AGENDA ITEM #

REQUEST FOR DECISION

6.1

Subject:	**Fiscal Update**
Meeting Date:	Tuesday, February 23, 2021
Prepared By:	Bill McKennan, Director of Corporate Services
Presented By:	Bill McKennan, Director of Corporate Services
Link to Strat Plan:	Improving Fiscal Sustainability

Recommended Motion:	That this report be received for information, as presented.

Background/ Proposal	On the Council agenda today there are various reports detailing the financial performance and tracking related to 2020 operating and capital budgets of the County. There also is the annual report for Council consideration on the proposed 2021 Operating and Capital Budgets for the County. In terms of the development of the 2021 Operating and Capital Budgets Council approved budget guidelines at its meeting held on September 8, 2020. Budget deliberations were openly undertaken by the Committee of the Whole on December 1st and 8th, 2020 and on January 19th, 2021. During these prior meetings Administration provided detailed information, answered questions and follow-up on all issues raised by Council. As Council noted during these meetings the focus of the budget deliberations is on the upcoming fiscal period however major factors in prior periods have had significant implications on the County's current budget. Based on the foregoing Administration committed to bring forward a summary report detailing relative factors that have had a major impact on the fiscal challenges the County has faced and also detail the measures Council and Administration has undertaken to address our ongoing fiscal challenges.
Discussion/ Options/ Benefits/ Disadvantages:	**<u>Executive Summary</u>** Council and Administration have restrained and controlled expenditure growth in the County. The overall tax burden for our ratepayers compares very favourably to other municipalities within the province. Like all municipalities across Alberta, in particular rural municipalities the implications of provincial policy have reduced revenues significantly. No one likes to see taxes increased; however, no one likes to see service cuts either. The County has balanced these issues and after a long history of no tax increases has implemented some modest increases to help transition through these very difficult times. Council and Administration will continue to seek measures to manage revenue and expenditures and to continue prudent financial practices to plan for the future. Council is committed to ensuring core services are not impacted and that our roads and other infrastructure are maintained and renewed.

Overview and Context

In recent years compounding measures have significantly impacted the revenues collected by the municipality. In addition, provincial policy has transferred significant expenditures to municipal governments. As a result, Administration and Council have worked diligently to manage expenses to mitigate the funding shortfall in the budget. Administration and Council on an ongoing basis strive to develop and implement strategies to manage the financial pressures facing the County.

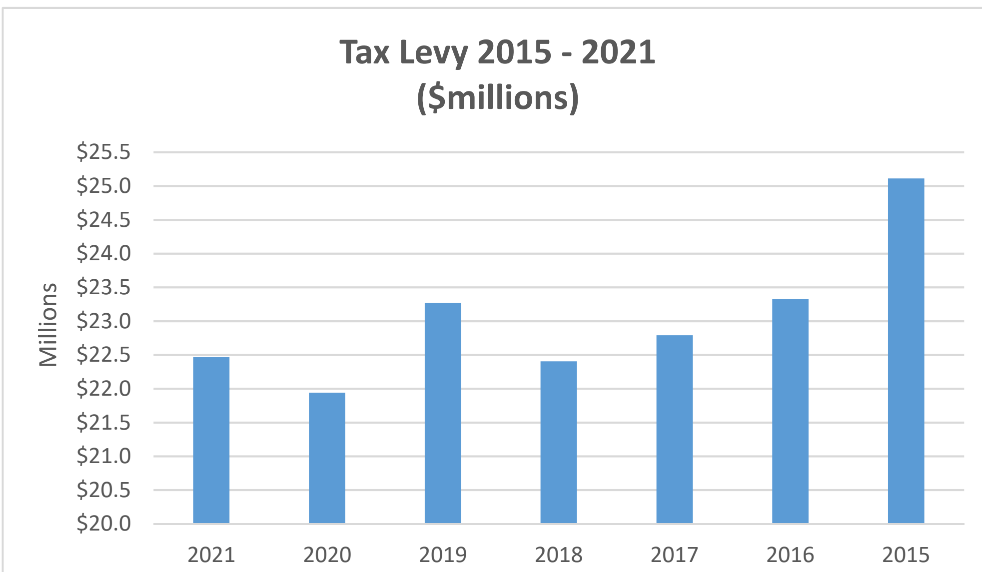
Notwithstanding the foregoing a few questions always arise during the annual budget deliberations of Council such as:

- Is the County restraining its expenditures?
- If expenditures are being managed what is driving the budget pressures?
- Is or can Administration do better with less?

