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Government Debt and Other Liabilities in the City of Vancouver

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Summary

- The City of Vancouver has the unique ability among British Columbia municipalities to directly issue long-term government debt. This means the city is not subject to the same regulatory process that applies to long-term borrowing for other municipalities in the province.

- In addition to long-term debt (debt outstanding for more than a year), the city has other liabilities such as pension obligations and other future claims on government resources. All liabilities added together make up the city's gross liabilities.

- Starting in 2002, and continuing through to 2013 (the most recent year of available data), the City of Vancouver's gross liabilities exceeded financial assets in every year, placing the government in a net liabilities position. In contrast, the collective financial assets of the other Metro Vancouver municipalities exceed gross liabilities, putting other city governments in the region in a net financial assets position.

- The City of Vancouver's net liabilities more than quadrupled from $101 million in 2006 to $419 million in 2011. While net liabilities decreased in 2012 and again in 2013, the decline stemmed from an increase in financial assets, not a reduction in gross liabilities.

- The City of Vancouver's gross liabilities reached a record high of $1.8 billion in 2013, more than double the amount of liabilities in 2002 ($857 million). A consequence of growing gross liabilities is increased annual servicing costs (repayment of principal plus interest on past debt). With more money going to servicing past debt, less is available for municipal services.

Introduction

The debt and other liabilities of municipal governments in British Columbia typically do not receive a lot scrutiny since provincial regulations generally prohibit municipalities from accumulating large amounts of debt. The City of Vancouver has the unique ability to issue long-term government debt directly; other municipalities must do so through the Municipal Financing Authority (MFA). This distinction, along with the fact that the City of Vancouver is the largest municipality in the province, makes the city an interesting case study.

This short paper examines data on government liabilities in the City of Vancouver. Government liabilities include more than just debt borrowed by municipal governments.[1] For example, many municipalities have obligations related to employee pension funds or landfill sites. Similar to borrowed debt, these types of liabilities have an impact on government finances[2] and are included in the data source (the Local Government Statistics database),[3] which the analysis draws from. The paper finds that from 2002 to 2013, the city's gross liabilities, which are all liabilities added together, have increased 115.4 percent from $857 million to $1.8 billion. In addition, since 2002 the city has consistently been in a negative overall financial position with gross liabilities exceeding financial assets every year over the 11 year period.

The paper begins with an overview of provincial regulations on municipal debt. It then compares the City of Vancouver's financial position to that of other Metro Vancouver municipalities. The final section discusses changes to the City of Vancouver's financial position as well as the factors driving those changes.

Rules for municipal borrowing in British Columbia

Municipal borrowing in British Columbia is limited to debt to pay for capital projects or short term borrowing for cash flow purposes (Bish and Clemens, 2008).[4] A municipality cannot incur long-term debt (ie., debt outstanding for more than a year) to pay for the cost of day-to-day operations. Any municipal project funded by long-term debt must provide benefits lasting for more than one accounting year; capital projects such as buildings and roads meet this criterion.[5]

1 For a more complete discussion of government liabilities in Canada, see Palacios et al., 2014.

2 In addition, research finds that government debt can be negatively related to economic growth. See Reinhart and Rogoff, 2010; Égert, 2012; Cecchetti et al., 2011; Kumar and Woo, 2010; and Checherita and Rother, 2010.

3 The Local Government Statistics database is published by the provincial government's Ministry of Community, Sport, and Cultural Development (see: **http://www.cscd.gov.bc.ca/lgd/infra/statistics_index.htm**). The complete list of liabilities includes: accounts payable, restricted revenue, deferred revenue, long-term debt (including debt guarantees), capital leases, future obligations (such as employee pensions), and other liabilities that do not fit into the other categories (British Columbia, Ministry of Community, Sport, and Cultural Development, 2013a). For further discussion of this database and municipal finances in Metro Vancouver, see Lammam and MacIntyre, 2014.

