Municipal Sinking Funds

By H. M. P. Eckardt.

With reference to the communication from a Toronto bond house which The Monetary Times published, I do not think the writer of the communication has given due consideration to the matter of the principle involved when a municipality uses an accumulated sinking fund for the purchase of its own newly-issued securities. I concede the expediency of such a policy. The immediate market for the municipality's bonds is sensibly improved, and perhaps one per cent. per annum is gained in interest upon the sinking fund. Also, it may be conceded that there is every probability that the transaction will not ultimately work to the disadvantage of the investors who hold the municipality's obligations, which are secured or covered in whole or in part by the fund. But the transaction may be wrong in principle.

Bonds Issued on the Sinking Fund.

When bonds are issued on the sinking fund plan and no mention is made at the time of issue of an intention of the obligant to invest the sinking fund in its own securities, the investors who buy the bonds assume that the fund will consist of cash or its equivalent, and it seems to me that in its custody of the sinking fund moneys the municipal officers ought to consider themselves as trustees in duty bound to safeguard the rights of both lender and borrower.

It hardly seems correct that the borrower should have the custody of a sinking fund of this nature, even when the borrower is a municipality. As it is customarily permitted to retain possession and control of the fund, the municipality should scrupulously avoid taking action with regard to it that will have the effect of weakening the security of the parties holding its bonds, or, in other words, increasing their liability to loss upon the bonds of the municipality held by them.

When a borrowing industrial corporation undertakes to create a sinking fund against a particular debt, the common understanding is that the fund is meant to provide security for the debt; and if it proceeds to accumulate a fund composed of its own promises to pay it could hardly be contended that it was carrying out its undertaking, even if it happened that its property and resources were increasing as rapidly as, or more rapidly than, the total of its promissory notes. This has its application to municipal borrowers also.

Bonds Guaranteed by British Government Marketable.

In the monthly statement of circulation and specie issued by the Finance Department of the Dominion Government the amount of the Dominion's outstanding demand notes is given, and is followed by a description of the security held against them. There is so much specie and bullion, then comes this entry: "Guaranteed sterling debentures, £400,000 sterling, $1,946,666.67." These are debentures of the Canadian Government guaranteed by the British Government. The combination of liability of the two goverments makes the debentures practically rock-ribbed, and marketable almost at any time. But the only justification for recounting them as security against the Dominion note issues is in the guarantee by the Imperial Government. That brings in an outside obligant.

Some time ago the Finance Department published each month after the item of the guaranteed sterling debentures, an item of so much in unguaranteed debentures of the Canadian Government, and counted them also as security for the Dominion notes. The theory, of course, was that, as these debentures were authorized and printed, they could, if necessary, be marketed in London, and thus provide funds for the redemption of the notes. But even in the case of the Dominion Government, there was an element of absurdity in thus counting the Government's long-time promises to pay as security for its promises to pay on demand. And in the case of a municipality or any other corporation possessing less strength financially than the Dominion Government the absurdity would be somewhat more pronounced.

Holders of St. Pierre Bonds Injured.

In referring to the St. Pierre illustration quoted by me, the writer of last week's article argues that the town might invest its sinking fund in its own obligations and leave the net liability exactly the same as if a cash fund were held. But the point is that the holders of the outstanding bonds were injured by the town's action.

Take Victoria's case for example. Suppose the city were to adopt the mayor's suggestion and use $200,000 cash, taken from the sinking fund, for the purchase of newly-issued local improvement bonds maturing before the maturity of the bonds against which the sinking fund is held. And suppose that shortly after the transaction took place Victoria was destroyed. It would simply mean that the value of the property into which the $200,000 cash was placed had been destroyed, whereas if it had been left as cash on deposit it would be intact. The outstanding bonds would be injured to that extent.

The city is not released from responsibility for the injury done them, even if its net liability is exactly the same as it would have been if the fund had been left in the form of cash.

No Municipality Immune from Disaster.

An article which recently appeared explained how, when a municipality purchases its own bonds with sinking fund moneys and cancels the bonds purchased, the proceeding may work an injustice to the bondholders in general: "Where there is an accumulating sinking fund on deposit with the Government or invested in a well-selected range of securities, the protection of this fund is behind every outstanding bond. If the fund is expended in the purchase and cancellation of bonds, however, the remaining bondholders lose entirely their share of the protection which the sinking fund affords."

The writer of last week's article mentions that catastrophes such as happened in St. Pierre, Campbellton and San Francisco occur about one in 10,000. That is true enough, but smaller disasters, in which the property of a municipality, while not being utterly wiped out, is nevertheless injured to such an extent as to make it difficult for it to meet its obligations, occur rather more frequently, and no municipality has the right to assume that it will enjoy immunity from such disasters.

MARINE INSURANCE RATES.

Why British companies should charge higher marine insurance rates between British and Canadian ports than they do between ports of Great Britain and the United States, was the question asked by Hon. L. P. Brodeur at a recent meeting of the Halifax Board of Trade. He saw no valid reason for the existence of such conditions. Insurance rates to Boston and Portland are lower than they are to Canadian ports. This he declared was unjust discrimination.

He had discussed this question with various shipping interests in Canada, and it had been decided to take some concerted action. He hoped that he would be fortified by the Board of Trade of Halifax, in the efforts that will be made to end this discrimination. It will not only be of great benefit to Halifax but to all Canadian Atlantic ports.

He declared that in some instances the rates are so high that the shipper finds it cheaper to send his goods via the United States ports, than direct to Canada.

While in London, he had brought this matter before Lloyds and other insurance companies, and he had received valuable assistance from Lord Strathcona in presenting the Canadian case.

The marine insurance losses of recent years have been small, and he thought that the insurance people were making a good thing of marine risks. He strongly urged united action to get rid of this discrimination. If we succeed in our purpose, Halifax will have more business than ever before.