SUSTAINING PROSPERITY TOGETHER

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The Next Crucial Challenge for Alberta – Can We Sustain the Alberta Advantage?

Senior policy makers are facing an issue of economic and fiscal importance to all Alberta.

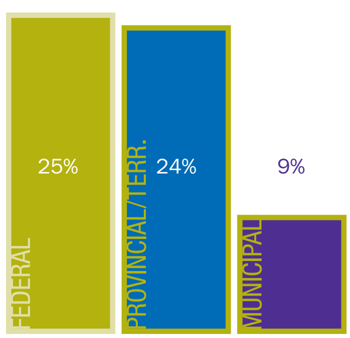
- Alberta has enjoyed a decade of economic growth driven by the key competitive strategies of the Alberta Advantage – low taxes, low debt, business friendly policies and a low-cost business environment.
- Alberta is at a crucial turning point in its economic strategy. If growth and prosperity are to continue, Alberta must add value across its key economic sectors and maintain these key competitive advantages, while ensuring sufficient infrastructure to support growth.
- As primary partners in sustaining economic growth, Alberta's municipalities must help maintain these key competitive advantages. But right now, Alberta's municipalities are experiencing "triple jeopardy". They have limited access to flexible revenue sources – and are facing a growing infrastructure deficit, coupled with pressures to sustain ongoing economic growth.

Can Alberta Municipalities Continue to Support Economic Growth?

- Over the past decade, municipalities have effectively reduced operating costs and managed accelerated growth and demands for higher infrastructure and service standards (water, sewage, sanitation, protection and local roads). *These services are essential to viable, vital communities.*
- National and provincial sources of revenue are escalating and growing as the economy expands. At the same time, municipal revenue sources are limited.
- Existing municipal infrastructure in Alberta is deteriorating rapidly and new investment is lagging current levels of economic and population growth.
- This situation has serious consequences for Alberta's goals of *sustaining economic growth and maintaining services and a high quality of life for Albertans.* Delaying an effective response only escalates the scale of the problems.

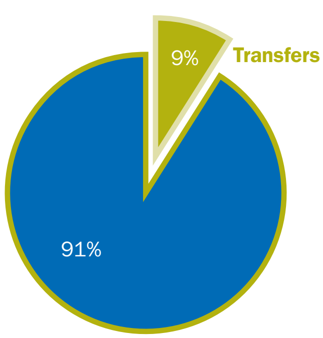
Government Revenue Growth

1996–2001



"Cities have managed well but the fiscal situation is not sustainable into the future." *TD Bank Report*

Municipal Revenues in Alberta in 2002



Own Source
(Property Taxes/User Fees/Investment Income)

Source: Statistics Canada

Why the Current Situation is Not Sustainable

Alberta's municipalities are under severe pressure to maintain current services, sustain their current infrastructure, meet new, higher standards and support further growth.

- Municipal capital funding requirements in Alberta grew 109% over the 1990's *(Source: Nichols Applied Management).*
- There is a shortfall of about $670 million each year in infrastructure investment in Alberta *(Source: AUMA).* Municipal taxes would have to increase to unprecedented levels to fund this deficit. This tax increase would not include costs to meet the demands of growth.
- About 50% of Alberta's current infrastructure inventory (buildings, local roads, water, sewer and sanitation) is built and maintained by municipal governments.

Revenue sources to fund municipal infrastructure and services are constrained and under severe pressure.

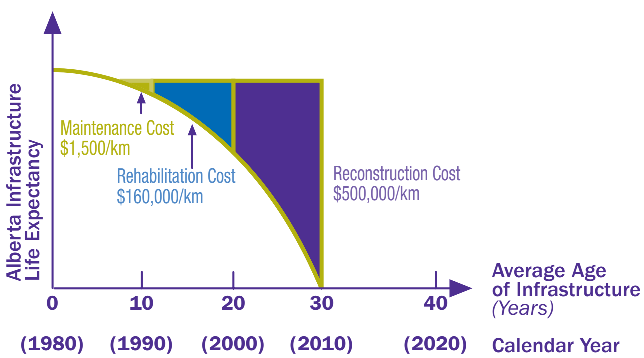
- Property taxes are the prime source of municipal revenue, and do not grow proportionate to economic growth. In addition, the escalating education portion of the property tax is reducing municipalities' ability to fund core municipal services.
- Between 1992 and 2002, Alberta municipalities have seen:
  - "Own source" revenues increase by 61%
  - Property taxes increase by 72%
  - Provincial transfers to municipalities drop by 46%
- Today, "own source" revenues account for over 90% of municipal revenues

Now is the Time to Invest in Sustaining Alberta's Growth.