4 This discussion about the limitations on municipalities refers to a particular type of liability: direct debt. Direct debt is money that governments borrow directly. However, governments can incur liabilities in other ways including debt guarantees, capital leases, and future obligations such as employee pensions.

5 For more information, see BC Ministry of Community, Sport and Cultural Development, 2014a.

Short term or cash flow borrowing can be approved by the municipal council, but long term borrowing involves a more complicated process (Bish and Clemens, 2008). With the exception of the City of Vancouver, municipalities are not allowed to issue long-term debt directly. Instead, they must apply to the Municipal Finance Authority (MFA), which then issues securities on the municipality's behalf. The MFA is an independent organization created by the province to provide financial services to BC municipalities; it is governed by appointees of the regional districts.[6]

A municipality's application for a long-term loan must have the approval of its municipal council, provincial government officials, and the regional district board (Bish and Clemens, 2008). The only municipality in Metro Vancouver that does not have to go through this process is the City of Vancouver, which is free to issue long-term debt on its own. The City of Vancouver's long term borrowing, however, is restricted to funding capital projects.

In addition to being a gatekeeper for municipal debt, the MFA also provides financial services to municipalities and helps to reduce the cost of long-term debt. Although each municipality is responsible for repaying its own loan, the MFA pools together municipal loans to provide extra security and enables municipal governments to borrow at a lower rate.[7] Furthermore, the MFA provides a loan guarantee for municipal debt with a fund that would cover the debt payments if a municipality were to fail to meet its obligations (Bish and Clemens, 2008).

Pooling debt risk through the MFA means that municipalities, particularly small ones, can benefit from lower borrowing costs due to the MFA's high credit rating. Lower borrowing costs translate into lower capital costs, thereby requiring municipalities to find less revenue to pay for capital spending than if they had borrowed directly.[8]

A final restriction on municipal government debt is a provincial regulation requiring that the total cost of servicing liabilities, such as interest payments on debt, not amount to more than 25 percent of the previous year's total revenue. This restriction applies to a greater range of liabilities than just debt directly borrowed through the MFA. It also includes loan guarantees, unused borrowing, debts, contingent capital commitments, and general capital commitments.[9]

Financial position of the City of Vancouver

The overall financial position of a municipality is calculated as financial assets[10] minus gross

[6] For more information on the governance structure of the MFA, see **http://mfa.bc.ca/about-us and http://mfa.bc.ca/about-us/governance.**

[7] For more information, see BC Ministry of Community, Sport and Cultural Development, 2014a.

[8] As of April 15, 2014, the credit rating agencies of Moody's, Fitch, and Standard and Poor's assigned the MFA credit ratings of Aaa, AAA, and AAA, respectively. The City of Vancouver, which can borrow directly, enjoys a favourable, although slightly lower credit rating. It received at Aaa rating from Moody's and AA rating from Standard and Poor's. All ratings are taken from the websites of rating agencies on April 15, 2014.

[9] For more information on the liabilities included in the "25 percent of previous year's revenue" rule, see BC Ministry of Community, Sport and Cultural Development, 2014b.

[10] Financial assets can include: cash and investments, taxes receivable, amounts receivable, Municipal Finance Authority (MFA) deposits, loans receivable, property held for resale, government

liabilities (including long-term debt). If gross liabilities exceed financial assets, a municipal government is in a net liabilities position.[11] The financial position is an important indicator of the financial resources available to municipal governments. Municipalities with greater financial assets are better able to manage and sustain higher levels of gross liabilities given their ability to liquidate assets and pay down debt if needed.

To provide context for the City of Vancouver's financial position, table 1 compares the city's net financial position to other municipalities in the Metro Vancouver region. The table shows that in 2012 (the latest year of comparable data) virtually all municipalities were in a net asset position, whereby financial assets exceed gross liabilities (see also figure 1).[12] A notable exception is the City of Vancouver, which is in a net liabilities position.

