APPENDIX C

2011 – 2014 FISCAL MANAGEMENT STRATEGY

FISCAL MANAGEMENT STRATEGY

2011 - 2014

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REGIONAL MUNICIPALITY OF WOOD BUFFALO

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1.0 Introduction and Assumptions

1.1 Introduction

As part of long-term financial planning, the Regional Municipality of Wood Buffalo (Municipality) undertakes an annual in depth review of its current financial position through a process of systematic forecast of future financial needs. The resultant findings provide context for setting the current year's property tax rates and guidelines for future budget development in light of existing Council mandates regarding: debt, operating and capital reserves, user fees and investments.

The 2011 – 2014 Fiscal Management Strategy assumes two likely exclusive futures under two scenarios:

- **PROPERTY TAX REVENUE NEUTRAL Plus CONSTRUCTION Growth 'LOW RISK'** – *conservative* outlook on projected property assessment growth, supporting operating costs other than debt service growing at 3% per annum and the 2011 - 2017 capital budget and plan,
- **PROPERTY TAX REVENUE NEUTRAL Plus CONSTRUCTION Growth 'HIGH RISK'** – *optimistic* outlook on projected property assessment growth, supporting operating costs other than debt service growing at 3% per annum and the 2011 - 2017 capital budget and plan.

Property tax revenue accounts for at least 80% of total revenue for the Municipality. As such, financial planning for the municipality, to a large extent, requires proper understanding of this revenue source and associated variables; opportunities and risks associated thereof.

1.2 Analysis Limitations

The forecast analysis is limited to the following:

- Maintain a minimum balance of $50M in the Capital Infrastructure Reserve (CIR),
- Maintain a maximum balance of 15% of prior year's net audited property taxes subject to a minimum uncommitted balance of $50M in the Emerging Issues Reserve (EIR),
- Debt limit of 75% of MGA limit,
- Debt service limit of 75% of MGA limit,
- Approved 2011 Operating and Capital Budgets
- Adjusted 2012 – 2013 Operating Plan
- Adjusted 2012 – 2017 Capital Plan

The following assumptions are specific to the Adjusted Capital Budget and Plan: (2011 – 2017)

- $1B to be completed in 2011 (representing 2011 and prior approved capital projects in progress)
- $373M to be completed in 2012
- $411M to be completed in 2013
- $385M to be completed in 2014
- $364M to be completed in 2015
- $280M to be completed in 2016
- $320M to be completed in 2017

The following assumptions relate to the Adjusted Operating Budget and Plan: (2011 – 2014)

- Property tax revenue neutral plus construction growth;
- No increases to user fees pending completion of user fees study in 2012;
- Operating costs growth of 3% per annum exclusive of debt service;
- Undrawn debt of $206M at the end of 2010 will be drawn in 2013 and thereafter all debt is drawn three years after commitment or approval;
- An interest rate of 4% has been assumed for future debt draws.

In addition to the above assumptions, other items such as the update of the Municipal Development Plan (MDP) and labor negotiations with the Municipality's unions may impact the budget. Recommendations for appropriate budget adjustments, if needed, will be brought forward as details come available.

1.3 Economic Outlook

The world economy has slowly climbed out of the worst recession since the great depression. The just ended recession was characterized by significant declines in demand for energy. The gradual increase in demand for energy coupled with political instability in some oil producing countries has seen price for oil increase to just over $100 per barrel. The increase in the price of oil has direct impact on the levels of investments within the Municipality's jurisdiction. Increases in investments in the region result in increased demand for municipal services, programs and infrastructure.

2.0 PROPERTY TAX REVENUE & STRATEGY

2.1 Taxation Principles

The Municipality's taxation strategy is guided by three underlying principles;

- Predictability
- Stability
- Transparency

The taxation strategy seeks to achieve the following:

- The Urban Residential Taxation Class – this class will have one of the lowest total tax burdens per square foot as compared to major Alberta cities,
- The Rural Residential Taxation Class – this class will have an equal or lower tax burden per square foot as Urban Residential Taxation Class,
- The Urban Non-Residential Taxation Class - this class will have one of the lowest total tax burdens per square foot as compared to major Alberta cities, and
- Rural Non-Residential Taxation Class – this class will have a tax burden that provides the Municipality with a balanced budget while taking into account other Taxation Classes.

The property taxation strategy contributes to the affordability of living and working in the region while supporting long term capital infrastructure needs. The strategy also takes into account the growth facing the region and the underlying growth drivers.