Alberta has an opportunity to tackle its infrastructure deficit now, and reduce the burden of future costs significantly while sustaining growth and prosperity.

- The average life expectancy of a roadway is 25 years. Effective asset investment requires annual maintenance, with major rehabilitation after about 12 years and every 6 years after that. Cost escalation if maintenance is ignored is significant:
  - Maintenance cost per road kilometre (km) is $1,500 in the first 10 to 12 years.
  - It escalates to $160,000 per km for rehabilitation.
  - And rises to $500,000 per km for reconstruction.

Infrastructure Rehabilitation Costs Increase Exponentially Over Time*



**Alberta Roadbuilders Association*

- By 2005, a significant portion of Alberta's existing infrastructure will reach a critical point in its lifecycle. There is a window of opportunity in Alberta between 2004 and 2010 to minimize risks and costs by investing in infrastructure renewal.
- If Alberta's value-added economy is to benefit ***all*** Albertans – new infrastructure will also be required to ensure access to markets and safe, viable growth in communities.
- Alberta needs to conduct a comprehensive study of the province's infrastructure renewal costs and complete an Alberta Infrastructure Renewal and Investment Strategy.

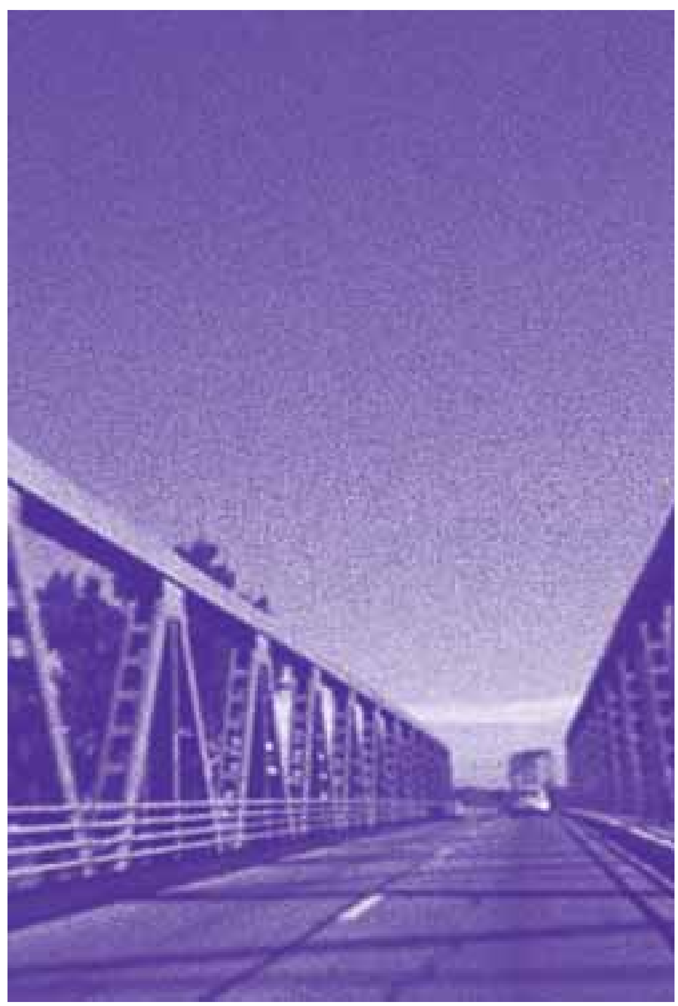
Impact on the Alberta Advantage and Other Key Government Policies.

The fiscal realities of Alberta's municipalities will impact the Alberta Advantage. Without a solution, Alberta will soon experience:

- Inadequate municipal infrastructure to support Alberta's economic growth targets.
- Growing municipal debt, which will erode Alberta's low debt advantage.
- Municipal tax increases that will undermine Alberta's low business cost advantage.

Sustainable infrastructure is key to ongoing community prosperity.