Figure 2 displays the collective net financial position of all municipalities in Metro Vancouver from 2002 to 2012, excluding the City of Vancouver. While there has been some fluctuation over the period, other Metro Vancouver municipalities have been collectively in a net financial asset position throughout. Net financial assets for these municipalities started the period at $1.2 billion and reached $2.0 billion by 2012.

Table 1: Net financial assets (or liabilities) in 2012 by Metro Vancouver municipality

Municipality	Net financial position (millions $)
Burnaby	676
Richmond	469
Coquitlam	166
Surrey	153
North Vancouver (City)	118
Delta	108
North Vancouver (District)	72
Port Coquitlam	41
Langley (City)	37
White Rock	34
Maple Ridge	33
Langley (District)	28
New Westminster	25
Port Moody	24
Pitt Meadows	8
Bowen Island	4
Anmore	3
Lions Bay	(0)
West Vancouver	(1)
Belcarra	(3)
Vancouver	(268)

Note: The net liabilities of Lions Bay amount to approximately $259,000 but appear as zero due to rounding.

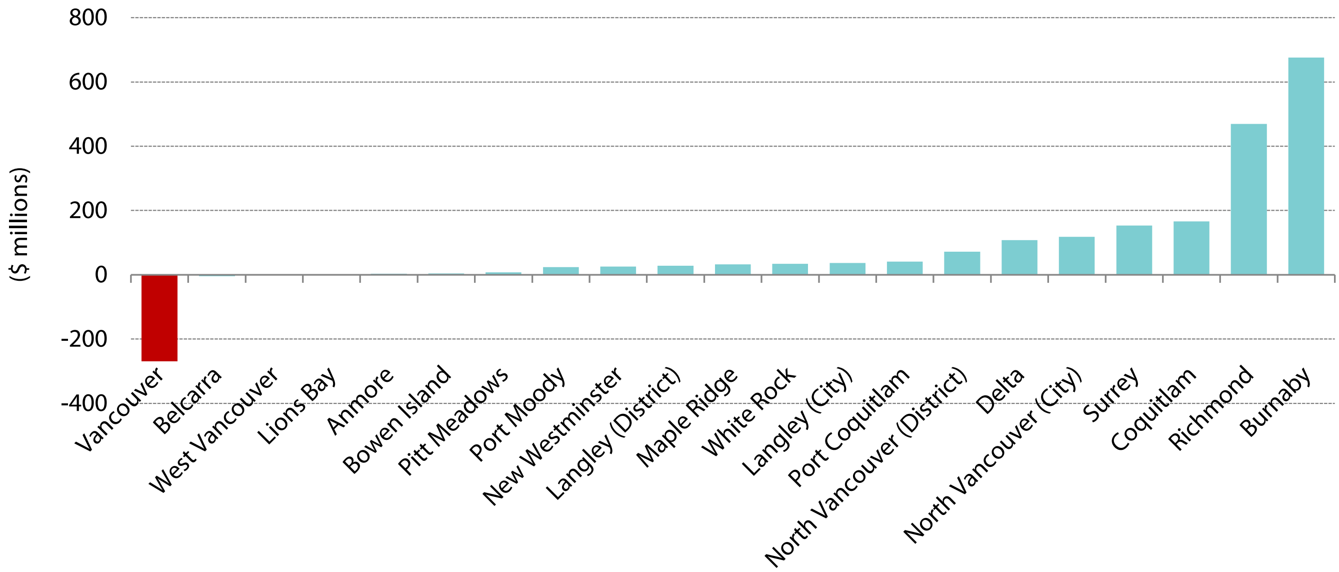
Source: British Columbia, Ministry of Community, Sport, and Cultural Development, 2013b; calculations by authors.

business enterprise equity, and other assets and investments that do not fall into one of the other categories (British Columbia, Ministry of Community, Sport, and Cultural Development, 2013a).

11 Net liabilities are basically a deferred tax bill since they ultimately must be repaid by city taxpayers over time. For seminal work on debt as future taxes, see Barro, 1974. For a less technical work, see Law and Clemens, 1998.