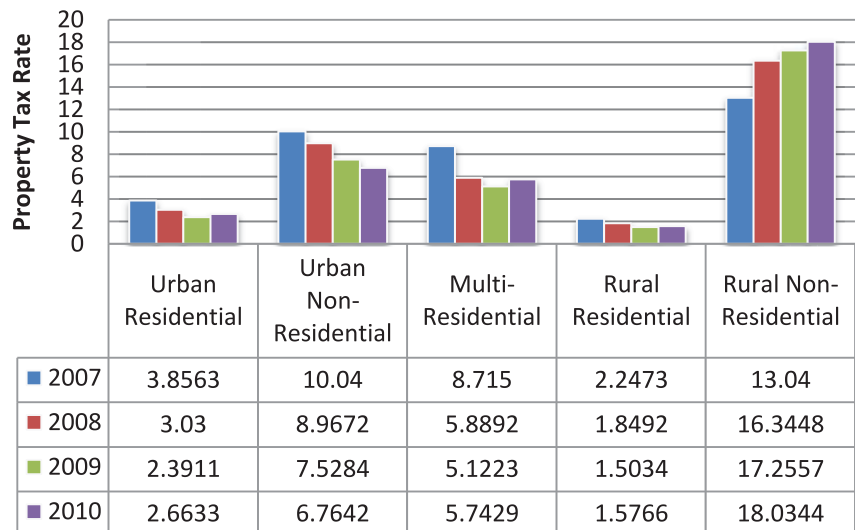
Based on the principles and property taxation strategy outlined above, urban residential property tax rates have declined from 3.9% in 2007 to 2.7% in 2010. A 1.2 basis point decrease over 4 years.

Comparatively, the rural residential property tax rate has declined by .6 basis points since 2007. In concert with the principles, the rural residential property tax rate is lower than the urban residential property tax rate.

The multi-residential property tax rate also declined 3 basis point from 8.7% in 2007 to 5.7% in 2010.

The urban non-residential rate also decreased by 3 basis points between 2007 and 2010.

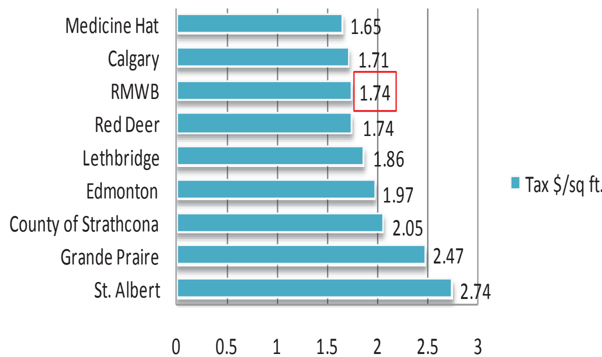
Municipal Tax Rates 2007 - 2010

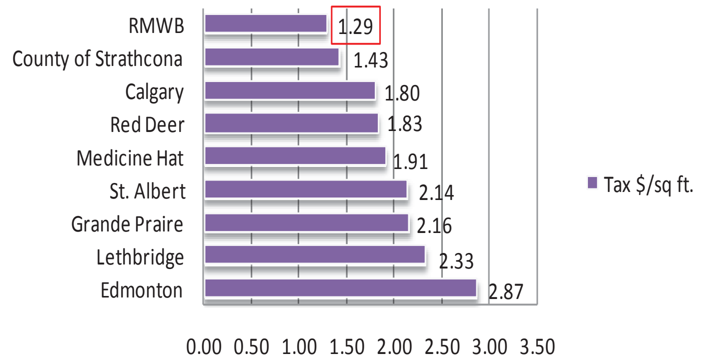


	Urban Residential	Urban Non-Residential	Multi-Residential	Rural Residential	Rural Non-Residential
2007	3.8563	10.04	8.715	2.2473	13.04
2008	3.03	8.9672	5.8892	1.8492	16.3448
2009	2.3911	7.5284	5.1223	1.5034	17.2557
2010	2.6633	6.7642	5.7429	1.5766	18.0344

However, during the same period, the rural non-residential property tax rate increased 5 basis points from 13% in 2007 to 18% in 2010. Growth in the oil sands industry is primarily responsible for the unprecedented demand for municipal infrastructure and services. The current property taxation strategy places greater reliance for municipal revenue generation on this class of property tax.

Consequentially, the Regional Municipality of Wood Buffalo, property tax costs per square foot in 2010 were competitive compared to other major Alberta cities;

