Financing Local Government Capital Investment

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Financing Municipal Infrastructure: Introduction

- Presentation focuses on ways of financing municipal infrastructure
- Choice of financing tool depends on the type of infrastructure investment
- Financing tools should relate the benefits of infrastructure to the cost of providing it (get the prices right)

Outline of Presentation

- Types of municipal infrastructure
- Criteria for evaluating financing tools
- Analysis of selected financing tools

Types of Municipal Infrastructure

- Financing tools depend on type of infrastructure investment:
  - Services in new developments
  - New services in existing developments
  - Maintenance and replacement of old services
  - Mega projects

Criteria for Evaluating Financing Tools

- Economic efficiency
- Equity
- Accountability
- Ease of administration

A Range of Financing Tools

- Own-source revenues: taxes, special assessments, user fees, development charges
- Federal and provincial/state grants
- Reserves and borrowing

Property Taxes

- Appropriate for capital expenditures that benefit current users where expected life of asset is short (e.g. computers)
- Appropriate for current maintenance (e.g. roads)
- Not related to benefits received for long-term investments
- Not appropriate for investments that are "lumpy" (i.e. investments that are large in some years and small in other years)

- Also known as local improvement charges
- Used for new services in existing developments
- Based on frontage, size of lot, the assessment base, or by zone

- Based on benefits received
- Can be difficult to determine geographic boundaries of benefits (e.g. park)
- Funds infrastructure that benefits neighbouring properties

User Fees

- Lead to efficient use of services
- Control over-consumption of services provided by physical infrastructure
- Reduce demand for investment in infrastructure

User Fees

- Adverse impact on equity: “lifeline” pricing schemes may be appropriate
- Behavioural change versus revenue generation

User Fees

- Appropriate for capital expenditures where beneficiaries can be identified and non-payers excluded

- Appropriate for water, sewers, and garbage collection; tolls to finance highways

Development Charges

- Also known as lot levies
- Charge per lot or per hectare to cover the growth-related capital cost associated with new development
- Covers cost of off-site infrastructure (e.g. highways, sewer lines, etc.)
- Applicable to new growth

Development Charges

- New growth pays for itself and is not a burden on existing taxpayers

- If levied on a development by development basis, development charges can lead to efficient land use decisions

- Appropriate to cover growth-related costs in new developments

Development Charges

- Can lead to urban sprawl where municipalities levy a uniform charge regardless of location

- Municipalities may borrow more cheaply than developers

- Density bonusing –developers are granted increased density in exchange for providing something the municipality wants
- Linkage fees – imposed on commercial developers to finance affordable housing
- Parkland dedication – developers required to set aside land for parks

Intergovernmental Transfers

- Conditional grants – donor government decides where grants will be spent; can be matching or non-matching

- Unconditional grants – can be spent on anything recipient chooses

Intergovernmental Transfers

- Appropriate to address spillovers (where the benefits or costs of services provided in one jurisdiction spill over into another jurisdiction)

- Potential problems:
  - Not stable and predictable
  - Distort local decision-making
  - Inefficient local revenue decisions
  - Accountability problems

Reserves

- Set aside revenues for future use
- Opposite of borrowing
- Obligatory or discretionary

Borrowing

- Municipalities can borrow to pay for at least some of the costs of major capital works
- Repayment of borrowed funds comes from operating revenues (property taxes, user fees)

Borrowing

- Synchronizes costs and benefits over time
- Allows for immediate benefit from infrastructure investment
- Allows municipalities to avoid large year-to-year fluctuations in local taxes

Borrowing

- Debt charges may “crowd out” other municipal expenditures
- Debt charges can constrain local flexibility

Borrowing

- Appropriate to finance:
  - large capital investments (mega projects)
  - new services in existing developments
  - services in new developments

Borrowing Tools- General Obligation Bonds

- Bonds are backed by the revenues of the municipality regardless of what the bond is used for

- Types:
  - serial debentures
  - sinking fund debentures

- Legally secured by a specific revenue source (e.g. for utilities)
- Promote full-cost pricing of services
- Shift the risk to the investor
- Often charged higher rates because they are not backed by the government’s overall revenues
- Those who benefit from the service pay for the facility

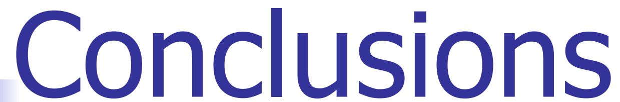
Borrowing Tools- Tax-Exempt Bonds

- Interest income is exempt from personal and corporate income taxes
- Lowers borrowing costs for municipality
- Criticized for being regressive; central governments forego revenues; transactions costs

Borrowing Tools – Pooling Debt

- Pooling of debt through provincial financing authorities or state infrastructure banks

- Lowers the cost of borrowing (interest costs and transactions costs)



Conclusions

- Choice of tool depends on type of infrastructure investment and type of infrastructure
- Need a variety of tools
- Financing tool should relate benefits to costs