Municipalities download debt to new-home buyers

System doomed to fail when housing sector slows down

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If you are making mortgage payments on a new home, your borrowing is helping finance the municipality in which you live.

The heavy reliance by municipalities on development charges and pay-as-you-go schemes to finance public infrastructure has downloaded costs onto new homebuyers, placing upward pressure on household debt at a time when the Bank of Canada and many economists are warning that household debt in this country has risen to worrisome levels.

Local governments own most of the public infrastructure in Canada -- the water lines, sewer lines, roads, bridges and the like. They are also taking on more responsibility for infrastructure as the federal and provincial governments download their responsibilities. TransLink is a good example of this downloading. In 1999, the provincial government transferred responsibility for Metro Vancouver's network of major arterial roads, including aging and antiquated bridges and overpasses.

This downloading is burdening local governments in more ways than one. Basic infrastructure is aging fast. According to Statistics Canada, the average age of basic urban infrastructure in Canada was 16.3 years in 2007. Many components of Canada's infrastructure have either reached or passed their half usable life, requiring additional investment. Meanwhile, growth in our urban centres is far outpacing the replacement and expansion of this infrastructure, causing an "infrastructure gap".

Many local politicians argue that cities are limited in their access to revenues, with primarily property taxes, user fees and development charges being their only sources. Increasingly, cities are turning to hefty development charges, such as Vancouver's Development Cost Levies (DCLs) and Community Amenity Contributions (CACs), as a way to finance infrastructure and attempt to close the infrastructure gap.

A recent study commissioned by the Canadian Home Builders' Association has now found that development charges, like the CACs, which require new homebuyers to pay for growth-related basic infrastructure that ultimately becomes part of the public capital stock, are off-loading debt to households through personal mortgages.

The study, The Urban Infrastructure Challenge in Canada: Making Greater Use of Municipal Debt Options, undertaken by Altus Group Economic Consulting, points out that while Canada's government debt-to-GDP ratio declined from 69 per cent in the 1994/95 fiscal years to 28 per cent in 2007/08, during this same period household debt as a share of personal income rose from 100 per cent to 135 per cent. This increase in personal debt is occurring at the same time our neighbours to the south are still weathering a mortgage crisis brought on by homeowners carrying too much debt. Meanwhile, municipalities in Canada persist in passing the costs of infrastructure to new homebuyers in the price of new homes and these homebuyers are borrowing to pay these costs. This is bad public policy. This approach to financing basic urban infrastructure is both inequitable and inefficient.

New and upgraded basic urban infrastructure like streets, sidewalks, and sewerage treatment systems water supply lines benefit the entire community and deliver benefits over a long period of time. The costs associated with this basic infrastructure should be borne by the entire community and should be spread out over time to match the productive lifespan of that infrastructure, not over the life of someone's mortgage.

Financing public infrastructure debt through the household mortgage market is not only dangerous, it is also inefficient. Collectively, Canadian municipalities have relatively strong credit profiles and a capacity to finance infrastructure through municipal debt at costs well below what home mortgage holders pay. In short, Canadians are paying too much for the cost of borrowing this debt that is financing infrastructure.

Finally, the more municipalities rely on development charges as a source of revenue, the more they are setting themselves up for tough times ahead, especially when the housing sector slows down and these cyclical revenue sources slow to a dribble.

The cyclical nature of this revenue source turns development charges into revenue traps. Municipalities are forced during down times to cut back spending in other areas just to keep up with infrastructure maintenance, while having to postpone infrastructure renewal just as that infrastructure is aging.

We're all fooling ourselves if we think we've collectively, as communities, found the best way to financing urban infrastructure and pay for growth with development fees. It's time we looked at alternative financing methods, such as well planned municipal borrowing that amortizes infrastructure costs over time, minimizes borrowing costs and shares the real cost burden with all of those who benefit from the infrastructure.

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