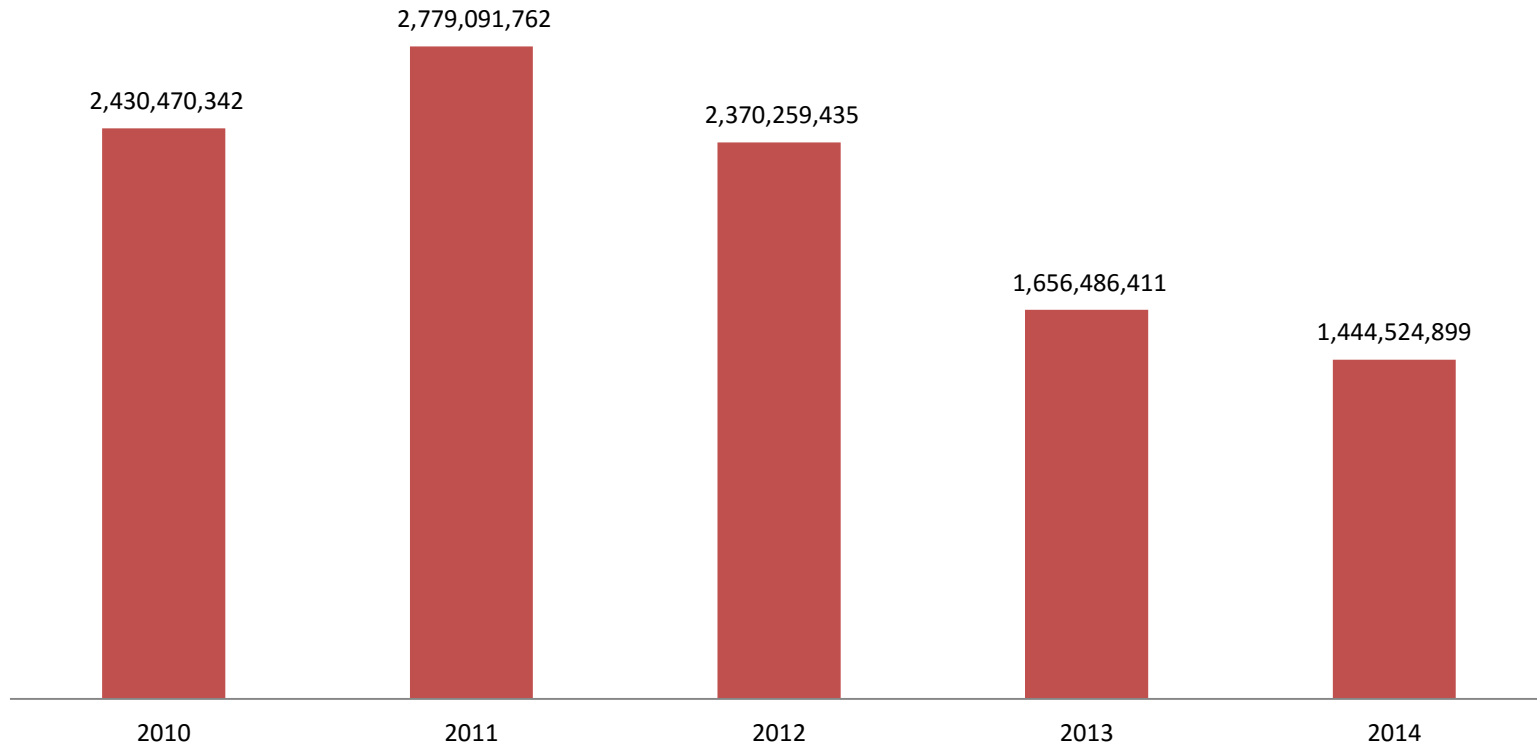
Source: Statistics Canada (in million C\$).

# Ontario – Municipalities, Long Term Debt Stock (2010-2014)



Source: Ministry of Municipal Affairs – Ontario (in C\$).