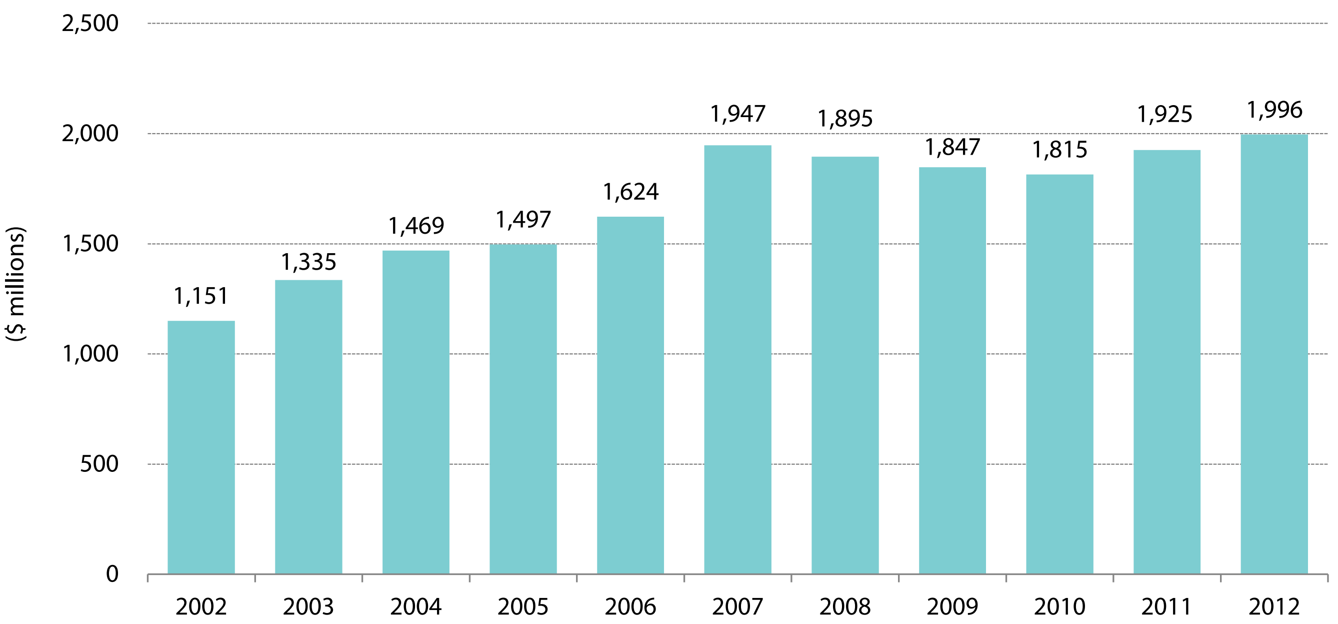
12 As discussed earlier, provincial regulations encourage municipalities to be in a net asset position by limiting the amount of long-term debt that municipal governments can accumulate.

Figure 1: Net financial assets (or liabilities) in millions of dollars, by Metro Vancouver municipality, 2012



