12 Capital Expenditures, Borrowing & Contracts

Methods of Capital Financing

1. Annual Revenue
2. Reserve Funds
3. Leasing
4. Partnering Agreements
5. Borrowing

Financial Plan

A municipality must annually adopt, by bylaw, a five-year financial plan. Among other things, the plan must show proposed expenditures, including capital expenditures, and the proposed funding sources for those expenditures (see Fact Sheet #7).

The financial plan should show the impact on future budgets of proposed liabilities or commitments (which may arise from capital spending or from leases or other commitments for equipment or facilities). It should also show how the local government intends to finance the future impacts.

Liability Servicing Limits

A municipality cannot incur a capital liability if it would cause the total annual debt servicing cost to exceed the liability service limit prescribed by regulation [CC s. 174 & BC Reg. 254/2004]. The regulation sets the liability service limit at 25% of municipal revenues. The revenues used in the calculation relate to those that are primarily within the municipality's control, such as taxes and fees, unconditional grants and payments in place of taxes. Adjustments in the calculation are made for revenue from taxation of Class 4 properties (major industry) in some cases where a municipality is heavily dependent on this source of revenue.

The limitation applies to the cost to service all borrowing, leases, loan guarantees and general capital commitments that are of a capital nature. "Servicing" in this context means principal and interest on debt, lease payments or other commitments to repay the liability and related financing charges. Contractual payments under a partnering agreement would also be captured by the limitation if the payments relate to items of a capital nature.

A municipality may exceed this limit with the prior approval of the Inspector of Municipalities. Given the significance of the limit to the Municipal Finance Authority (MFA) and its credit rating, the Inspector has agreed to consult with the MFA prior to approving the excess.

Capital Financing from Annual Revenue

Capital expenditures may be financed out of current revenue, provided that the expenditure is included in the financial plan. Any revenue source, so long as it is not otherwise restricted, may be used to finance capital items.

Capital Financing from Reserve Funds

Reserve funds may be established by council as a way of setting aside funding for certain specified purposes. While the purpose can be either operating or capital, reserve funds are often used to accumulate funding for future capital purposes [CC s. 188-189]. In addition to statutory reserve funds, capital projects can be financed from surplus.

Development Cost Charge (DCC) Reserve Funds are a specific type of reserve fund that must be established if a local government imposes DCCs. The *Local Government Act* sets out the framework for imposing DCCs for the purpose of providing funds to assist the local government to pay the capital costs of sewer, water, drainage, roads and parks that are incurred as a result of development. [LGA Division 19, Part 14].

Capital Financing Through Agreements (Leases, Partnering Agreements)

Capital assets (such as buildings and equipment) may be financed under an agreement, in which case a liability is incurred under the agreement. The *Community Charter* allows a liability under an agreement, provided that the liability is not a debenture debt and the period of the liability is not longer than the reasonable life expectancy of the service under the agreement [CC s. 175].

Liabilities under agreement are subject to the liability servicing limits noted previously, and may be subject to elector approval requirements. If the liability under the agreement is of a capital nature and the agreement is more than 5 years, or would be more than 5 years if a right of renewal or extension were exercised, then elector approval will be required. There are some exceptions to this general rule for certain types of liabilities and for municipalities with total liability servicing costs below a prescribed threshold [CC s. 175; Municipal Liabilities and Regional District Liabilities Regulations]. Common forms of liabilities under agreement include leases, P3 projects, and equipment financing loans from the Municipal Finance Authority.

Another form of agreement that may provide for capital assets is a partnering agreement. A partnering agreement is any agreement between a local government and a person or public authority under which the person or public authority agrees to provide a service on behalf of the local government. In some cases, a partnering agreement will include the provision of capital assets, which are financed by one of the parties under the agreement.

Capital Financing Through Borrowing

Capital projects may be financed by short-term capital borrowing or borrowing through a loan authorization bylaw (long-term borrowing). Choices between these two forms of borrowing will generally be based on the length of term of the debt, since short-term borrowing is limited to 5 years and long-term borrowing may be undertaken for up to 30 years.

Short-Term Capital Borrowing

A municipality may borrow for 5 years or less for any purpose of a capital nature. The maximum that may be borrowed under these provisions is $50 per capita. The servicing costs (principal and interest payments) of short-term capital borrowing are included in the liability servicing limits noted previously. The borrowing must be undertaken by bylaw approved by the Inspector of Municipalities [CC s. 178]. There is no requirement for elector approval to the bylaw.

Long-Term Borrowing (Loan Authorization Bylaw)

Long-term debt may be used to finance capital expenditures or provide funding for a limited number of other uses (e.g., to lend to, or guarantee a loan of, a partner; to comply with a court order or judgment). All long-term borrowing must be undertaken through adoption of a loan authorization bylaw approved by the Inspector of Municipalities. The maximum term of the debt is the lesser of 30 years or the reasonable life expectancy of the capital asset or the term of any related agreement [CC s. 179].

Once a loan authorization bylaw is fully approved and adopted, a local government can undertake interim borrowing (during the planning and construction phase) under the authority of a "Temporary Borrowing Bylaw" under s.181 CC or s.409 of the LGA. This borrowing may then be rolled into debenture debt through an RD security issuing bylaw under s.411 LGA. All security issuing is done through the MFA (see Fact Sheet #13).

Most loan authorization bylaws require elector approval. There are exceptions to this general rule for certain types of liabilities (e.g., borrowing for court or arbitration costs) and for municipalities with total liability servicing costs below a prescribed threshold of 20% of the liability servicing limit as set under s.7 of BC Reg 254/2004 [CC s. 175; Municipal Liabilities and Regional District Liabilities Regulations].

Long-term borrowing for all municipalities (except Vancouver) must be undertaken through the regional district, which in turn borrows from the Municipal Finance Authority (see Fact Sheet #13).

Revenue Anticipation Borrowing

The *Community Charter* allows borrowing needed to meet current expenditures. In this case, the borrowing relates to operating needs of the municipality (i.e., this is not a method to finance long-term needs or capital items). Revenue anticipation borrowing, while not included in the liability servicing limitation noted above, is limited in a different way. The municipality must not borrow more than the amount of unpaid taxes imposed during the current year and the money remaining due from other governments. If the borrowing takes place before the adoption of the property tax bylaw, the amount that can be borrowed is limited to 75% of the preceding year's tax levy. If there is revenue anticipation borrowing outstanding, revenue from property taxes must be used first to repay that borrowing [CC s. 177].

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