The following sections of this report will address these questions and place the proposed 2021 budget in the context of the overall multi-year fiscal picture.

Overall Tax Billings of the County

Similar to all municipalities in the province once the Council has adopted the annual budgets a tax levy by-law is approved to establish taxation rates for the various classes of properties. Overall the total taxation burden is determined by the individual Councils and it is predominately influenced by the level and breathe of services provided to the ratepayers. So how much tax revenue has the County levied? The chart below provides this data.



Based on the data the total proposed levy for 2021 is approximately the same levy as in 2018 and significantly lower than the years prior to 2018. Compared to 2015 the overall tax levy has been reduced by approximately $2.5 million. There are numerous other factors and measures that will be discussed, however it is clear that the County levy has trended downward over this time period.

Some other general observations should also be made:

- The impacts on farmland has been very consistent since the assessed values related to farmland are not based on "market values" and have remained virtually unchanged during the 2015-2021-time period.
- Impacts related to residential properties have seen some fluctuations which has predominately been driven by assessment valuations.
- The major change in 2019 relates to the increase in the tax ratio for the non-residential classes of properties.
- Given the foregoing the impacts on residential ratepayers has at worst been modest.

Property Assessment in the County

Annually, all property classes in the province are assessed a value for property tax purposes. The MGA gives direction to municipalities to prepare assessments every year. The MGA sets out two types of valuation standards—the market value standard and the regulated standard.

The market value standard is considered the fairest and equitable means of assessing property. It is fair because similar properties are assessed in the same manner; it is equitable because owners of similar properties in a municipality will pay a similar amount of property tax. The following types of properties are included in this approach: residential units, retail, hotels, commercial offices, etc.

The regulated standard uses rates and procedures prescribed by Municipal Affairs to calculate assessed values for certain types of properties. These types of properties include farmland, machinery and equipment, and designated industrial property.

Farmland is assessed on the basis of its productive value for agricultural use. There are four classifications for agricultural use – dry arable land, dry pasture land, irrigated arable land, and woodlot. Productive value means the ability of the land to produce income from the growing of crops or other horticultural products and/or the raising of livestock. The productive value of farmland is determined using a process that sets a value for the best soils, and then makes adjustments for less-than-optimum conditions.

Machinery and Equipment Machinery and equipment includes a broad range of items used in manufacturing, processing and other industrial facilities, such as tanks, mixers, separators, fuel gas scrubbers, compressors, pumps, chemical injectors, and metering and analysis equipment.

Machinery and equipment is used in conjunction with properties such as meat processing plants, refineries, chemical plants, pulp and paper plants, and oil sands plants. Most machinery and equipment is assessed by the municipal assessor; however, machinery and equipment that is part of designated industrial property is assessed by the provincial assessor.

