

TO: UBCM Members
FROM: UBCM Executive
DATE: September 24, 2008
RE: **FINANCING LOCAL GOVERNMENT:
ACHIEVING FISCAL BALANCE**

POLICY PAPER

#1

2008 CONVENTION

1. DECISION REQUEST

To consider three recommendations that will provide a mandate for UBCM to pursue changes to the current arrangements with respect to local government financing.

2. BACKGROUND

The UBCM membership has expressed concern that the current scheme of local government financing is at an imbalance with the provincial and federal orders of government. Throughout the past year this concern and a call for change has resonated through Convention resolutions (C1-C14) and through correspondence to the UBCM.

The resolutions and correspondence from the membership indicate the following themes:

- Local governments are dependent on a single taxation source (property tax) – a tax that they do not fully control.
- Local governments are struggling to contain property taxes while the provincial and federal governments are running surpluses and cutting taxes.
- Local governments' budgets continue to be impacted by direct and indirect offloading.
- Provincial fiscal support to medium and large sized municipal and regional district operating budgets is very low.

3. EARLIER LOCAL GOVERNMENT FINANCE INITIATIVES

This is not the first occasion when local governments in British Columbia have expressed a desire to reform the local government financing regime. Indeed it may be helpful to review some of the history of local-provincial financial relations in BC.

The stresses and tensions around local property taxation and local-provincial financial relations have been with UBCM throughout its history. In the 1930s, the context was soaring local welfare costs brought on by the depression. Then, in the 1940s provincial

inquiries into education, finance and provincial-municipal relations again reflected the tensions around local government finance. In fact, financing local government reports / studies appear to have emerged in every decade since.

Local governments fought hard, up until the late 1970s, for a revenue sharing program. The program that was introduced in 1978 provided a guaranteed share of major provincial revenue sources including personal and corporate income taxes, sales and fuel taxes and natural resource revenues. This share of provincial revenue was used to finance unconditional operating transfers and conditional operating and infrastructure support to BC local governments.

Initially most of the revenue sharing funding was unconditional. However over time more and more of the money became conditional and by 1992-93 less than half of the funding was unconditional.

The 1989 UBCM Convention considered a report entitled "Financing Local Government" that was the joint product of local government-provincial working groups formed to consider a host of vexing financial issues.

By the early 1990s it was evident that the then Revenue Sharing Program, while providing certainty on transfers into an account for distribution to local government, wasn't delivering. Over \$250 million in transfers into the account had built up without being paid out to local government.

This fact, combined with a reduction in the overall transfers in 1992, led to the formation of a technical working group that produced the report "Local Government Transfer System: Options for Reform" that was considered at the 1993 UBCM Convention. The Convention adopted one of the options, which was subsequently reflected in the 1994 *Local Government Grants Act*. It was at this time that the link to provincial revenues was terminated.

In the fall of 1996 the local government-provincial financial relationship as reflected in the *Local Government Grants Act* was called into question. Section 2 of the *Local Government Grants Act* was repealed as a cost cutting measure. General unconditional support was eliminated in 1997, although some grants to small communities continued.

In response to this, delegates at the 1997 UBCM Convention endorsed terms of reference for a second Financing Local Government study. This study was completed and its findings were presented to the 1998 Convention. The study was wide-ranging and focused on the related themes of restructuring grant programs; developing new, more diverse sources of revenue for local government; and fixing the problems with existing sources of revenue.

As a result of the 1998 study and UBCM follow-up, a number of changes were made to the system of local government financing. These included:

- the recommendation to continue grants to small communities and regional districts was accepted and had a significant value. Small communities were

protected and their grants maintained throughout the period where many other public sector bodies experienced funding reductions.

- the recommendation to remove restrictions on business license fees was followed and municipalities were given full autonomy in this sphere.
- the recommendation to provide municipalities more flexibility in budget preparation was implemented.
- the recommendation to improve financial reporting standards was been implementing and has had the added benefit of making BC local governments compliant with federal Gas Tax reporting requirements.
- while the study did not make any specific suggestions on police cost funding it did identify it as a priority matter for resolution. After a long and at times difficult period of discussions a new police cost funding formula was implemented for small communities and rural areas.

A summary of the study's conclusions is included as Appendix A.

In 1999, traffic fine revenue sharing was introduced and the portion allocated to local governments was raised to 100 percent of traffic fine revenue in 2004.

Small Community grants were protected throughout the early 2000's and the program was redesigned in 2006 and is on schedule to be doubled by 2009.

