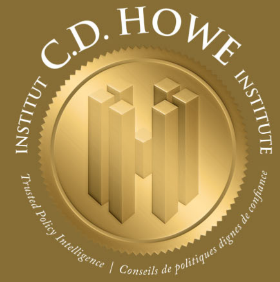
Intelligence MEMOS



From: Nick Dahir and William B.P. Robson

To: Municipal Fiscal Observers

Date: August 26, 2024

Re: **IT'S TIME TO UNLEASH CANADA'S MUNICIPAL FISCAL CASH HOARD**

The short supply and high cost of housing are top-of-mind concerns for many Canadians. So it is necessary to pay more attention to the quirks of municipal financial management, as cities budget for and finance infrastructure in ways that can slow construction and raise costs.

Many of Canada's major cities are sitting on large amounts of cash collected before – often years before – the start of the capital projects they are intended to fund. If cities matched the revenues they collect more closely with the expenses they incur, we could enjoy more and less expensive housing.

Panic over cities' budgets is an annual ritual. And when Ontario municipalities met last week in Ottawa, many reiterated how hard-up they are. However, the C.D. Howe Institute's **annual report card** on the fiscal transparency of Canadian municipalities covering 32 cities – the 26 largest municipalities by population and the six largest regional municipalities in Ontario – shows otherwise.

Unlike their debt-ridden federal and provincial cousins, those cities had a combined positive net worth of more than $257 billion at the end of 2022. Just as surprising is the total amount of cash held by these cities: More than $21 billion at that time.

Municipalities' positive net worth is a good thing. It means they have run surpluses over time and invested much of that in infrastructure important to our quality of life such as roads, water and sewage, and transit. But their cash hoard is less obviously good.

In municipal budgets, a lot of this money appears as "reserves." In municipal financial statements, a lot of it appears under "deferred revenue" or under other labels such as "capital deposits." The significance of those categories is that the cash has corresponding liabilities: The city has an obligation to use that money for the specific purpose for which it was raised, and cannot just do what it pleases with the money.

Some of the deferred revenue and similar funds came from special levies and regular property taxes. Some of it came from senior government grants for capital projects. And some of it came from development charges – upfront levies on builders of houses. Although the cash is an asset on municipal balance sheets, it is only there, alongside counterpart liabilities, because the city has not yet incurred the expenses the cash was raised to fund.

For example, homebuilders build the houses, but the infrastructure they require, such as water and sewage, are the responsibility of the municipality. When municipalities issue building permits, they collect cash in the form of development charges to finance that infrastructure. However, they defer recognizing this cash as revenue until the bulldozers roll. In the meantime, the money sits as a liability because the city is obligated to use it to finance that infrastructure.

The distribution of these unspent funds across these municipalities is uneven, even when considered in per-person terms. In Halifax, for example, such idle cash amounts to less than $100 per person, but the large amounts in Ontario particularly jump out.

In fast-growing Vaughan, north of Toronto, this amount is the highest. There're two levels of taxation there, one for the city and one for York Region, the wider municipality of which Vaughan is a part. Factoring in both levels, the amount of idle cash tops more than $3,000 per person, which is nearly $1 billion in total.

The large amounts of deferred revenue held by Ontario municipalities, in particular, has **prompted suggestions** for more professional funds management, so municipalities could get returns that are better than bank deposits.

But the people from whom those revenues were prematurely raised had their own plans for the money. Developers who paid for infrastructure still unbuilt could have used that money for other purposes – such as building more houses.

Upfront fees add to new home costs and, ultimately, prices. In some Ontario municipalities, **development charges** add more than $100,000 to a new single-family home. Reduced reliance on these fees would improve housing affordability.

There are alternatives. For example, instead of passing the costs of providing water-related infrastructure through to the price of new homes, municipalities could finance them with end-user pricing, charging the full cost of these projects as their services are delivered while freeing up resources for developers to increase the supply of housing.

Aligning the collection of funds better with the actual construction of projects would distribute the costs of infrastructure more fairly and help alleviate Canada's housing crisis

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To send a comment or leave feedback, email us at ***blog@cdhowe.org****.*

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