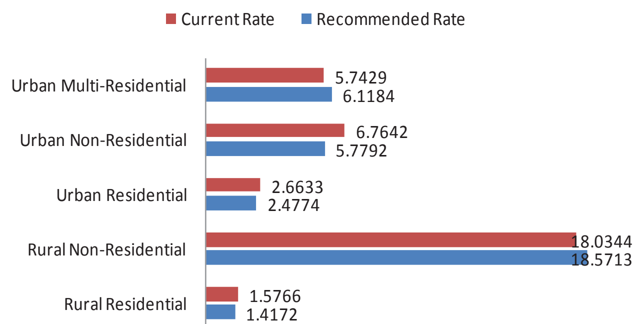


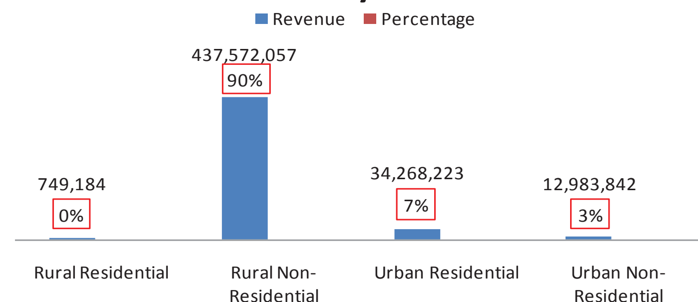


2.2 Property Tax Revenue Projections

At finalization of the 2010 property assessment, additional growth translating to $38.5M in additional property tax revenue in 2011 was identified. Much of this additional growth had been originally projected for 2012 fiscal year. The estimated property tax revenue for 2011 is now projected at $485.6M based on 2010 tax rates.

Property tax revenue contribution and recommended municipal property tax rates for 2011 are as follows:





In projecting property tax revenue, two scenarios; LOW RISK and HIGH RISK are used. Low Risk scenario assumes a conservative outlook on future tax base growth while the High Risk assumes an optimistic outlook based on development timing.

The following chart indicates projected property tax revenue for 2011 through 2014;

Property Tax Revenue Projection
2011 - 2014

		2011	2012	2013	2014
Low Risk	*Rural Residential*	749,184	752,908	758,237	764,032
	Rural Non-Residential	437,572,057	469,720,190	473,366,664	481,859,320
	Urban Residential	34,268,223	35,200,215	36,138,840	37,876,913
	Urban Non-Residential	12,983,842	13,235,237	13,235,237	13,235,237
	Total	**485,573,306**	**518,908,550**	**523,498,978**	**533,735,502**
High Risk	*Rural Residential*	749,184	756,936	760,484	764,032
	Rural Non-Residential	437,572,057	473,366,664	481,859,320	528,837,280
	Urban Residential	34,268,223	35,914,553	36,895,733	37,876,913
	Urban Non-Residential	12,983,842	13,235,237	13,235,237	13,738,026
	Total	**485,573,306**	**523,273,390**	**532,750,774**	**581,216,251**

With early realization of growth in the rural non-residential property tax class, growth is now projected to be flat between 2012 and 2014 in the low-risk scenario. The projected additional revenue expected to be realized in 2011 presents an opportunity for the municipality to address its revenue risk by designating funding towards a fiscal stability reserve.

3.0 DEBT AND DEBT SERVICE

3.1 Total Debt and Debt Service Limits

In July 2010, Council amended the municipality's debt policy (Policy No.: FIN-120) setting new debt and debt service as follows:

- 'Total municipal debt limit percentage shall not exceed 75% of the debt limit per Municipal Government Act and regulations',
- 'Total debt service shall not exceed 75% of the debt service limit per Municipal Government Act and regulations'.

In 2006, the Province of Alberta, through Alberta Regulation 255/2000, increased the debt and debt service limit for the Municipality:

- Debt limit originally calculated at 1.5 times revenue was changed to 2.0 times revenue.
- Debt service limit originally calculated at 0.25 times revenue was changed to 0.35 times revenue.

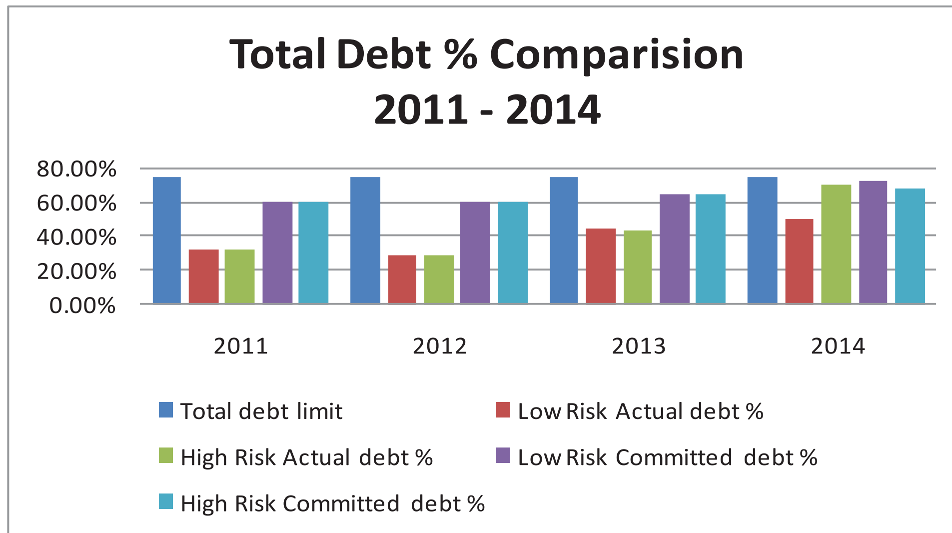
The revised debt and debt service limit are also applicable to Calgary, Edmonton and Medicine Hat. Alberta Regulation 255/2000 is due for review in December 2015.