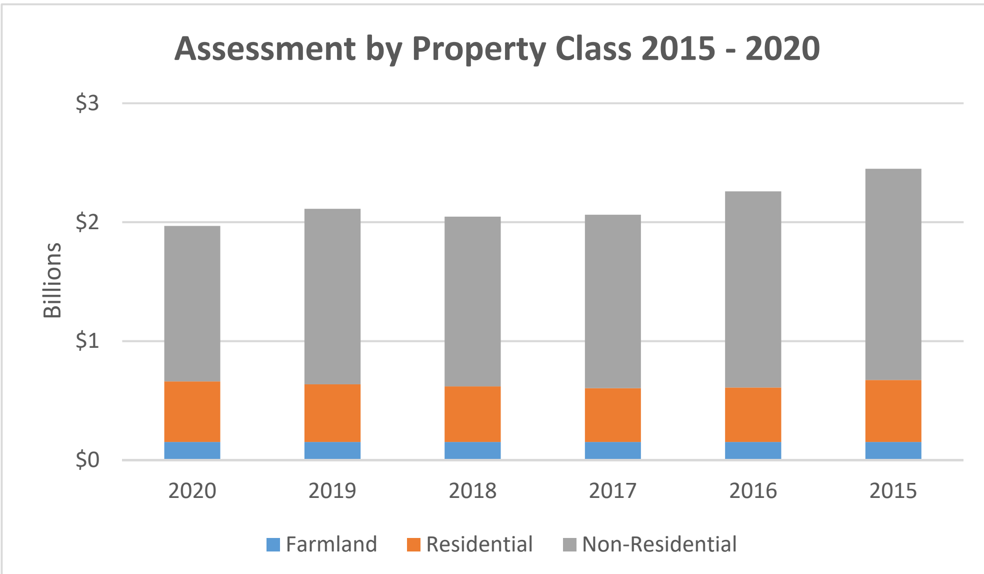
Designed Industrial Property includes linear property (oil, gas, telecom, etc.), railway, and specific major plants.

The bulk of the County's assessment is subject to the regulated standards set and administered by the province. The chart below notes an assessment reduction of

$480 million between 2015 and 2020 for this property class. Two direct provincial policy changes account for this reduction:

- Shallow Gas Relief in 2019/20 resulted in an assessment reduction totaling approximately $137.2 million translating into a revenue reduction of $1,925,000
- Assessment Model Depreciation 2021Change resulting in a further assessment reduction of approximately $45.1 million translating into a further revenue loss of $650,000.

The balance of the assessment reduction was due to a number of factors such as: depreciation impacts, wells being shut-in or abandoned. In addition, the market prices for oil and gas has resulted in reduced drilling activity.



For greater clarity the data in the above chart is as follows:

	2020	2019	2018	2017	2016	2015
Farmland	$151.7	$151.7	$151.7	$151.8	$151.8	$151.8
Residential	$509.9	$484.7	$467.4	$452.6	$457.7	$521.7
Non-Residential	$1,307.2	$1,475.5	$1,427.3	$1,457.5	$1,649.1	$1,775.4
Total	$1,968.8	$2,111.9	$2,046.3 .	$2,061.9	$2,258.6	$2,448.9

Some general observations can be made from this data:

- Farmland assessments have not changed over this period and bear no relationship to market values.
- Residential assessments have fluctuated based on market but also reflect growth from new residential units or improvements being made to existing properties.
- Non-residential assessments have declined significantly from the 2015 values.

The non-residential class includes properties such as retail and commercial operations but is predominately oil and gas infrastructure referred to as "linear assets". The economic challenges in the oil and gas industry have reduced the overall assessment values in the County however the bulk of the impact is related to provincial tax policy related to linear assets.

These impacts on the overall revenue streams for municipalities has received much attention over the last few years. The specific impacts to Kneehill County will be discussed further in this report.

Provincial Policy Impacts (Revenue Loss and Expenditure Downloading)

	2019	2020	2021	2022-24	Total
Shallow Gas	$2,326,000	$1,925,000			$1,925,000
Education Rebate	($2,326,000)				
ASB Grants			$94,000	????	$94,000
Policing		$160,000	$80,000	$240,000	$480,000
MSI		$300,000	$210,000	$75,000	$585,000
Elimination of Well Drilling Funding			$400,000		$400,000
Assessment Model Review			$650,000	????	$650,000
		$2,385,000	$1,434,000	$315,000	$4,134,000

The implications to the County of the above provincial policy changes have been significant. County revenues have over the last two years been impacted significantly (a reduction of $3,579,000) with expenditure downloading to date of $240,000 with a further $240,000 in 2022/23. The following provides additional background and information related to the provincial downloading specific to Kneehill County.