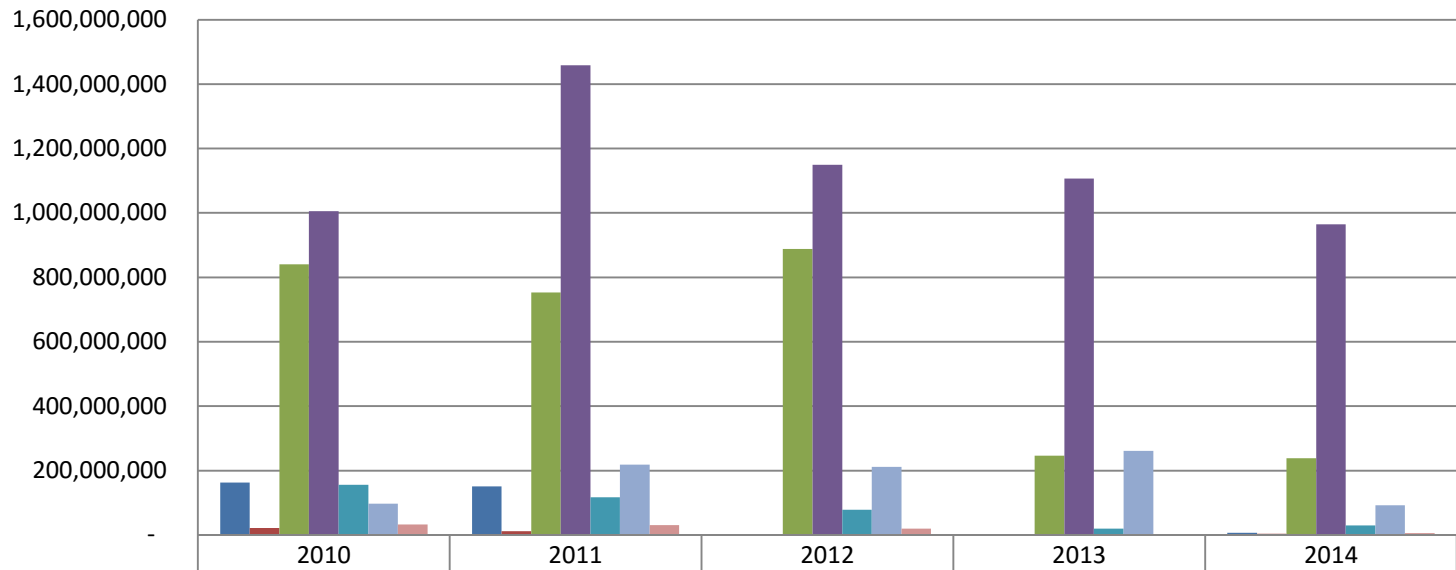
# Ontario – Municipalities, Long Term Debt Issuance (2010-2014)



Source: Ministry of Municipal Affairs – Ontario (in C\$).

# Ontario – Municipalities, Long Term Debt Issued (2010-2014)

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	2010	2011	2012	2013	2014
■ CMHC	162,885,261	151,416,725	2,101,632	915,138	6,492,560
■ OFA	21,778,463	12,072,850	982,839	1,799,790	3,628,267
■ Serial Debentures	840,248,530	753,074,843	887,956,432	246,248,067	238,956,040
■ Sinking Fund Debentures	1,005,753,090	1,458,434,370	1,149,897,552	1,106,840,433	964,520,987
■ Long term bank loans	156,051,069	117,668,742	78,495,184	19,694,728	29,601,397
■ OSIFA/IO	97,791,472	218,577,619	211,158,186	261,184,974	92,175,984
■ Construction Financing Debentures	32,331,564	30,341,807	19,599,920	2,680,931	5,813,535

Source: Ministry of Municipal Affairs – Ontario.

# Ontario – Municipalities, Use of Proceeds (2010-2014)

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	2010	%	2011	%	2012	%	2013	%	2014	%
General Government	713,814,144.00	5.57	726,956,959.00	4.92	724,862,568.00	4.41	768,173,599.00	4.37	881,763,693.00	4.81
Protection Services	492,325,210.00	3.84	553,601,996.00	3.75	559,344,980.00	3.40	585,280,138.00	3.33	585,529,138.00	3.19
Transportation Services	3,207,713,699.00	25.01	3,655,805,895.00	24.75	4,167,222,418.00	25.34	4,502,925,949.00	25.62	5,051,994,728.00	27.56
Environmental Services	3,654,429,948.00	28.49	5,055,717,514.00	34.23	6,107,796,720.00	37.14	6,676,712,525.00	37.98	6,923,761,529.00	37.78
Health Services	133,078,091.00	1.04	107,624,559.00	0.73	117,094,467.00	0.71	121,786,510.00	0.69	132,042,979.00	0.72
Social And Family Services	579,946,176.00	4.52	534,839,776.00	3.62	466,717,441.00	2.84	488,761,807.00	2.78	447,306,619.00	2.44
Social Housing	2,416,391,528.00	18.84	2,309,546,386.00	15.64	2,342,494,713.00	14.24	2,354,873,507.00	13.40	2,283,753,719.00	12.46
Recreation And Cultural Services	1,171,841,106.00	9.14	1,323,721,719.00	8.96	1,474,504,221.00	8.97	1,580,622,075.00	8.99	1,533,747,941.00	8.37
Planning And Development	275,312,082.00	2.15	326,821,381.00	2.21	326,109,327.00	1.98	318,277,044.00	1.81	310,980,538.00	1.70
Other Long Term Liabilities	180,388,642.00	1.41	175,659,245.00	1.19	159,781,720.00	0.97	181,189,006.00	1.03	177,894,697.00	0.97
<b>TOTAL</b>	<b>12,825,240,626</b>		<b>14,770,295,431</b>		<b>16,445,928,575</b>		<b>17,578,602,160</b>		<b>18,328,775,579</b>	

Source: Ministry of Municipal Affairs – Ontario.