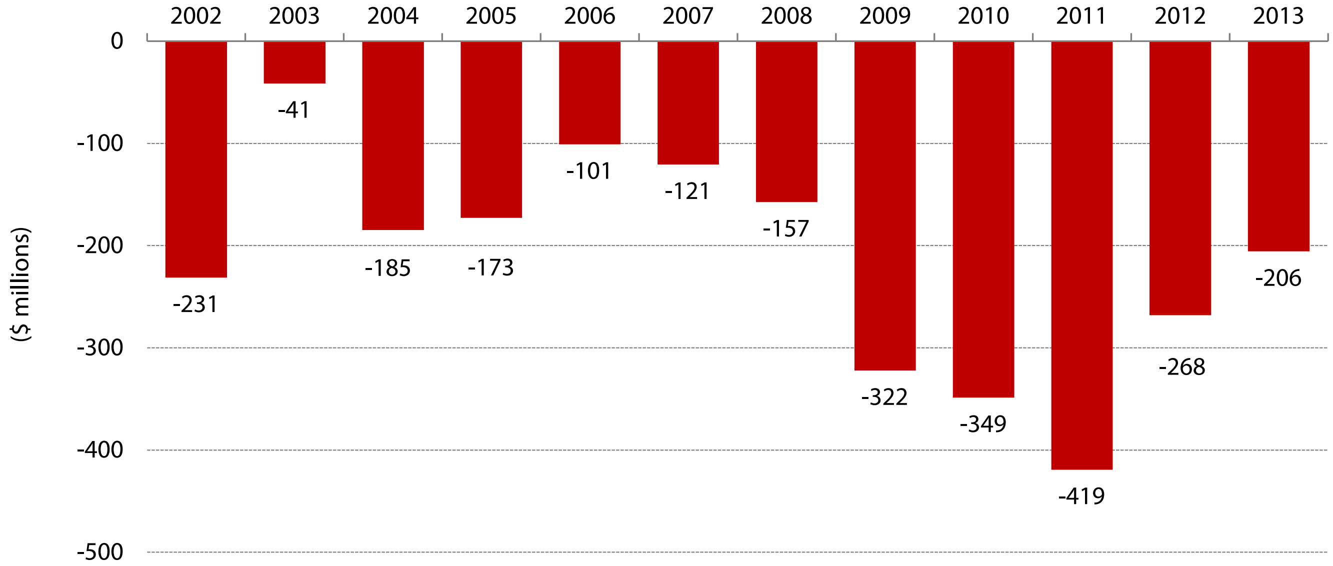
Source: See table 1.

Figure 2: Total net financial assets of Metro Vancouver municipalities (excluding City of Vancouver) in millions of dollars, 2002-2012



Note: The figure shows the collective financial position of 20 municipalities in Metro Vancouver excluding the City of Vancouver.
Source: See table 1.

Figure 3: Net liabilities of the City of Vancouver in millions of dollars, 2002-2013



Sources: British Columbia, Ministry of Community, Sport, and Cultural Development, 2013b; City of Vancouver, 2014a; calculations by authors.

By contrast, the City of Vancouver fell into a net liability position in 2002 (British Columbia, Ministry of Community, Sport and Cultural Development, 2013b) and has remained there up to 2013, the most recent year of available data for the city. In other words, 2001 was the last year the city reported a net financial asset position. Figure 3 shows the city's financial position from 2002 to 2013. Net liabilities initially decreased from $231 million in 2002 to $101 million in 2006 before they more than quadrupled to $419 million by 2011 (in 2009 alone, net liabilities more than doubled). Net liabilities decreased in 2012 and again in 2013, ending the period at $206 million.[13]

Gross liabilities and financial assets of the City of Vancouver

When the City of Vancouver's net financial position is broken down into gross liabilities and financial assets, a clearer picture emerges of the factors driving the changes in net liabilities. Figure 4 displays the gross liabilities and financial assets from 2002 to 2013, while figure 5 shows the annual percentage change for each variable over the period.

In the period from 2006 to 2011, net liabilities more than quadrupled from $101 million to $419 million. Over the period, gross liabilities increased from $969 million to $1.8 billion, representing an 89.9 percent jump.[14] Meanwhile, financial assets also increased, but at a slower rate (63.7 percent). Specifically, financial assets