Shallow Gas/Education Rebates ($1,925,000 Revenue Reduction)

During 2019 the Province introduced a program that provided industrial property tax relief to shallow gas producers and protected municipalities from lost revenue. Property tax on shallow gas wells and pipelines was reduced by 35%. Our tax billings to the specific linear ratepayers were adjusted to reflect this provincial policy in the amount of $2,326,000. The Province then reduced our legislated contribution to education by the same amount, so the net financial impact on the County was zero in 2019.

On December 19, 2019 the Provincial Government announced that until the new assessment models can be implemented, assessment for shallow gas assets would receive a 35% property assessment reduction effective 2020. The effect of this announcement was to provide the industry the same relief as they received in 2019 but have the municipal ratepayers fund it.

The assessment reduction for Kneehill County totaled $137,211,640 which was a 13.2% reduction in our overall linear assessment compared to 2019. This translated into a budget revenue reduction of $1,925,000. Three specific points should be noted:

- This municipality was required to absorb a significant financial impact without consideration of any phasing or input.
- The provincial policy change was being implemented prior to the review of the assessment model.
- Kneehill county hit was 13.2% of linear, the average hit across the province was 2.2%

ASB Grants ($94,000 Revenue Reduction)

This reduction was announced in the 2020 provincial budget. The County's 2021 budget reflects this revenue reduction.

Policing Funding Model

Small and rural communities will begin contributing a portion of front-line policing costs in 2020. The funding model is being phased in: communities will contribute 10% of policing costs in 2020, followed by 15% in 2021, 20% in 2022, and 30% in 2023. The introduction of the 2020 provincial budget does not change the original plan detailed in the 2019 provincial budget. Kneehill County will have an additional expenditure of $159,611 in 2020, this amount will increase to $479,178 in 2024.

MSI Funding

The 2020 provincial budget continues the planned reductions, mainly related to capital grants, under the MSI Program. The timing of these reductions are detailed in the table above. Overall this represents a 25% reduction in Provincial Capital Grants over the 2020-2024 timeframe.

Assessment Model/Well Drilling ($1,050,000 Revenue Loss)

The province released four scenarios under the assessment model review. The impact to the long-term sustainability and viability of municipalities across Alberta was a major concern. Revenue reductions to the County under these scenarios ranged from $3.5 million to $7.1 million. Council and all municipal associations in the province raised major concerns with the provincial government with the implementation of the proposed options. Numerous stakeholders' meetings involving industry, municipalities and other partners was undertaken by the provincial government. Based on these consultations the government put a "pause" on the new assessment model but did provide industry some immediate relief. Specific industry properties did receive a reduction to their assessments.

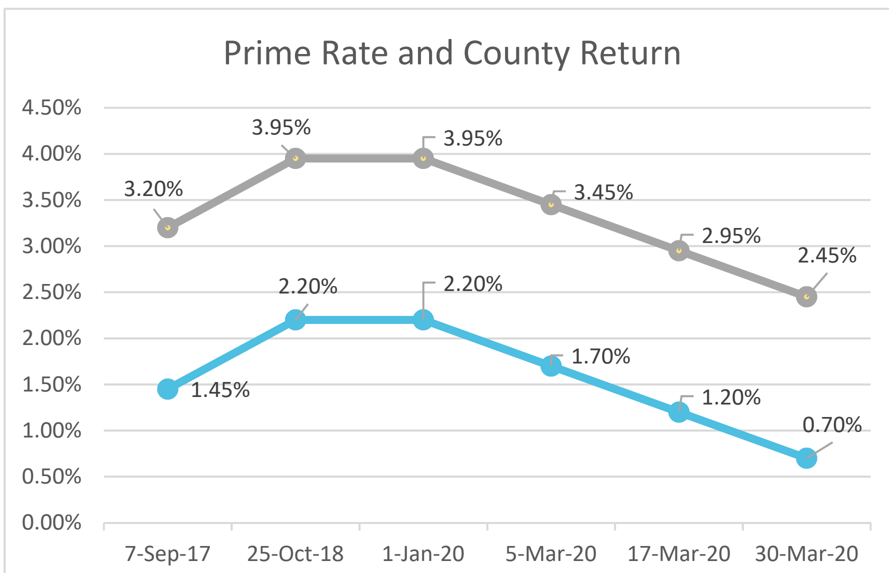
The assessment reduction in Kneehill County resulted in a loss of revenue of approximately $650,000. In addition, the province eliminated the ability for municipalities to impose levies related to oil and gas well drilling. The County budgeted $400,000 in 2020, which has been reduced to zero in the proposed 2021 budget. It should also be noted in prior years the actual revenues related to well drilling have generally exceeded the annual budget.

