REPORT TO THE CAPITAL REGIONAL DISTRICT BOARD
MEETING OF WEDNESDAY, MAY 8, 2019

SUBJECT **Joint and Several Liability Mechanism in British Columbia Local Governments**

ISSUE

That the Board receive for information an overview of the joint and several liability mechanism inherent in the British Columbia (BC) local government governance framework.

BACKGROUND

On January 9, the Board requested an overview of the joint and several liability mechanism in the BC local government borrowing system and an outline of what happens if a participant or group of participants were unable to meet debt repayment obligations.

The debt financing system for local governments in BC is unique, with over 160 municipalities and 27 regional districts deciding all debt issuances within the province. One of the critical elements of the BC local government framework is the concept of joint and several liability[1]. Joint and several liability is a legal principle that, in certain circumstances, creates the liability of more than one party for which each party may be liable to pay back the entire amount of a debt on behalf of all the parties. Being jointly and severally liable means that each party remains responsible of the entire liability, so long as any part of the debt is unpaid.

All long-term borrowing for BC local governments is between the Municipal Finance Authority of BC (MFABC) and a regional district. The regional district is liable to make repayment to MFABC and the local government entity requesting the financing (i.e. a municipality or a regional district service area) is liable to make repayment to the regional district. The responsibility for repayment lies with the entity requesting the financing; however, all members of the regional district are jointly and severally liable to repay the debt, in the event of default.

Furthermore, the *Municipal Financial Authority Act* provides, under section 27, for the obligations of regional districts to the MFABC. In operation, this section obligates regional districts to provide for, and pay to, the MFABC the money that is required to discharge the MFABC's obligation to its bondholders. In the event a regional district is unable to pay the contractually required payments to the MFABC, this section states that the regional district's obligation remains outstanding. In other words, there can be no bad (uncollected) debts under the statutory framework.

The long-term financing for BC local governments is undertaken by MFABC. Financing requests from all BC local governments are pooled together and funded twice each year, by selling bonds in the capital markets. Capital market participants who buy MFABC bonds, and become bondholders, rely on several safeguards, which enhance the attractiveness of MFABC long-term bonds as an investment.

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[1] *Local Government Act, s 412(1)*

The first safeguard is the borrowing approval framework (including joint and several liability provisions) under which BC local governments operate. Second is the MFABC debt reserve fund, which is held and can be drawn upon in the event of a payment default. Third is the power of MFABC to tax all land and improvements in BC, to replenish the debt reserve fund. This authority is granted by the *Municipal Finance Authority Act*, and does not require permission from another level of government.

The safeguards form the foundation of the MFABC AAA credit rating and help keep debt costs affordable for local governments. As a testament to the inherent strength in this BC local government borrowing system, the MFABC has never had a default nor missed a contractual interest payment since its inception nearly fifty years ago.

Given the multiple lines of defense against default, such as robust financial planning and reporting requirements and the legislated borrowing approval framework, the risk of a BC local government being unable to fulfill its long-term debt payment obligations (thereby triggering joint and several liability provisions) is considered very low.

ALTERNATIVES

Alternative 1
That the report on the Joint and Several Liability Mechanism for British Columbia Local Governments be received for information.

Alternative 2
That the report be referred back to staff for additional information.

FINANCIAL IMPLICATIONS

Based on the principle of joint and several liability, if a regional district service area or a municipality was unable to fulfill its obligations, the regional district would still be responsible to make the required debt payment to MFABC. If the regional district does not have sufficient cash or investments on hand, it may look to its members to make the payment. Note that the impaired regional district service area or municipality is still responsible for its own debt and would eventually be required to repay the other regional district member municipalities, or regional district itself, which covered the payment obligation, as soon as possible.

Further action can be taken under Section 412 (2) of the *Local Government Act,* which states that if a municipality defaults on the payment of money due and payable by it to the regional district, the Lieutenant Governor in Council may, at the request of the board, appoint a commissioner for the municipality and, on being appointed, the commissioner has all the powers and duties of a commissioner appointed under Division 3 [Administrative Commissioner] of Part 19 [General Matters and Provincial Authorities]. This would provide an avenue to recapture monies owed.

If the regional district and all its members (municipalities and electoral areas) were unable to fulfill its obligations, the MFABC would rely on its Debt Reserve Fund to pay the bond holders. Note that the impaired regional district would be required to repay the MFABC, which covered the payment obligation from its Debt Reserve Fund.

The Debt Reserve Fund is security held in trust by the MFABC as protection against loan default. One percent of all gross loan requests is held back, in a pool of funds and retained until the loan has been repaid.

If the MFABC trustees are of the opinion[2] that payments to replenish the Debt Reserve Fund will not be recovered in a reasonable period, they have the right to impose property tax on all taxable land and improvements in British Columbia sufficient to restore the funds to their previous level. Note that this right of MFABC to implement property taxation is unencumbered in that no permission is required for the MFABC to impose the requisite property taxation. Further, if the Debt Reserve Fund were depleted below a statutory threshold of fifty per cent, the MFABC trustees would be obligated[3] to impose property tax on all taxable land and improvements in British Columbia sufficient to restore the Debt Reserve Fund to its previous level.

SAFEGUARDS

For BC local government, there are preventative measures in place to mitigate the risk of 'default' of a municipality or a regional district service:

Municipalities and regional districts are required to maintain fiscal health sufficient to discharge its obligations. The Ministry of Municipal Affairs and Housing (Ministry) provides governance oversight of municipality and regional district fiscal health. The Ministry is instrumental in monitoring to ensure a BC local government does not borrow beyond its means.

For municipalities, the Ministry applies rigorous testing to ensure the municipality has the capacity to borrow. The Ministry reviews the audited financial statements and financial plans of each municipality, annually. The Ministry also approves all loan authorization bylaws, after verifying that the proposed debt servicing costs are within legislated limits (equivalent to 25% of annual, sustainable own-source revenues) and that the project is included in an approved, balanced financial plan. A balanced five-year financial plan outlining the revenues and expenses must be approved by Council, annually. The regional district board has an opportunity to review and approve all long-term municipal borrowings, during the security issuing process.

For regional districts, legislation requires each service area to be accounted for as if it were the only service operated by the regional district, in a separate set of books. A balanced five-year plan outlining the revenues, expenses, and with no deficit created, must be in place and approved by the board annually. Proposed regional district borrowing bylaws, and security issuing bylaws containing the regional districts proposed borrowing, are reviewed and approved by the Ministry. The review includes verifying that the regional district has the capacity to borrow, without exceeding requisition limits set by bylaw. In addition, the regional district must meet internal financial management practices designed to ensure the regional district has the capacity to borrow and does not over leverage itself.

For both municipal and regional district borrowing, the MFABC further reviews that all the requisite steps have been followed and that all paper work is in order. The MFABC trustees examine the collective borrowing before loan requests are reviewed at the MFABC's Annual and Semi-Annual General Meetings, then the money is raised in the capital markets for re-distribution to the participating local government borrowers.

CONCLUSION

Given the multiple lines of defense against default, such as robust financial planning and reporting requirements and the legislated borrowing approval framework, the risk of a BC local government

[2] *Municipal Finance Authority Act, s 15(11)(a)*
[3] *Municipal Finance Authority Act, s 15(11)(b)*

being unable to fulfill its long-term debt payment obligations (thereby triggering joint and several liability provisions) is considered very low.

RECOMMENDATION(S)

That the report on the Joint and Several Liability Mechanism for British Columbia Local Governments be received for information.

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