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Capital Funding Alternatives
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RECOMMENDED MOTIONS

1. That Policy C-FS-05 Budget and Taxation Guiding Principles (Section 14.b.ii) be amended to distribute new assessment growth as follows:
   a. 25% to offset the base budget
   b. 10% to increase contributions to life cycle reserves
   c. 65% to fund new initiatives

2. That Policy C-FS-05 Budget and Taxation Guiding Principles (last paragraph of Section 14.a) be replaced as follows:

   "As part of the annual budget the equivalent of a 1.50% property tax increase, less the amount calculated in Section 14.b.ii, be included in the municipal tax requirement and specifically targeted to capital reserves to support the repair, maintenance and replacement of existing capital assets."

3. That this planned increase remain in effect at the stated levels until the earlier of 2040 or the point in time that more robust data from the asset management plan suggests that an alternate plan or schedule is warranted with the first reassessment scheduled no later than 2027.

PURPOSE OF REPORT

In June 2019, Council was presented with a recommendation to increase property taxes by 1.5% for 20 years to close a funding gap related to RMR (Repair, Maintain, Replace) capital requirements. This recommendation followed two previous presentations in March and June 2019. Council supported the recommendation to a limited degree, approving a three-year 1.5% tax increase to support the RMR funding requirements. A subsequent motion was put forth by a member of Council requesting alternative solutions to the RMR funding gap. This paper addresses that motion. The analysis used to prepare this report only considers municipal assets (excluding land). Utilities capital assets are funded through utilities rates and therefore are not a part of this analysis.

ALIGNMENT TO PRIORITIES IN COUNCIL'S STRATEGIC PLAN

Strategic Priority #4: Infrastructure Investment: Identify and build needed capital assets.

Adopt a total cost of ownership approach in assessing lifecycle of existing and new assets.

ALIGNMENT TO LEVELS OF SERVICE DELIVERY

Financial Planning

Stewardship of development of annual operating and capital budgets for Municipal and Utility operations.

Municipal Capital Budget Development:

Available capital dollars are used towards the repair, maintenance and replacement of existing assets prior to consideration of new capital growth projects and assets.

ALIGNMENT TO COUNCIL DIRECTION OR MANDATORY STATUTORY PROVISION

Municipal Government Act

283.1 (3) Each municipality must prepare a written plan respecting its anticipated capital property additions over a period of at least the next 5 financial years

On March 11, 2019, the Governance, Priorities and Finance Committee passed the following motion:

(AR-19-024)

That by Q2 2019, Administration develop options and recommendations for a detailed funding strategy related to RMR (Repair, Maintain, Replace) capital requirements that is designed to both close the current capital asset funding gap as well as develop a sustainable capital funding solution for future years.

BACKGROUND AND DISCUSSION

According to the Alberta Urban Municipalities Association (AUMA), the province’s municipalities are responsible for approximately 60% of the public infrastructure but receive only about a tenth of every tax dollar paid. This presents a challenge for communities and the City of St. Albert is not immune from this issue. There are only a handful of revenue sources available to municipalities. Property taxes, user fees, franchise fees and government transfers account for most of this total. For example, in 2020 the preceding four revenue categories accounted for almost 80% of all revenue sources for the City of St. Albert.

The City relies on government grants to a large degree. Grants should be used to enable the construction or purchase of new infrastructure. However, the City has been using grant money to fund RMR capital projects for many years. This makes it more difficult to green-light growth projects.

Properly caring for the City's existing capital assets requires a great deal of financial discipline. When capital assets are constructed, acquired or transferred from developers to the City as development projects are completed, provision must be made for the periodic maintenance of those assets to keep them in sufficient working order and providing the expected service levels to the City. In addition, planning for the end of life of an asset must be considered and funds should be set aside each year for the eventual replacement of that asset. This is where the discipline becomes so important. It can be very tempting to not think about the end of life of an asset when it is years, sometimes decades away.

In 2019, Administration prepared analysis which looked at the state of funding for RMR capital expenditures. The findings indicated that the City is far behind in funding requirements for RMR. 20 years of a 1.5% tax increase would be required to close the gap in funding for RMR capital. A recent update of that analysis shows that the situation has improved to a marginal degree but there is still a long way to go.

The root of this problem can be traced to three issues:

1. Historical under-funding of capital assets (the current gap)
2. The level of capital asset growth
3. Contributed assets from developers

Integral to the under-funding of capital assets is the continuing practice of using grant revenue to fund RMR rather than using the City's own revenue sources. As the province begins to deal with a slowing economy and growing provincial debt, provincial expenditures are contracting. One of the targets of that contraction is grant funding. This puts pressure on both RMR expenditures and growth capital spending.

The most recent provincial budget revealed changes in the MSI grant program, one of the most significant sources of capital funding for the City. The MSI program is expected to be replaced by the Local Government Fiscal Framework Act (LGFF) but the LGFF has not yet been passed into legislation. In the near term, the MSI program has been extended for three years to fill this gap but the total amount of the funding has been reduced by about 25%. This is significant for the City and all other Alberta municipalities. The future is not clear with respect to capital funding grants from the province.