Other Factors

Similar to all ratepayers the County has had to manage the general costs pressures in the market place particular increases related to insurance coverage and utilities.

Other factors have negatively impacted the County which are Covid-19, general economic conditions (interest rates), and the lack of provincial legislation to collect taxes related to linear properties (tax write-offs).

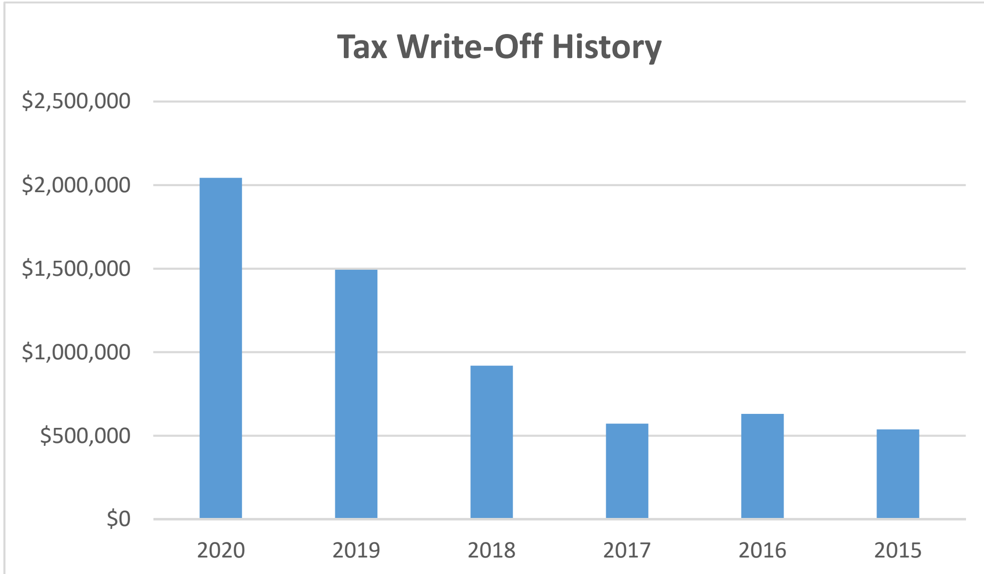
Given the general economic conditions the County will see a significant reduction in interest earnings. The anticipated interest earnings reduction for 2021 is $400,000.



The economic conditions over the last few years have seen significant increases in the uncollectability of taxes, mainly related to linear properties (oil and gas).

All municipal governments in the province have experienced an increase in tax write-offs and efforts have been made to have the province amend the legislative framework to afford greater protection to our ratepayers.

Administration must exhaust all collection avenues prior to Council approving any tax write-off. The chart below details the write-offs history of the County.



<u>What Actions has Council and Administration Taken?</u>

As indicated on the first chart of this report the taxes collected by the County are approximately $2.5 million ***less*** than in 2015. The County has restrained its expenditures and at the same time managed the significant revenue losses and provincial cost downloading. The balance of this report will present the framework in which this has been managed and provide comparators to other Counties similar to Kneehill County.

The fiscal challenges of the past and future consume a significant amount of Council and administration time and focus. As such Council and management of the County take the management and stewardship of public funds seriously. The budget continues to follow a rigorous budgetary process that is focused on containing costs and implementing best practices with the goal of demonstrating leadership in financial management.