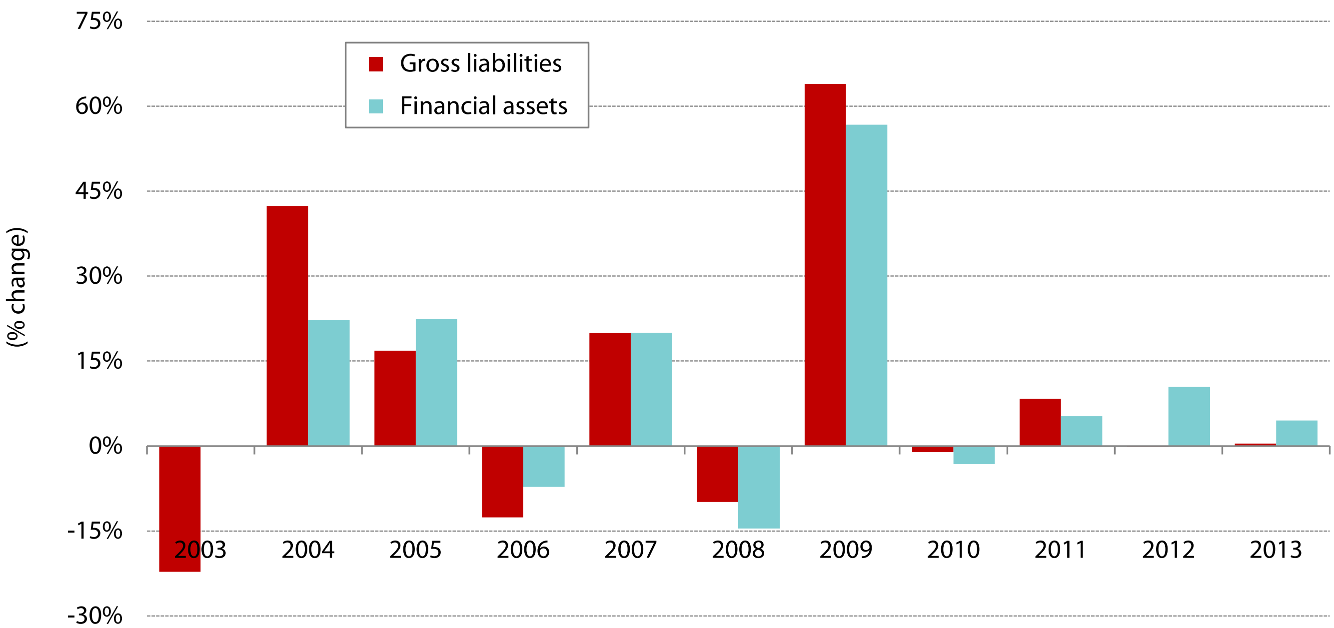
13 Adjusting for population, in 2012 (the latest year of comparable data), the City of Vancouver was in a net liabilities position of $402 per person, while the rest of Metro Vancouver municipalities were collectively in a net assets position of $1,141 per person.

14 A large proportion of the total $871 million increase in gross liabilities took place in 2009.

Figure 4: City of Vancouver gross liabilities and financial assets in millions of dollars, 2002-2013

Note: Gross liabilities are presented as negative numbers elsewhere but are presented here as positive numbers to facilitate comparison with financial assets.
Source: See figure 3.

Figure 5: Annual percent change in gross liabilities and financial assets for the City of Vancouver, 2003-2013



Source: See figure 3.

Table 2: City of Vancouver liabilities by type (millions $)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Total long-term debt	490	463	541	636	496	578	543	1,190	1,170	1,132	1,061
Restricted revenue	204	30	183	221	173	324	207	221	206	383	446
Future obligations	37	37	88	94	102	164	140	125	150	156	150
Other liabilities	126	136	137	158	199	97	158	181	172	169	181
Total	857	667	949	1,109	969	1,162	1,047	1,717	1,699	1,840	1,837

Notes:

- Long term debt includes debt guarantees, which is a promise to pay all or part of the principal and/or interest on a debt obligation in the event of a default by the borrower.
- Restricted revenue includes developer cost charges that are not yet considered revenue. It also includes MFA debt reserves and other restricted revenue.
- Future obligations include future payroll obligations (such as pension obligations) and landfill liabilities.
- Total lease liabilities is another type of municipal liability, but throughout the period the city of Vancouver did not report any liabilities of this type.
- Other liabilities include "accounts payable and accrued liabilities" and liabilities that do not fall under one of the other types, such as excess collection of requisitioned property taxes which must be applied to taxes levied the following year.