The Municipality's debt and debt service limits of 75% of the Municipal Government Act coincide with limits set by Alberta Capital Finance Authority (ACFA) as a threshold to require additional due diligence.

3.2 Forecast Total Debt

The debt and debt service forecast for 2011 through 2014 indicates that both low risk and high risk outlook debt percentages are below the limits set by Council and below the ACFA 'red-flag' limit.

	2011	2012	2013	2014
Total debt limit	75.00%	75.00%	75.00%	75.00%
Low Risk Actual debt %	31.59%	28.52%	43.91%	50.05%
High Risk Actual debt %	31.59%	28.31%	43.25%	69.73%
Low Risk Committed debt %	60.01%	60.37%	65.08%	72.50%
High Risk Committed debt %	60.01%	59.94%	65.08%	67.41%



The Municipality uses debt to fund capital projects based on two principles:

- Use debt to fund capital projects that have a long useful life,
- Use debt finance as a revenue source of 'last resort'.

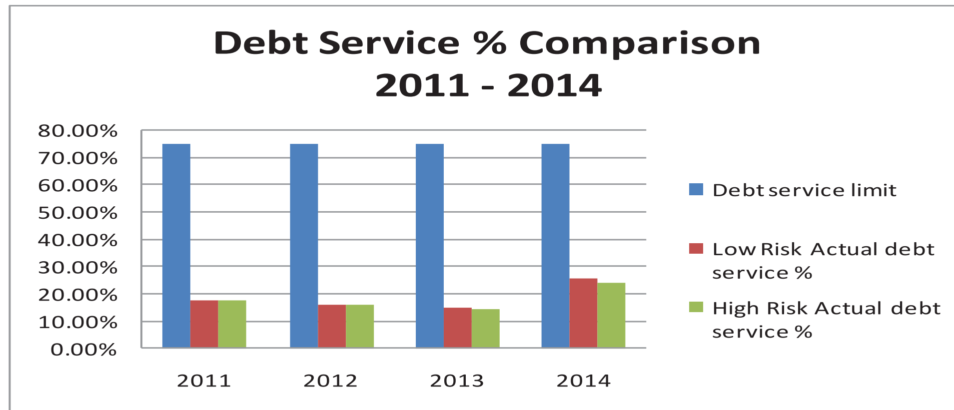
The first principle respects the 'inter-generational equity' philosophy that dictates that each generation that benefits from an amenity, must bear their fair share of financial burden and the second principle indicates a conservative approach to debt use.

For a municipality facing rapid population growth and the associated demand for new infrastructure and infrastructure rehabilitation, use of debt is a reality as general revenue growth normally lags infrastructure demand.

3.3 Forecast Debt Service

The forecast results indicate that both low risk and high risk outlook debt service percentages are below the 75% of MGA limit as set by Council.

	2011	2012	2013	2014
Debt service limit	75.00%	75.00%	75.00%	75.00%
Low Risk Actual debt service %	17.31%	16.07%	14.62%	25.81%
High Risk Actual debt service %	17.31%	15.96%	14.41%	23.99%



The debt service ratio is a critical variable in financial management. It is a measure of financial resource demand on annual revenues that, if not, managed would divert significant resources from current services and programs.

While total committed debt is being tracked, committed debt service remains elusive as such would be tied to predictable capital projects delivery. With current capital project delivery backlog, it is difficult to predict when the undrawn debt would be drawn. For planning purposes, debt is assumed to be drawn three years after approval.

Debt service is variable based on timing and interest rates prevalent at the time debt is secured. Debt service represents interest and principal payments, therefore the greater the debt service payments, less is available for service/program provision.

4.0 Fiscal Stability Reserves

4.1 Fiscal Stability Reserves

Central to best practices in public financial management is maintenance of adequate reserves to mitigate current and future risks such as:

- Revenue shortfalls,
- Unanticipated expenditures,
- To ensure stable property tax rates.

A number of considerations come into play in setting and funding fiscal stability reserves:

- Predictability, diversity and underlying risk associated with revenue sources,
- Disaster index,
- Liquidity or working capital requirements to cover disparity between financial resources available.