Councils guiding principles in the preparation of the annual budget may be summarized as follows:

- Maintain existing service levels
- Improve customer service
- Keep tax rates competitive
- Incorporate a proactive infrastructure renewal plan
- Identify and incorporate efficiencies
- Ensure rates and fees for services are appropriate

<u>Guidelines Designed to Provide Lowest Possible Tax Increase</u>

The annual budget process has followed rigorous budgetary process focused on containing costs and implementing best practices, with the goal of demonstrating leadership in financial management.

Council and the Administration of Kneehill County has always taken the management and stewardship of public funds very seriously and due to the current and recent past economic environment, the approach to the annual operating budget had an even greater focus on financial constraint and tightening the budget. This will be accomplished through the following actions:

- Freeze most account budgets at 2018 levels unless cost pressures are documented
- Strict process to evaluate funding requests
- Thorough multi-layered review process
- Reinforced priorities through business planning and best practices

Under these guidelines, departments will only be permitted to include very specific documented increases, typically related to predetermined agreements, contracts or Council approvals.

There have been no across the board increases for inflation, increases related to staffing compensation have been in line with market. In 2021 there is no provision for an across the board compensation increase and the budget reflects staffing reductions.

The objectives of the guidelines were to provide the lowest possible tax increase while maintaining our service levels. **Overall the County does not have an expenditure issue, the root of the challenge has been the significant reduction in revenues which are generally outside of Council influence.**

<u>Summary of Cost Savings and Efficiency Measure Realized To-Date</u>

As noted in the budget guidelines above the maintenance of existing service standards is a major objective of Council. Numerous of the measures detailed below have been accomplished without impact service levels while increasing efficiency and effectiveness of program delivery. The following points provide more specifics on measures achieved or incorporated into the budget in 2021 or prior years:

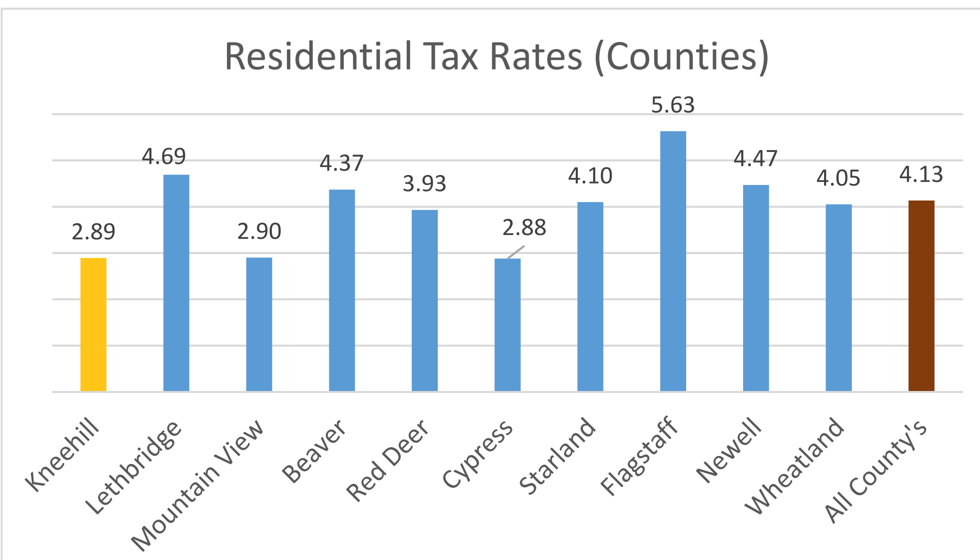
- Reduction of two (2) permanent positions and seasonal positions saving $240,000 annually.
- Selection of Amendments to benefit plans and carrier contracts saving $140,000 annually.
- Council compensation reductions in excess of $52,000 incorporated within 2021 budget.
- Greater utilization of the internal workforce to undertake maintenance which was previously contracted out (bridge truss decks, etc.).
- Optimizing grader beats to insource work reducing external contracts savings over $200,000. This includes a reduction of full-time positions, three contract graders and seasonal staffing.
- Optimize fleet replacement based on life cycle models saving $225,000 annually.
- Gravel management program will result in a 15 year supply with significant reduction in the unit cost. Historical average cost of $20/t will be reduced to approximately $7/t.
- Reviewed and implemented revised surface treatment standards extending the life cycle of numerous road surfaces. Resulting in long term cost savings based on life cycles.