Source: See table 1.

increased from $868 million in 2006 to $1.4 billion in 2011. The larger growth in gross liabilities compared to financial assets explains why net liabilities grew between 2006 and 2011.

From 2011 to 2013, net liabilities declined. The 50.9 percent drop in net liabilities to $206 million from $419 million is the result of financial assets increasing at a faster rate (15.4 percent) than gross liabilities, which essentially remained flat (a 0.3 percent growth). The decline in net liabilities is not due to a decrease in gross liabilities; rather, the decline is primarily driven by an increase in financial assets. In fact, the City of Vancouver's gross liabilities in 2013 are the highest they have been over the period examined (2002 to 2013).

Over the entire 11 year period, gross liabilities more than doubled from $857 million to $1.8 billion. An important consequence of increasing liabilities is that the cost of servicing municipal government debt also increases. When the city holds long-term debt, it is required to pay interest on that debt in addition to repaying the principal. In 2013, debt servicing costs (repayment of principal plus interest on past debt) were 7.8 percent of operating expenditures; this ratio is expected to reach approximately 9 percent by 2019 (City of Vancouver, 2014b: 15).[15]

[15] An extra $400 million in debt will be borrowed if the City's July 2014 draft capital plan for 2015 to 2018 comes to fruition (City of Vancouver, 2014c: 36). This would cause debt servicing costs to increase 17 percent (or the equivalent of a 2.2 percent increase in property taxes over four years). The ratio of debt servicing costs to operating expenditures would then jump from 7.8 percent in 2013 to 8.8 percent in 2019 and reach 9.2 percent by 2027 (City of Vancouver, 2014c: 11).

Table 3: City of Vancouver financial assets by type (millions $)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Cash and investments	390	473	623	791	702	878	645	501	617	788	1,115
Olympic Village project	0	0	0	0	0	0	80	695	524	462	310
Other financial assets	235	152	142	145	166	164	165	199	209	171	144
Total	625	625	764	936	868	1,042	890	1,395	1,350	1,421	1,569

Notes:

- Government business enterprise equity and other financial assets are additional types of financial assets, but throughout the period the City of Vancouver did not report any such financial assets.
- Financial assets related to the Olympic Village project were reported as loans receivable in 2009 to 2011. In 2012, they were reported as property held for resale.
- Other financial assets include account receivables, loans receivable (other than loans receivable related to the Olympic Village project), taxes receivable, and MFA deposit notes.

Source: British Columbia, Ministry of Community, Sport, and Cultural Development, 2013b; City of Vancouver, 2014a; calculations by authors.

Types of liabilities and financial assets

Liabilities and financial assets are general categories and the City of Vancouver holds different types of each. For instance, long-term debt is a particular type of liability (and the largest), while cash and investments are a type of financial asset. Breaking down liabilities and financial assets by type helps inform which liabilities and/or financial assets are responsible for the overall change. Table 2 displays the city's liabilities by major type and table 3 does the same for financial assets. Both tables present data from 2002 to 2012.[16]

From 2006 to 2011, when net liabilities more than quadrupled, table 2 shows that the largest driver of the increase in gross liabilities (in dollars) came from long-term debt.[17] Specifically, long-term debt increased $636 million (or 128 percent) over the period, with the bulk of the increase occurring in 2009 when long-term debt more than doubled in one year. Most of this increase in long-term debt reflects the city's decision to take on the liabilities associated with the Olympic Village project that was undertaken as part of the 2010 Olympics. In 2009, the City of Vancouver took out a $630 million loan for financing development of the property southeast of False Creek (City of Vancouver, 2010).

