

## "How Capital Expenditures Are Paid For"

Instead of providing working capital by an issue of capital stock as do commercial concerns; municipalities resort to borrowing for their requirements usually by way of an issue of redeemable bonds. The term of the bonds is determined by the prospective life of the improvements they are used for. As an example, bonds for road macadam and sewers are generally repayable in twenty to forty years from the date of issue and bonds for the construction of sidewalks in ten to twenty years.

The borrowing powers of a municipality may be regulated in a special charter under which it was incorporated, but in the majority of cases the provisions of the Cities and Towns Act of 1909 will apply. Under that Act, the borrowing powers may briefly be stated as follows:—

The Council may borrow, from time to time, various sums of money for improvements in the municipality and generally for all objects within its jurisdiction.

The loan shall be by an issue of bonds, obligations or debentures payable to bearer at periods fixed by the council with interest (not exceeding the legal rate) payable half yearly on May 1st and November 1st. You will note that the act specifies particularly that the interest payments shall be made on these dates

The principal and interest shall be secured by the general funds of the municipality.

Loans may only be made under a bylaw of the council approved by a majority in number and real value of the Proprietors who are electors and who have voted. The bylaw must be submitted to the electors within 30 days after being passed by the council.

It is customary for the council to advertise the bonds for sale calling for tenders. The tenders should only be opened at a council meeting on a date specified in the advertisement and naturally the highest bid should be accepted.

You will very rarely find an issue of bonds sold at par. Under normal conditions it is not unusual for a strong municipality to dispose of its bonds at a premium but at the present time unless the rate of interest is unusually high, the municipality will realize less than par value.

An interesting point in accountancy arises as to the treatment of this discount or premium, in the accounts. On first thoughts it would seem to be unwise to increase our assets by an amount that is represented by nothing tangible. That being so, the discount should be charged against Revenue, but it is obvious that to charge the discount on a large issue of bonds against the revenue of any one year would be unfair. The logical course would then be to write the amount off during a period of years. As municipalities are bound under statute to provide out of revenues an annual amount for investment to form a sinking fund to redeem the bonds at maturity, in estimating the annual amount required for any given issue, the discount on the bonds could be added and in this way satisfactorily cared for. If the municipality is in the enviable position of obtaining a premium for its bonds, this premium should be credited to a special account, which is often known under the name of Contingent Account, and any expenses that may properly be considered as bond issue expenses can be charged as off-setting the credit obtained for premiums.

The repayment of loans is a very important matter, the standard methods are as follows:—

- 1st Annual repayment of principal and interest on outstanding balance known as installment system.
- 2nd Fixed annual payment of principal and interest known as annuity system.
- 3rd Repayment of debenture bonds by the establishment of a Sinking Fund.

Although the first two methods are not much in vogue in this country, I think our municipalities would find it to their interest to give more consideration to the many advantages they offer, and endeavor to make their loans repayable on either of these principals. The greater advantages are:—

- 1st The amount of loan repaid is a certain known quantity.
- 2nd The cost of the establishment and administration of a Sinking Fund is entirely obviated.
- 3rd The trouble, anxiety and possible loss from misappropriation or bad management of the Sinking Fund are avoided.

On the other hand, it may be argued that there is a more limited market for such loans in Canada, and to float them it may be necessary to pay a higher rate of interest. It is done successfully in other countries, notably in Great

Britain, where large insurance and other financial corporations have for many years accommodated their local authorities with loans upon these conditions.

The Province of Quebec Cities and Towns Act provides that where the repayment of loans is by annuity the term must not exceed fifty years, and each annual payment must contain the interest and an instalment of capital.

Where the loans are upon debenture Bonds repayable at a certain fixed date provision for the redemption is by way of a Sinking Fund. The annual installment required will vary according to the term of the bonds, but under the cities and Towns Act it must not be less than one per cent of the amount of the issue. The annual installments of Sinking Fund are provided from revenue, but a mere book entry debiting Revenue and crediting Sinking Fund Account is not sufficient. It is necessary also to set aside and invest funds to the amount of the annual installment. Unless special provision for this investment is made in the Municipality's Charter, it must be in the form of—

- 1—Public Funds of the Dominion or the Province.

—A first hypothec to an amount not exceeding one half of the assessed valuation.

- 3—The redemption of bonds issued by the Corporation; or
- 4—Deposits in a chartered Bank.

Where the investment is on first hypothec, the borrower must provide insurance in favor of the corporation to an amount not less than one half of the property insured.

In providing our Sinking Fund out of revenue and at the same time making an investment of the amount, a double purpose is accomplished. We have not only obtained funds to liquidate the Bonds, but we have completely depreciated the assets originally purchased with the cash obtained from the sale of the bonds. And this is only proper. Bonds are generally issued redeemable at long periods in many cases 40 years, and no matter how well made the improvement was originally, or how carefully it has been maintained, its value at the end of the period must be questionable, or in any event will have very materially increased in cost of upkeep and so have become an extra charge against revenue.

As the Bonds are paid off the book, credit in Sinking Fund will be transferred to a surplus reserve account.

Passing on to the statutory restrictions as to the amounts which a corporation may borrow under the Cities and Towns Act, we find that when the total debit amounts to 20 per cent of the assessed valuation of taxable property, any further borrowing must be by by-law approved by three-quarters in number and real value of the proprietors, who are electors, and who have voted, also the approval of the Lieut.-Governor-in-Council, if necessary.

Again, where the interest and sinking fund on the loans absorb one-half of the Corporation Revenues, any new loan by-law must be approved by a majority in number and real value of proprietors who are electors and who have voted, in addition to having the special authorization of the Lieutenant-Governor-in-Council. In the event of such a loan being made, a special tax must be levied to provide the annual interest and at least 1 per cent. Sinking Fund.

While we have been considering loans for capital expenditures it may be remembered that for administration purposes, pending the collection of general or special taxes or water rates, the council may on a mere resolution contract temporary loans for a period not exceeding the current fiscal year and for an amount not exceeding one-fourth of the revenue then due and receivable.

### TORONTO SENDS BASEBALL OUTFITS.

The Toronto City Council has just contributed seven cases of baseball paraphernalia to the Canadian troops serving at the front. The kindly thought emanated with Mayor Church—who is a thorough sportsman—as a consequence of the many requests from the boys at the front who desire to play ball when taken back from the firing line to rest or when held in reserve.

### ESQUIMALT, B.C., NEW SEWERAGE SYSTEM.

The Corporation of Esquimalt, B.C., are installing a large sewerage system comprising over five square miles. It is expected that the work will be completed before the winter sets in.