There have been significant improvements in the capital support provided to local government. The Canada-B.C. Infrastructure Program delivered over \$800 million in shared funding of capital projects. This Program was followed by the Municipal Rural Infrastructure Fund and the new Building Canada Communities Component. The federal government also responded to local government's request for sharing gas tax revenues by establishing a program that will provide \$1.7 billion to B.C. by 2014 as well as additional financial support to public transit.

Since 2004, the provincial government has introduced a wide range of application-based programs targeted to specific initiatives such as wildfire prevention; seniors housing and support; and community tourism. These are all welcomed programs but they are either largely restricted to capital works or one-time grants that do not provide the certainty and predictability desired by local governments.

4. REVENUE SHARING PROS AND CONS

A number of the resolutions submitted by the membership call for the reinstatement of an unconditional revenue sharing program.

When working properly, the provincial revenue sharing program served local governments well. It was a predictable revenue source, which reflected fluctuations in the provincial economy.

On the negative side, history has proven that revenue sharing programs are unable to survive provincial restraint measures, even when they are protected by legislation (as was the case with our past revenue sharing program). It is often difficult to retain political support to “guaranteed” programs when tough budget choices are necessary. In addition it is difficult to retain political traction for program funding which is unconditional. As mentioned earlier, the experience in BC with the last revenue sharing program was that more of the funding became conditional as time passed.

So the return to a revenue sharing has both positive and negative implications. Indeed this is one potential solution to addressing local government financing challenges. However, it is certainly not the only potential solution. Other potential solutions such as a transfer of tax room are also viable potential alternatives and should be reviewed through the same lens. A potential list for consideration could include:

- a share of dedicated property purchase tax;
- a dedicated sales tax;
- a dedicated fuel tax;
- additional hotel tax options; and
- residential school taxes room – for example the provincial school tax could be reduced, leaving the opportunity for local governments to assume this tax room.

Each of the proposals on this list has a host of design options. For instance, the proposal for access to new revenue through a sales tax could be accomplished by a sales tax that is collected provincially and redistributed. Another alternative is that local governments be given the option to levy and collect the sales tax. However, the purpose of this paper is not to debate that level of design, but to seek agreement on a process, the scope of that process, and the principles to guide the further work.

Review of the resolutions submitted by the membership to the 2008 Convention indicates support for a return to revenue sharing or a broader approach. While there may not be unanimity on the solution, it is clear from the membership that something needs to be done to address the current local government financing framework.

5. GOING FORWARD

There is a growing body of literature on municipal-provincial fiscal relations in Canada. FCM has provided leadership on a national scale on this issue. In 2006, FCM presented a study entitled “Restoring Municipal Fiscal Balance” which included the following recommendations:

- Clarify roles and responsibilities;
- Develop a long-term plan to eliminate the infrastructure deficit;
- Diversify municipal revenue tools;
- Focus on integrated approaches to rural and northern development;
- Invest in public transit; and
- Change municipal practices (legislative and administrative framework).

While some of the items listed above may be higher or lower priorities from a BC context, our process forward needs to recognize that there is no one solution to this issue. Achieving fiscal balance will require a comprehensive approach.

Initially many of the resolutions received from local governments supported a return to unconditional revenue sharing. However, a recent report from the City of Vancouver recommended that UBCM undertake the following:

"Establish a commission made up of impartial experts in the field of municipal finance and policy to deliver a set of practical, implementable solutions to the municipal fiscal imbalance issue in British Columbia by Spring, 2009."

In addition, correspondence from local governments initially showed support for a return to revenue sharing. However recent correspondence also indicates support for a broader approach.

UBCM Executive endorses the establishment of a task force to consider a range of solutions and offers the following comments:

- a. The Commission should report to a Steering Committee comprised of the UBCM Presidents Committee and appropriate provincial officials.
- b. As much as possible, this process needs to be collaborative with the Province.

UBCM has a long history of collaboration with the Province throughout projects with the potential for significant impact on local governments. At the end of the day, any changes to the existing local – provincial fiscal relationship must be agreed to by the Province. Therefore, it is imperative that provincial officials be involved at all stages of the project.

6. ADOPTION OF PRINCIPLES

A number of years ago UBCM adopted a broad range of policies to guide our action on projects such as this one. These policies, extracted from UBCM's General Policies, have on occasion, been amended to include the following principles:

- Local public services should be provided by a democratically elected, responsible, accountable and accessible local government.
- The powers of local government should be adequate to meet local needs. The legislation that sets out local government responsibilities should be reviewed regularly and amended so it continues to meet those needs. When local government is empowered to carry out a responsibility, it should be done in a clearly written statute.
- The ultimate determination of the local public interest in terms of local responsibilities lies with locally elected representatives; including the freedom to determine the level of local services, expenditures and taxation.