- Implemented new methods and alternative materials/supplies in road grading (carbide blades) and enhanced operator training savings and cost affordance in excess of $50,000 annually.
- Increased revenues from adjacent municipalities for service provision related to by-law enforcement and other service areas.
- Maximized the eligibility of the County to receive Provincial and Federal Grants related to infrastructure renewal, student employment, etc.
- Focus on preventive maintenance, energy management and planned maintenance related to water and sewer plants, buildings and other in infrastructure has reduced expenditures in excess of $340,000 in 2021 compared to 2020.
- Eliminated the ASB rental fleet which reduced capital replacement costs in excess of $20,000 annually. Also had non-financial impacts of minimizing the spread of agricultural diseases.
- Managed Covid-19 impacts with minor impacts to public services. Introduced contact free inspection in numerous areas resulting in savings.
- Optimized field equipment configurations to extend equipment life and enhance efficiency.
- Increased staffing hours by delivering on line or onsite training rather than off-site.
- Greater utilization of hand held technologies in the field and internal process reviews to drive operational efficiencies.

It is important to emphasize that the County has not deferred infrastructure renewal or investment that would reduce the service levels and increase costs of future ratepayers.

So How Do We Compare to Other Municipalities?

The chart below displays the residential tax rate for the Kneehill County and numerous County's that would be comparable in terms of services provided and population mix served.



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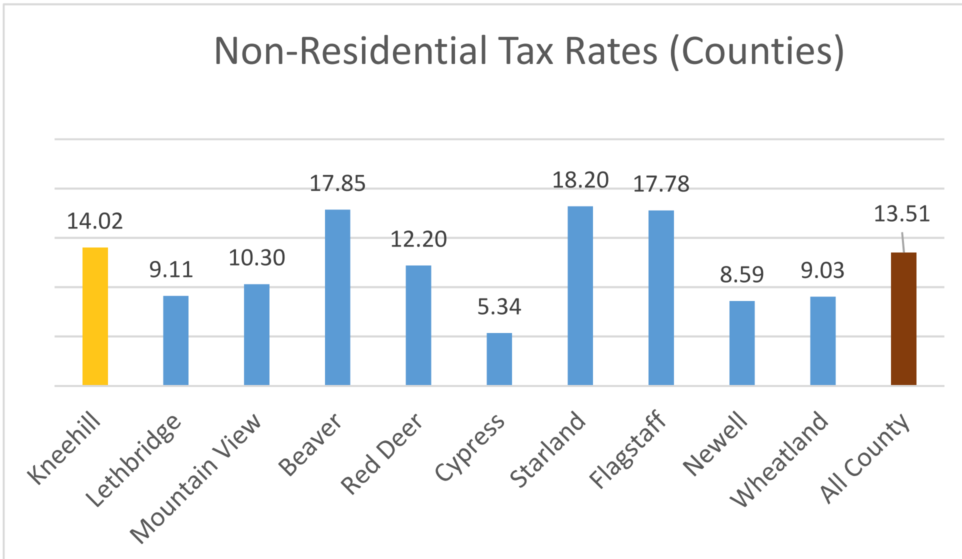
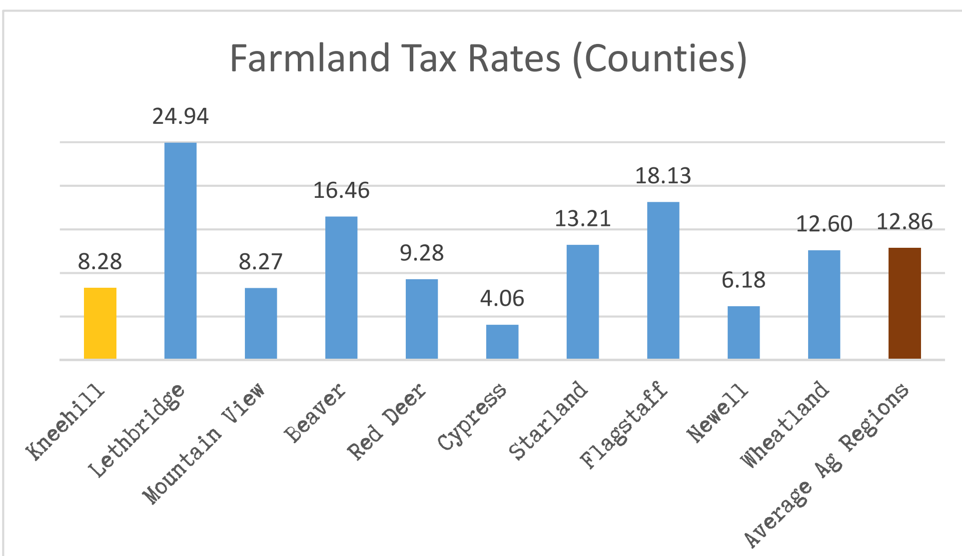
The residential tax burden of Kneehill County ratepayers is very favorable and significantly below the provincial average. Kneehill County's continues to be in the lowest 25% (tax burden) of all County's in the province and significantly below more urban areas.