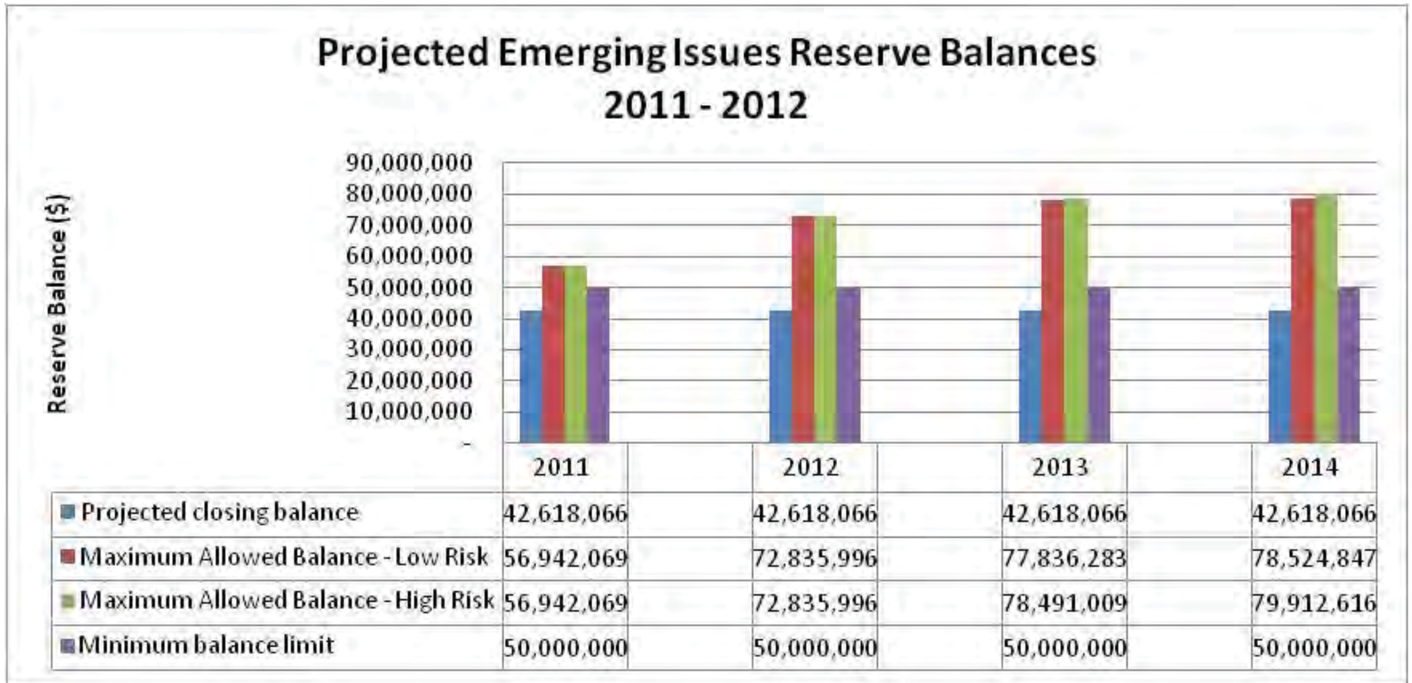
Through policy, the Municipality has created two fiscal stability reserves; Emerging Issues Reserve (EIR) and Capital Infrastructure Reserve (CIR).

4.2 Emerging Issues Reserve

Past policy has required that each year $1.1M is budgeted plus the prior year's surplus to cover any unanticipated operating spending. The uncommitted balance at the end of each year is normally transferred to the Capital Infrastructure Reserve. The 2011 – 2014 Fiscal Management Strategy enhances the Emerging Issues Reserve as follows:

- Based on a comprehensive review of the Municipality's operating revenue risk index, set a maximum EIR balance equivalent to 15% of audited prior year's net property tax revenue and is subject to an uncommitted minimum balance of $50M,
- Discontinue the $1.1M annual funding beginning 2012,
- Transfer funds in excess of the minimum EIR balance at each year end based on Council direction.

The following graph indicates projected balances in the EIR for the years 2011 – 2014.