- Local government should have the necessary legislative powers to meet its responsibilities, the power to ensure its policies and financial programs are mutually supporting, and the discretion and flexibility to determine the most appropriate methods of meeting the local needs.
- Local government should have access to sufficient revenue to support local services.
- Property taxation distribution must be the responsibility of local government; it should be based on actual value assessment and grants in lieu of taxes paid by other governments and their agencies should be paid on the same basis as the ordinary taxpayer.
- Local government should have access to a share of provincial revenues which should be predictable as to the amount and the timing of its announcement and the major portion of shared revenue should be in unconditional grants.
- Access to additional revenue should be provided when local government is assigned new responsibilities.
- As the basis for relations between local and senior levels of government, local government must be recognized as a full and equal partner in the system of Canadian government.
- Other order of government policies and regulations that affect local government should respect the varying needs and conditions of different areas of the province.
- Programs that are exclusively determined by another government should be financed by that government from their revenue sources.
- Financial assistance should be provided to local governments by other orders of governments when their policies over-ride local priorities or impose an additional financial burden on local government and that assistance should equate to the added cost burden.
- The ability of other orders of government to over-ride local government decisions must be established by legislation and must be clearly limited to those matters that would substantially affect a provincial responsibility and be subject to appeal.

Over time these principles have informed UBCM in its work on past joint processes and in arriving at recommendations for previous reviews on financing local government. As well, over time a number of these general principles have found their way into legislation, including the *Community Charter* and *Local Government Act*. The following are excerpts:

Excerpt from Principles of municipal governance

(2) In relation to subsection (1), the Provincial government recognizes that municipalities require

(c) the ability to draw on financial and other resources that are adequate to support community needs,
(d) authority to determine the levels of municipal expenditures and taxation that are appropriate for their purposes,

Excerpt from Principles of municipal-provincial relations

(2) The relationship between municipalities and the Provincial government is based on the following principles:

(b) the Provincial government must not assign responsibilities to municipalities unless there is provision for resources required to fulfill the responsibilities;

(c) consultation is needed on matters of mutual interest, including consultation by the Provincial government on

(i) proposed changes to local government legislation,

(ii) proposed changes to revenue transfers to municipalities, and

(iii) proposed changes to Provincial programs that will have a significant impact in relation to matters that are within municipal authority;

As part of their activities, the Commission will want to include the body of work and recommendations from past financing studies and reviews as well as identify new approaches for achieving local government fiscal balance. All recommendations generated by the Commission should be reviewed through the UBCM's General Policies lens and the principles that have been captured in existing legislation.

7. 2008 CONVENTION ACTIVITIES

Activities at the 2008 Convention pertaining to Achieving Fiscal Balance include a pre-conference study session on Monday, September 22 from 9 am to noon. This session will include the following presenters:

- Brock Carlton, Executive Director, FCM
- Dr. Harry Kitchen – expert on local government finance
- Mr. Gaetan Royer, author of “Canadian Cities Are Running Out of Time”
- Ms. Judy Rogers, City Manager, City of Vancouver
- Mr. Al Kenning, Deputy City Manager, City of Nanaimo

This policy paper will be presented to delegates at the Convention during the Wednesday morning policy session.

8. RECOMMENDATIONS

That UBCM, in partnership with the Province, establish a task force of impartial experts in the field of local government finance and policy to deliver a set of practical, implementable solutions for restoring local government fiscal balance in British Columbia by spring 2009; and

That UBCM engage the Province in a collaborative effort throughout this process; and

That the General Policies and principles set out on page 5 to 7 of this paper be reaffirmed to guide this review.

Appendix A

Summary of the 1998 Financing Local Government Study's Conclusions

Among the useful insights provided by the report, the following are the primary conclusions and recommendations:

Provincial-Local Transfers

- continue unconditional grants to small communities and regional districts
- gradually replace equalization grant program with program that distributes funds in proportion to population. Program would be a rough compensation to local governments for impacts of provincial programs and legislation
- local government and province should negotiate a multi-year arrangement to provide greater certainty

Payments in Lieu of Taxes

- the report acknowledges that it will take some time to come to a mutually agreed on program. But the report sets out two variations on principles to guide discussions, and the groups favoured Option 2 (as described on pp. 17-18 of the report) as a starting point.