# Toronto – Debt (2015)

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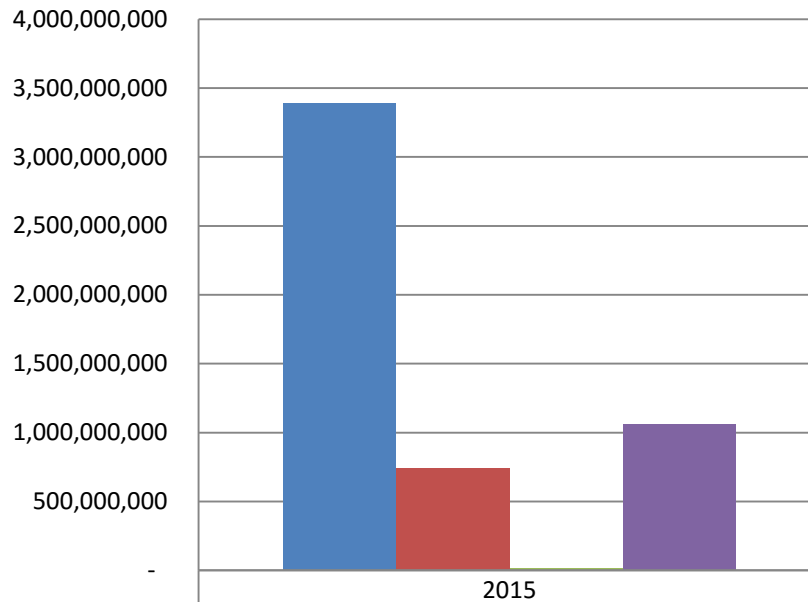
## Current position:

- Toronto's outstanding debt: approx. C\$7.2 billion; net debt: approx. C\$ 5.2 billion
- Serial debentures issued: approx. C\$ 228 million; bullet debentures issued: approx. C\$ 248 million
- No revenue bonds or bonds in foreign currencies have been issued so far
- Interest payments + financial expenses: approx. C\$ 528 million, 13.6% of own-source revenue

Source: Ministry of Municipal Affairs – Ontario.

# Toronto – Debt Stock and Use of Proceeds (2015)

## Debt Stock



■ Sinking fund debentures	3,390,058,236
■ Serial debentures	738,521,321
■ long term bank loans	19,602,463
■ others	1,064,224,880

	2015	%
General government	136,764,415	2.62
Protection services	87,702,020	1.68
Transportation	2,934,866,537	56.31
Environmental services	266,575,481	5.11
Health Services	11,408,079	0.22
Social and Family Services	4,911,694	0.09
Social Housing	1,514,418,556	29.05
Recreation and Cultural Services	146,873,979	2.82
Planning and Development	108,886,139	2.09
<b>Total</b>	<b>5,212,406,900</b>	

Source: Ministry of Municipal Affairs – Ontario.



# Highlights – US, Canada (Ontario) 24

- Individual investors predominate in the US, institutional investors in Canada
- Many municipalities may not have market access in both markets
- Tax-exempt status in the US helps lower borrowing costs, but costly in terms of tax revenues and potentially regressive

# Highlights – US, Canada (Ontario) 25

- In both jurisdictions there is political and ideological resistance to borrowing, but in the US there are also ways to circumvent limits
- In both, infrastructure spending could be higher. There is room for market expansion in Canada and Ontario

What can we learn from experiences elsewhere?

Alternatives: green bonds, credit enhancements, and pooled borrowing

# Alternatives – Green Bonds

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Bonds used for the financing of low-GHG emission projects or green infrastructure:

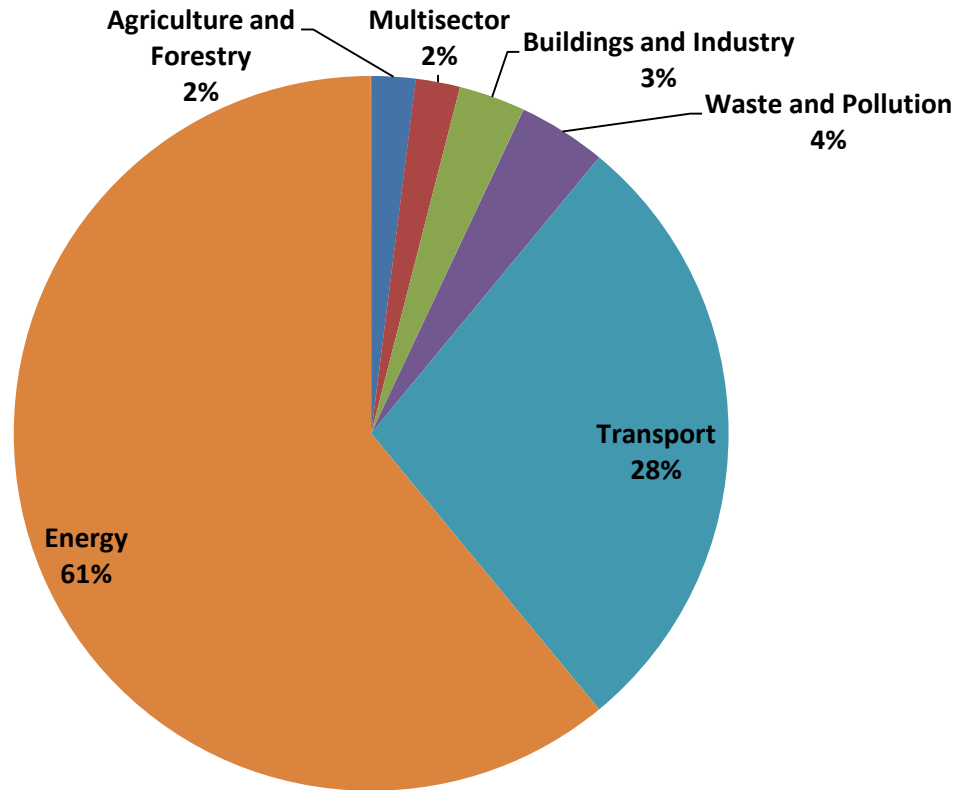
- Can be GOs, revenue bonds, others
- Can be either “labelled” green bonds or “climate-aligned” bonds
- Market-based verification based on different “green bond standards” (Green Bond Principles, Climate Bonds Standard)

# Alternatives – Green Bonds

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- International pioneers: multilateral banks, in 2007. First labelled Canadian issuances in 2014 (Ontario, TD Bank, EDC); no Canadian muni issues so far
- International market size is estimated to be around US\$ 600 billion; Canadian market is estimated to be approx. C\$33 billion, with C\$3 billion in “labelled” green bonds
- 88% of Canadian issuers were corporate and 4% provincial entities

# Green Bonds, Canada – Use of Proceeds (2016)



Source: Climate Bonds Initiative.

# Green Bonds, Pros & Cons (Ontario) 29

Pros	Cons
Increased awareness of and demand for environmentally and socially responsible bonds.	Challenges for verification and implementation.
Investors have longer time horizons.	Higher administrative and borrowing costs.
“Reputational” benefits for the issuer.	Privilege proven technologies and projects with clear revenue streams.
No major regulatory change is needed.	Small market; may have no impact on liquidity and access.

Third party programs, or entities, designed to mitigate default and liquidity risks, among others.

Municipal bond insurance (US):

- Relatively common, but small proportion of all issues (US\$ 18 billion as of August 2015)
- Mainly default insurance. Two private companies and Build America Mutual, a pool of municipalities
- Fees are paid by the issuing municipality

## Debt guarantees (LGUGC - Philippines):

- Comprehensive or partial repayment guarantees
- Repayment covered by fees paid by the issuer
- “Intercept” provisions allowing the guarantor to retain transfers from or revenue shared by higher levels of government



Liquidity provision or secondary market support:

- Buying of outstanding debt, providing liquidity to investors (e.g. VRDOs' in the US)

Bond Banks and Pooling Issuance Entities:

- Institutions at the state/provincial level that “intermediate” borrowing for municipalities (e.g. Municipal Financial Authority of British Columbia, Canadian Infrastructure Bank(?))

# Credit Enhancement, Pooled Issuer, 33 Pros and Cons (Ontario Context)

Pros	Cons
May have a positive impact for borrowing costs and market access for smaller municipalities.	Borrowing costs for the major and more creditworthy issuers may increase (insurance or guarantee fees).
Liquidity facilities may improve market liquidity.	With the exception of liquidity facilities, may not have any impact on liquidity and market size.
Insurance and liquidity facilities may be easier to implement and require minor regulatory change.	Guarantees and pooled borrowing may require considerable political goodwill and regulatory change.

- Municipalities in Ontario are not as restricted in their borrowing powers as usually assumed, but opposition to borrowing is a problem
- Alternative instruments may expand the market or help municipalities to borrow more, but they cannot solve everything; they are incremental steps
- Tax-exemption may increase individual investor base, but at a cost
- Future research: other instruments and mechanisms

# Q and A

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