In the case of the Non-Residential tax burden the County is in the middle of the pack. Generally, for County's the major factor related to the rate is the level of activity. Areas with high activity can have a lower rate since the quantum of tax levy will be significant. Kneehill County is in line with the average rate across the province.



The chart below displays the farmland tax rate for the Kneehill County and numerous County comparators. The average reflects the top 25 agricultural regions in Alberta.



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<table>
<tr><td></td><td>Based on the above data the County is significantly below the average farmland rate in the province. The County's rate is in the lowest 30% provincially (County's only). It must be remembered that farmland receives "special" regulated status under the provincial assessment model. Overall the tax burden on farmland is lower than the provincial average but comparable to some adjacent municipalities.

<u>Conclusion</u>

Council and administration have managed and controlled expenditure growth in the County. The overall tax burden for our ratepayers compares very favorable to other municipalities within the province.

Like all municipalities across Alberta, in particular rural municipalities the implications of provincial policy have reduced revenues significantly.

No one likes to see taxes increased however no one likes to see service cuts either. The County has balanced these issues and after a long history of no tax increases has implemented some modest increases to help transition through these very difficult times.

Council and administration will continue to seek measures to manage revenue and expenditures and to continue prudent financial practices to plan for the future. Council is committed to ensuring core services are not impacted and that our roads and other infrastructure are maintained and renewed.</td></tr>
<tr><td>Financial Implications:</td><td>There are no direct financial implications related to this report. It does provide a "report card" and details the framework and challenges Council has managed past and current fiscal challenges.</td></tr>
<tr><td>Council Options:</td><td>1. That Council requests additional information.
2. That this report be received for information.</td></tr>
<tr><td>Recommended Engagement:</td><td>☒ Directive Decision (Information Sharing-One way communication)
Goal: To educate and inform citizens
Tools: ☐ Individual Notification or ☒ Public Notification
☐ Consultative Decision (Consulting the Public – Two way communication)
Goal: To seek feedback, test ideas, develop concepts and collaborative solutions
Tools: ☐ Public Hearing ☐ Open House ☐ Focus Group ☐ Other-
☐ Collaborative Decision (Active Participation- Share or delegate decision making)
Goal: To share or delegate decision making
Tools: ☐ Participatory Decision Making ☐ Inter-Municipal Agreement ☐ Other-</td></tr>
<tr><td>Attachments:</td><td>None</td></tr>
<tr><td>Follow-up Actions:</td><td>That administration continue to enhance information to our ratepayers related to the fical challenges and Council action plan.</td></tr>
</table>

Bill McKennan

Director Approval:
Bill McKennan, Director of Corporate Services

CAO Approval:
Mike Haugen, Chief Administrative Officer