- The impact of Alberta's infrastructure deficit will mean further community erosion, including decreased development and depopulation, especially in smaller communities.



The Problem is Real and It's Growing. Alberta Needs Solutions.

- The province has taken positive steps to improve Alberta's investment in infrastructure (its new provincial capital plan; municipal grants extensions to 2006; the 3 R's Council) – but these measures *do not provide a viable long-term solution.*

Municipalities are facing tough choices that will impact the province's economic agenda. Without solutions, municipalities must either:

CUT SERVICES

RAISE TAXES TO UNPRECEDENTED LEVELS

ACCEPT SLOWER GROWTH.

or

DEVELOP A NEW FINANCIAL RELATIONSHIP WITH THE PROVINCE.

- There is action the province ***can*** take now:
  - Reinstate the freeze on the province's portion of the property tax at $1.2 billion, while defining a new financial relationship with municipalities.
  - Place an immediate priority on developing an Alberta Infrastructure Renewal and Investment Strategy, including a review of the life expectancy of Alberta's infrastructure and the scale of the current and future infrastructure deficit.
- A new financial relationship between the province and Alberta municipalities must identify ways to provide predictable, long-term sources of revenue. It should consider:
  - Reduced property taxes, allowing tax room for municipalities to finance infrastructure and manage growth.
  - A defined share of provincial fuel taxes.
  - A defined share of provincial personal income taxes (or municipal piggybacking).
  - A defined share of provincial gaming resources (or municipal piggybacking).
  - A defined share of provincial natural resource royalties.

Key Questions

1. If the province's overall tax rate is the lowest in Canada, why not continue to increase the property tax in Alberta?

It's true that Alberta's overall tax rate is low, reinforcing our province's competitiveness. But it's also true that property taxes in Alberta are under severe pressure to fund two key competitive economic drivers – education and infrastructure – and this pressure cannot be sustained. Municipal revenue simply cannot grow fast enough to meet current and future pressures. The increasing burden of municipal taxation will jeopardize Alberta's global competitive advantages.

The property tax is not a suitable vehicle to fund these two key areas of responsibility. It does not grow proportionate to the economy and, even with unprecedented tax increases, cannot sustain the pressures for increased funding in these areas in the future. Alberta needs to take in a comprehensive action to ensure the best long-term solutions to sustain Alberta's hard-earned competitive advantages.

2. If Alberta municipalities have decreased their debt loads and improved their reserves in recent years, why not increase municipal debt financing to fund infrastructure?

For the same reasons the province has pursued debt reduction so rigorously. More debt means higher operating costs. Municipal debt loads are already increasing to keep up with the most urgent pressures of deteriorating infrastructure – and they will rise even higher in the years ahead. This has direct implications for Alberta's competitive advantage of maintaining low overall debt. Both high growth communities and smaller communities will be severely challenged to support the debt required to finance the current infrastructure deficit and future needs driven by growth.

3. How will the province fund the growth of education costs if the province's portion of the property tax is frozen?

The fact is that the property tax is not the mechanism to handle these pressures and it cannot continue to sustain the pressures for funding these two key areas of responsibility. Alberta needs a new financial relationship between the province and municipalities to ensure a viable, long-term solution to funding infrastructure and education. Investment in both education and infrastructure are key factors in sustaining Alberta's economic growth and prosperity. At the same time, increased demand pressures in both areas are the consequences of growth. Long-term solutions must include sustainability measures, new sources of revenue and a new financial relationship with the province.

4. What is the preferred option to resolve the infrastructure deficit?

Municipalities need long-term, predictable revenue sources. There are some important early actions that can happen right away. The province should:

- Reinstate the freeze on the province's portion of the property tax at $1.2 billion, while defining a new financial relationship with municipalities.
- Place an immediate priority on developing an Alberta Infrastructure Renewal and Investment Strategy, including a review of the life expectancy of Alberta's infrastructure and the scale of the current and future infrastructure deficit.

In the longer term, the province and municipalities need to develop a new financial relationship that provides predictable revenue sources and considers:

- Reduced property taxes – making tax room for municipalities to finance infrastructure and manage growth.
- A defined share of provincial fuel taxes.
- A defined share of provincial personal income taxes (or municipal piggybacking).
- A defined share of provincial gaming resources (or municipal piggybacking).
- A defined share of provincial natural resource royalties.

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