Growth in the City's capital assets has been significant in the past decade. The attachment titled Total Capital Asset Additions 2012 - 2020 shows that on average capital asset additions have averaged almost $28 million per year since 2012. this includes contributed assets. As development projects are completed throughout the City, infrastructure assets related to these developments (primarily roads) are transferred to the City, at which point the ongoing maintenance and eventual replacement of them become the City's responsibility. On average, almost $6.8 million of contributed assets have been added each year for the last decade, further compounding the RMR capital funding issue.

Our analysis indicates that a reinvestment rate of about 4.5% of the value of an asset is required to provide for major repairs, maintenance and eventual replacement. That means that we should have been contributing about $1.2 million in additional funding to RMR reserves during **each** of the last 9 years. This helps demonstrate how quickly a funding gap can grow under these conditions.

RMR Funding Challenges

There is no magic bullet that will resolve the capital funding challenge faced by the City. There are four options available.

1. Develop new revenue sources
2. Increase property taxes
3. Reduce service levels
4. Slow the pace of growth

In the longer term, the City must find new, sustainable sources of revenue to relieve the dependence on property taxes and government grants. To some degree, this is already under way. The City is working on new initiatives such as an energy corporation and a solar farm. These are examples of projects that could lead to new, viable streams of revenue that can be used to help alleviate the RMR funding requirements. The City is also embarking on new public engagement sessions with a variety of municipal stakeholders to explore possible new revenue generating opportunities. It is crucial that this work continue because in the longer term this is the most palatable solution to the funding challenges.

In the short term, options 2 and 3 may be all we can do to stem the tide. The RMR funding gap already exists. The current funding available for RMR is approximately $16 million less than what is required on an annual basis. The scale of this gap means there is no quick fix. It will require a long-term, sustained effort to bring it in line. Property taxes are the only revenue source that is currently available to the City and sufficient to positively impact the RMR funding gap.

A focus on service levels is another avenue that should be explored. There is a great deal of resistance to this. St. Albert has always been a community that provides residents and businesses with a very good quality of life and excellent service levels. However, we are entering into a period where financial means will be tested. The City is already forecasting tax increases in the 5% range over the next few years if the status quo is maintained.

The growth capital plan is packed with projects that will likely never be realized due to lack of funds. Should the City be decelerating the current growth rate? In the past decade capital assets have been growing at a rate of 5% per year while the annual population growth rate has averaged between 1% and 2% during the same period. As grant money contracts, RMR capital will have to be increasingly funded through internal revenue sources. The need to prioritize projects and services is real and present.

Growth Revenue

Another option to explore is growth revenue. Every year the City budgets about $2 million in new revenue from assessment growth. There is an argument to be made that some of this money should be allocated to RMR capital spending. As mentioned previously, every asset that is added to the City's capital asset base generates RMR funding requirements in future years for repair and maintenance and eventual replacement. Since assessment growth drives the need for new infrastructure it is reasonable to suggest that a portion of growth money should be diverted to support

RMR funding.

<u>Asset Management System</u>

The City has recently commenced a project to develop a corporate asset management system. This project should be considered a corporate priority. An asset management system incorporates several features, including but not limited to the following:

- an accurate inventory of all assets
- the current condition of assets
- the expected useful life span of each asset (this can change based on actual use, major maintenance or enhancements)
- the current position of each asset within its life span
- a reasonably accurate estimate of asset replacement costs
- a reasonably accurate estimate of when an asset needs to be replaced
- a forecast of major capital maintenance requirements for assets and when those costs will most likely be incurred

A lot of the information described in the preceding list is only partially available right now, and in many cases not available at all. In order to carry out the analysis required for this paper we have had to use financial record proxies in place of actual asset data. Primarily, accounting depreciation rates along with available asset life data has been used to determine annual funding requirements and asset replacement forecasts. This is not ideal. Specific information about individual assets would be preferable to general estimates.

There are other limitations in this analysis. Asset replacement costs are based on original acquisition or construction values. These values would likely not be accurate due to inflation, technological change and other market forces. There is currently no asset condition information which may indicate the need for major maintenance or early replacement, or conversely, that an asset could be used beyond its' currently estimated useful life. This means the underlying analysis could be understating or overstating the scope of the problem. It is impossible to know until we have better information to work with; hence the need to prioritize the asset management project and expedite the acquisition of detailed information of the corporation's capital assets.

Note: Once final motions are passed related to this item, Administration will bring the directed changes to policy C-FS-05 Budget and Taxation Guiding Principles back to Council at a subsequent Council meeting for approval.

STAKEHOLDER COMMUNICATIONS OR ENGAGEMENT

N/A.

IMPLICATIONS OF RECOMMENDATION(S)

Financial:

Property taxes will be impacted at a rate of 1.5% (less assessment growth applied) each year until 2040 or until such time as analysis of complete asset management data suggests an alternate amount or strategy.

Legal / Risk:

Not addressing this issue will potentially create a scenario where the City will not be able to adequately maintain or replace capital assets in the future. While the current commitment from Council is for a 3 year period, a long term/permanent strategy is still required.

Program or Service:

Shortfalls in capital funding may impact the level of service that our assets are able to perform at. Deferral of major maintenance, while reducing cash outflows in the near term, will have a long-term negative impact on the life and performance of the asset and is therefore not recommended.

Organizational:

None at this time.

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1. Council may choose to change the policy to reflect a shorter term commitment to address the funding gap.

Alternative 2. Do nothing. The RMR funding gap is large and real. Not taking/delaying steps to address this financial challenge will ultimately lead to the failing of City assets and prevent service levels from being maintained.

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