The Olympic Village project was also an important factor in the 2009 increase of financial

[16] Total financial assets and liabilities for 2013 are available from the City of Vancouver's annual financial report, but the types of financial assets and liabilities are not presented in a manner that is consistent with the Local Government Statistics (the main source of data for this report). This means that data for specific types of liabilities are only available up to 2012.

[17] In addition, a notable observation from Table 2 is that future obligations (including government employee pensions) were more than four times higher in 2012 than in 2002.

assets, which mitigated the impact of the city's borrowing on the net financial position. Table 3 displays cash and investments,[18] financial assets related to the Olympic Village project, and other financial assets.[19] In 2009, the City of Vancouver acted as a lender to the private developer of the Olympic Village property, thus increasing financial assets related to the project by $615 million (table 3). The following year, the private developer of the Olympic Village properties went into receivership and the City of Vancouver took possession of the properties in 2011, recording them as financial assets (City of Vancouver, 2012).[20] Still, the overall increase in gross liabilities in 2009 was larger than financial assets, leading to the more than doubling of net liabilities.

Table 3 also helps to explain the growth of financial assets in 2012, which caused a decline in net liabilities. In 2012, cash and investments grew from $788 million to $1.1 billion. At the same time, other forms of financial assets cumulatively fell by $179 million, offsetting the increase in cash and investments. The City of Vancouver's annual financial report for 2013 reveals a similar pattern. In 2013, cash and investments grew by $255 million and all other financial assets together fell by $185 million (City of Vancouver, 2014a). Despite the drop in other forms of financial assets in 2012 and 2013, the expansion of the city's cash and investments was large enough to increase total financial assets. With virtually no change in gross liabilities, the reduction in net liabilities in 2012 and 2013 was largely driven by growth in cash and investments.[21]

Conclusion

The City of Vancouver is the largest municipality in British Columbia and the only one that can directly issue long-term debt. This makes the city's liabilities an interesting case for study. An important finding of this paper is that from 2002 to 2013, the City of Vancouver has consistently been in a net liabilities position. This stands in stark contrast to the general trend for other Metro Vancouver municipalities, which have collectively been in a net asset position.

Another important finding is that both liabilities and financial assets have played an important role in the change in the City of Vancouver's net liabilities. From 2006 to 2011, the City of Vancouver's net liabilities more than quadrupled. The larger growth in gross liabilities

[18] Investments in this case are limited to those outlined by section 183 of the Community Charter (British Columbia, Ministry of Community, Sport and Cultural Development, 2013b). They generally include low-risk investments such as federal or provincial government securities. For a complete list, see *Community Charter*, BC, 2003.

[19] Other financial assets include accounts receivable, loans receivable (other than loans receivable related to the Olympic Village project), taxes receivable, and MFA deposit notes.

[20] The city has recently sold the last of these properties and has used the proceeds to pay down debt (Bula, 2014, April 28). According to recent news reports, however, the city failed to achieve good value for taxpayers in some of the Olympic Village property sales (Cooper, 2014, April 13).

[21] The City of Vancouver was able to increase cash and investments because it restrained spending growth in 2012 and 2013. Total spending grew by 0.3 percent in 2012 and 0.7 percent in 2013, while total revenue increased by 3.1 percent and 3.0 percent, respectively (British Columbia, Ministry of Community, Sport, and Cultural Development, 2013b; City of Vancouver, 2014a; calculations by authors). The slower growth in total spending meant that the city could accumulate more cash and investments, thus improving the city's overall financial position.

(89.9 percent) compared to financial assets (63.7 percent) explains why net liabilities grew over the period. On the other hand, the decline in net liabilities since 2011 was largely due to an expansion of financial assets. Although the city's gross liabilities have not changed much since 2011, they currently are the highest they have been over the period examined (2002 to 2013). Over the entire 11 year period, gross liabilities more than doubled from $857 million to $1.8 billion. An important consequence of increasing liabilities is that the cost of servicing municipal government debt also increases, which means less money is available for municipal services.

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