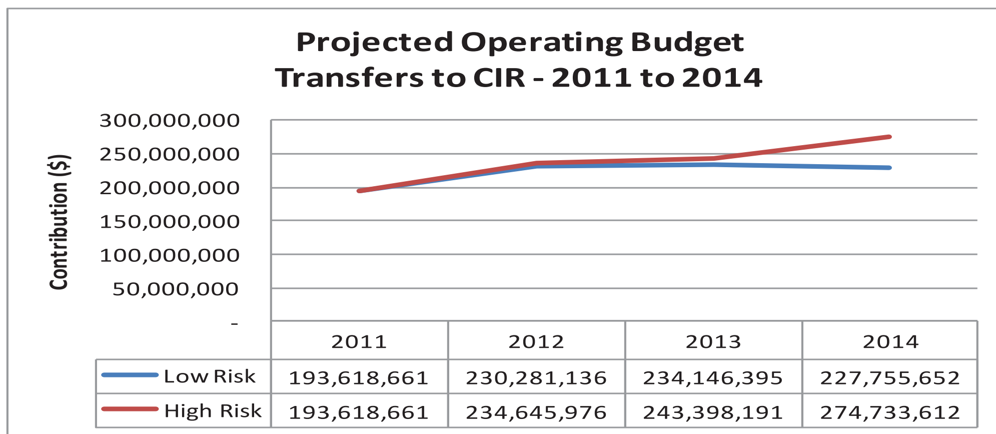
	2011	2012	2013	2014
Projected closing balance	42,618,066	42,618,066	42,618,066	42,618,066
Maximum Allowed Balance - Low Risk	56,942,069	72,835,996	77,836,283	78,524,847
Maximum Allowed Balance - High Risk	56,942,069	72,835,996	78,491,009	79,912,616
Minimum balance limit	50,000,000	50,000,000	50,000,000	50,000,000

Initial funding for the enhanced EIR will come from projected 2010 corporate surplus. Governance of the EIR is provided in the Fiscal Responsibility Policy.

4.3 Capital Infrastructure Reserve

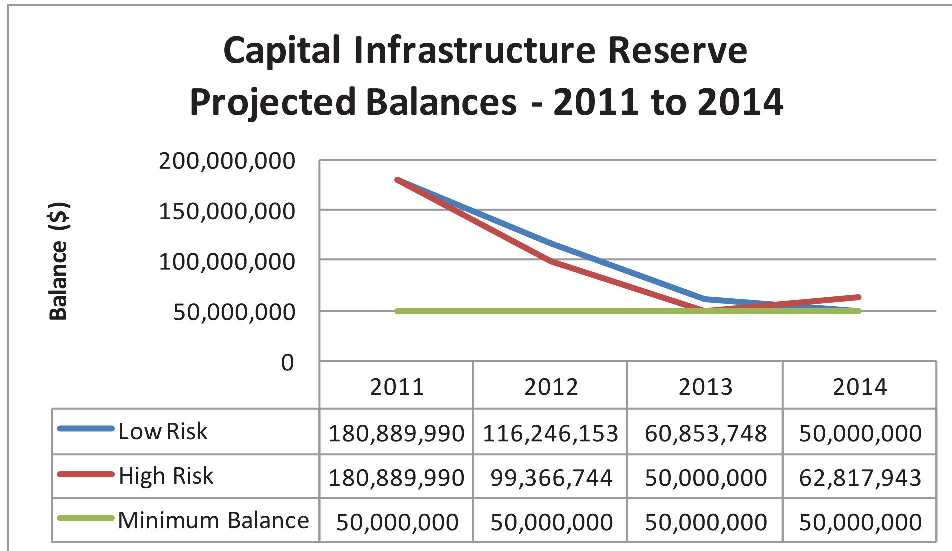
A Capital Infrastructure Reserve (CIR) has been established to provide a source for capital project funding with a minimum uncommitted balance of $50M being maintained.

The forecasted CIR contributions from operating budget are as follows:



	2011	2012	2013	2014
Low Risk	193,618,661	230,281,136	234,146,395	227,755,652
High Risk	193,618,661	234,645,976	243,398,191	274,733,612

Of interest to capital budget long-term financial planning, is how each of the forecast scenarios panes out in terms of ending balances relative to the minimum uncommitted balance of $50M requirement.



	2011	2012	2013	2014
Low Risk	180,889,990	116,246,153	60,853,748	50,000,000
High Risk	180,889,990	99,366,744	50,000,000	62,817,943
Minimum Balance	50,000,000	50,000,000	50,000,000	50,000,000

The preceding graph indicates that both forecast scenarios will meet the $50M uncommitted minimum balance requirement. The high risk scenario is projected to have $13M in excess of minimum uncommitted balance by the end of 2014 while the low risk will be right on the mark.

The projected CIR balances will provide flexibility to respond to future capital project funding requirements.