New Sources of Revenue

- enhance the range of local government taxing powers. New sources deemed most promising for further discussion with the province were fuel tax, real property transfer tax, and liquor tax). These would benefit a wide range of local governments and have a direct linkage to the services they provide.

Transfer of Property Tax Room

- The province currently partly occupies the property tax field (schools, health capital), the traditional primary source of local government revenue. If the province raised some of these revenues from other sources, then this tax room might become available to local government to help fund local services. The recommendation here was to ask the province to consider funding health capital from other sources.

Removing Restrictions on Existing Revenue Instruments

- recommends changes or improvements in these areas:
 - broaden the allowable uses of DCC revenue
 - use of hotel tax revenue
 - restrictions on business license fees
 - use of parcel taxes and flat taxes
 - taxation of telecommunications companies
 - revenue from municipal enterprises
 - collection of unpaid parking tickets
 - classification of properties for tax purposes
 - restrictions on the use of property tax rates/ratios
 - use of property taxation areas

- library user fees
- regional sharing of industrial tax base

Expenditure Mandates

- endorsed the approach of provincial-local government protocol agreements and processes in areas of shared responsibilities, as is currently used for joint environmental issues.
- recommends developing similar protocols in other shared areas, including justice and transportation.

Financial Management

- Of the many recommendations brought forward in this area, the ones with the most significant impact would be:
 - **Budget Preparation:** bring forward the final budget approval date for municipalities from May 15 to January 15 (with all the necessary complementary adjustments in other related activities such as the assessment cycle and regional district budgets). The dates for rates bylaws and adoption of the five-year capital plan would be moved to April 30 from May 15. These changes would encourage better multi-year planning by councils by separating the approval dates for the various budgets; would have the budget determined earlier in the fiscal year and unnecessary lag times between the provisional budget and the final budget; and would allow more time for preparation of tax bills and public information on tax changes.
 - **Financial Reporting:** local governments should adopt the financial reporting standards developed by the Public Sector Accounting and Auditing Board (PSAAB), to improve financial accountability to taxpayers. The study recognizes that implementation of this recommendations will require some training of staff, and suggests that it would be appropriate for the provincial government to share in these training and implementation costs.
- Recommendations relating to the operation of the tax collection system will be referred to the newly formed working groups given the task of reviewing these provisions of the *Municipal Act*.

Police Financing

- The study recognized the impact that police financing has on the local government financial burden, but was not able to develop any proposals in the time allotted. However, the study recommended that police financing be identified as a priority for further study given the impacts that the next census in 2002 will have on funding formulas. The study made some suggestions regarding principles that might be considered.

Appendix B

Extracts from Financing Local Government (1989)

ASSESSMENT AND TAXATION EXEMPTION

24. The assessment base be kept as clean and extensive as possible. Assessment exemptions should be kept to a minimum.
27. All properties should pay fees, charges, frontage taxes and parcel taxes associated with the provision of a specific service unless specifically exempted by local government.
28. The Assessment Authority continue to assess all properties regardless of their taxation status.

SCHOOL PROPERTY TAXATION

37. The present system of school funding be changed to ensure:
 - clearer accountability for taxing and spending decisions.
 - more equality in residential taxation.
38. Re-structuring of financial responsibility (i.e. 100% provincial funding of the core program).

GRANTS IN LIEU OF TAXATION

49. In principle, all Crown Corporations and government property should be taxable in the same way as private sector corporations, unless specifically exempted. Provincial property should be taxable for several reasons:
 - local services are provided to those properties in the same way as other property owners and residents;
 - land is developed that may otherwise be used for other purposes;
 - public services account for a large proportion of total economic activity in some municipalities;
 - property taxes are one of the costs of doing business.
50. Provincial properties should be taxable rather than pay grants-in-lieu of taxes (or grants "equivalent" to taxes) for a number of reasons;
 - it establishes clearly the principle of tax treatment similar to private companies;
 - it is administratively simple for taxpayers, municipal authorities and the Assessment Authority;
 - the due date for payment would be the same as other taxpayers – not later in the year as it is today.
51. The provincial government should move towards local taxation of all provisional property and begin by ensuring all commercial-like Crown Corporations are taxable.
52. The federal government use the assessments as determined by the BC Assessment Authority for determining their grants-in-lieu of taxation.

LONG TERM REFORM

72. There should be a restructuring of local government finances to allow for greater self-reliance by municipalities. This could involve: limiting access by school boards to property taxes; and providing municipalities with a wider range of revenue instruments.