5.0 FINANCIAL CONDITION INDICATORS

5.1 Financial Condition Measures

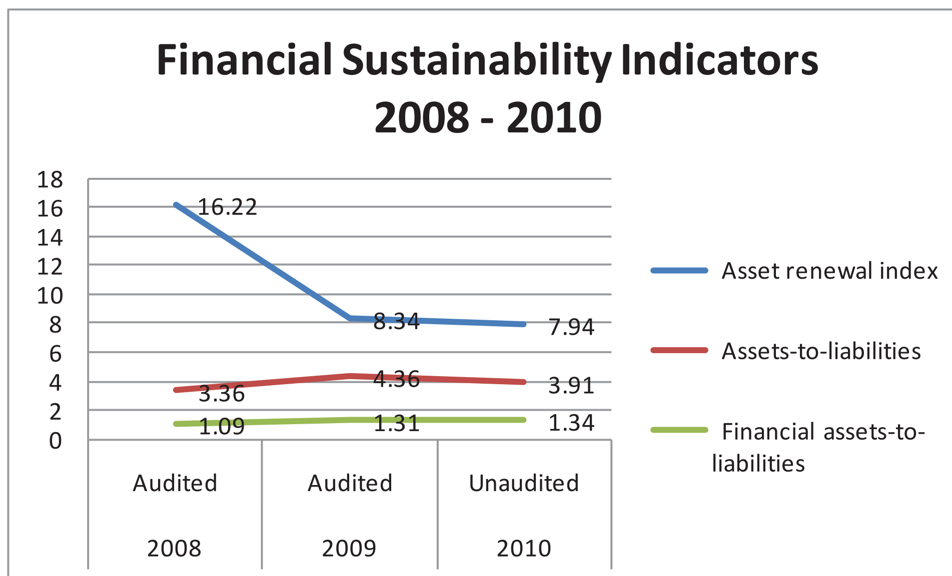
The Municipality uses three sets of financial condition measures:

- **SUSTAINABILITY** – the degree to which the Municipality can maintain existing programs, infrastructure and meet existing creditor requirements without increasing debt.
- **FLEXIBILITY** – the degree to which the Municipality can increase its financial resources to respond to rising commitments, by either expanding its revenues or increasing its debt burden.
- **VULNERABILITY** – the degree to which the Municipality becomes dependent on, and therefore, vulnerable to, sources of funding outside its control or influence.

5.2 Sustainability Indicators

Three indicators are used:

- *Assets-to-liabilities* – this is the degree to which total assets cover total liabilities. A ratio of 2:1 is desirable.
- *Financial assets-to-liabilities* – this is the degree of cover provided by cash and 'near' cash assets over total liabilities. A ratio of 2:1 is desirable.
- *Asset renewal index* – this is the measure of how much an organization is expending in asset renewal relative to depreciation expense.



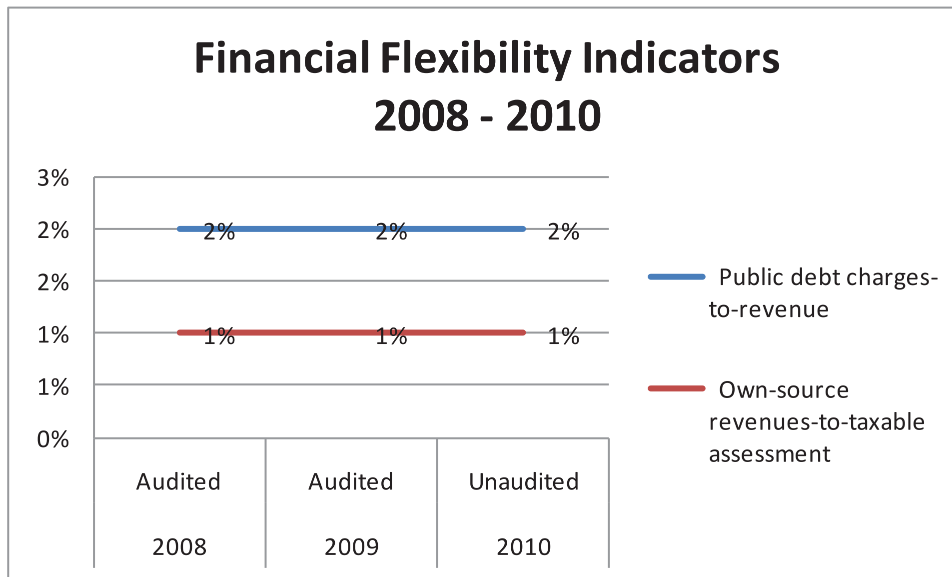
In general, the municipality is in a strong financial position. In terms of future pressure to spend on asset rehabilitation, such appears to be contained as the municipality is spending $8 in asset renewal for every $1 of depreciation in 2010. This indicates a high level of investment to keep infrastructure available. The municipality has financial and non-financial asset base to meet total liabilities. However, some degree of risk exists when comparing financial assets as a

cover for liabilities of 1.34:1 in 2010 in comparison to a desired ration of 2:1. Upon further review, a large component of the liabilities recorded impacting this ratio are attributed to grant funding received but not expended according to terms of grant agreements. For most part, this represents a timing difference.

5.3 Flexibility Indicators

Two indicators are used:

- *Public debt charges-to-revenue* – this is a measure of how much resources or revenues are dedicated to debt service or payment of interest.
- *Own-source revenues-to-taxable assessment* – this is a measure of non-property tax revenue against taxable assessment.

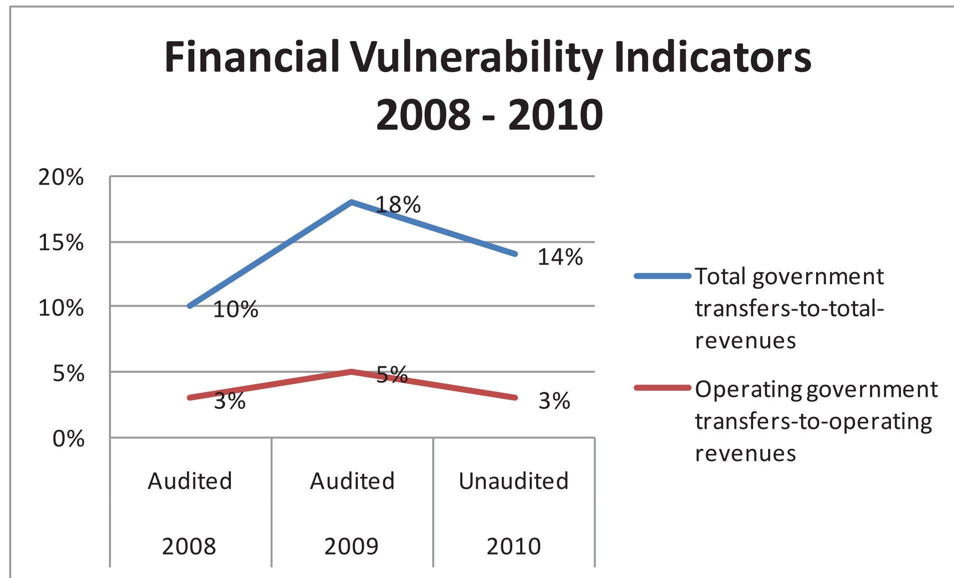


The Municipality has very a low debt service burden. This indicates that debt service levels are not negatively impacting delivery of programs and infrastructure or no significant amounts of revenues are being diverted to pay for debt. The own-source revenue ratio indicates heavy dependence on property tax revenue. However, a better context for this measure for the Municipality is that in reality the taxable assessment base is significant.

5.4 Vulnerability Indicators

Two indicators are used:

- *Operating government transfers-to-operating revenue* – this is a measure of how much the municipality is dependent on provincial and federal transfers to fund operating budget programs.
- *Total government transfers-to-total revenues* – this is a measure of level of provincial and federal transfers to support both operating and capital programs at the municipality.



Operating transfers from Alberta and Federal governments are limited. The bulk of the transfers support community or not-for-profit organizations and the Municipality acts as a distributing agency. Total government transfers are a combination of operating and capital transfers. Most government transfers relate to capital grants. More transfers for this purpose are desirable.

Alberta Municipal Affairs has developed a voluntary self-assessment toolkit for municipalities. This toolkit, which is still in draft form, awaiting ministerial approval incorporates some of the measures that the Municipality is already using to manage financial resources. Results from this assessment tool indicate that the Municipality has a sound financial management framework in place.

6.0 SUMMARY

The Municipality is in a strong financial position to address known operating and capital needs for the next three years. There is a need to provide adequate operating reserve coverage to protect the organization from property tax revenue losses or general downturn.

This strategy provides a prudent fiscal approach that aligns with current and projected financial position relative to prevailing and projected economic outlook. In summary, this Strategy is based on the following principles.

6.1 Property Tax

In each of the forecast scenarios, no tax increases are required. The optimistic outlook or high risk scenario would yield an estimated $13M of uncommitted funds in the Capital Infrastructure Reserve by the end of 2014 while the less optimistic outlook or low risk scenario will be right on the mark.

Principles:

1. Property taxation based on ‘revenue neutral’ plus construction growth strategy for 2011.
2. 2012 – 2014 budgets assume ‘Low Risk’ revenue neutral plus construction growth plus inflation revenue strategy for planning purposes.

6.2 Debt & Debt Service

Projected debt and debt service percentages for both scenarios are below the 75% of MGA limit set by Council:

Principle:

1. Debt and debt service limits are set at 75% of MGA limits.

6.3 Fiscal Stability Reserves

The Municipality has two major fiscal stability reserves: Emerging Issues Reserve (EIR) and Capital Infrastructure Reserve (CIR). At the time of the adoption of this strategy, both fiscal stability reserves are fully funded.

Principles:

1. Emerging Issues Reserve
   a. A maximum balance equivalent to 15% of prior year’s net property tax revenue is set subject to a minimum uncommitted balance of $50M.
   b. Transfer any excess funds in the EIR at each year end based on Council direction.
   c. Commencing for the 2012 Budget, the $1.1M annual funding is discontinued.
2. Capital Infrastructure Reserve
   a. An uncommitted minimum balance of $50M will be maintained.