# Cost Sharing Works: An Examination of Cooperative Inter-municipal Financing

November 2010

## EXECUTIVE SUMMARY

Much has been written and discussed about the financial condition of local government throughout Canada and the United States. For the most part the discussion focuses on how and why local municipalities are debit ridden and unable to sustain the range and level of services that are demanded by their communities.

In Alberta, as in other provinces, there is considerable debate concerning the relative merits of revenue sharing and/or of cost sharing. One of the difficulties of this discussion is the lack of a clear definition of what is meant by the two terms. For purposes of this paper, cost sharing means: two or more municipalities jointly contributing capital and/or operating dollars to have common access to some benefit (service). Revenue sharing, on the other hand, means one municipality sharing access to their assessment base for the purpose of generating revenue for one or more other municipalities. We will examine each of these definitions and what conditions give rise to their use.

## AAMDC'S POSITION ON COST SHARING

AAMDC has researched and evaluated various models of sharing throughout the province and has come to the conclusion that the residents of communities that are served regionally are best served by cost-sharing arrangements that are based on payment for benefit received.

Local conditions and circumstances will dictate the type of cost-sharing arrangement that best fits the needs of the local situation and that the fundamental rationale for sharing will always be that the region as a whole will benefit. Regional financing and regional cost sharing is appropriate for regional services.

AAMDC does not support revenue (tax) sharing among local governments as a desirable means of addressing regional financing of capital initiatives or the funding of service delivery, especially if the tax sharing is in the form of a grant from one local government to another.

Similarly, AAMDC does not support the concept or practice of one municipality permitting other municipalities' access to its taxpayers for the purpose of generating revenue to fund initiatives and services that may or may not be accessible by the taxpayer.

## HOW COST SHARING WORKS

Benefit-based cost sharing takes many forms in the context of local government in this province but the essential ingredients stay the same: those who benefit from a service pay for that service. The sophistication and complexity of cost-sharing arrangements ranges from the simplest sharing agreement that can be detailed on a single page, to the formation of for-profit corporations that require the approval of the Minister of Municipal Affairs. Cost sharing is, by far, the most common means of cooperative financing in use by Alberta's municipalities.

## EVALUATION FRAMEWORK

AAMDC's position on cost sharing was arrived at after carefully examining the alternatives for regionally financing, especially those alternatives associated with revenue sharing. To assist in this process we examined what literature exists on inter-municipal cooperative financing and the conclusions of others on this topic.


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In developing the framework we used the following factors as criteria that each of the options must successful meet:

- **Cost equity** – is the concept of fairness; those who benefit from accessing municipal services should pay for the services.
- **Accountability** – is the concept of transparency; tax payers can easily determine who was paid how much to deliver what service.
- **Cost-effective** – there is a value for money in terms of the cost of a service and the level of service provided.
- **Cost-efficient** – resources are not wasted and the services are delivered using the least cost possible.

These four factors are the 'mandatory' evaluation criteria that we will use to look at what we consider to be the alternative methods of addressing Inter-municipal financing challenges. We would add two additional factors that are significant to our discussion on sharing:

- **Ease of administration** – the sharing agreement should be easy to understand, easy to carry out and easy to audit.
- **Mandate justifiable** – the sharing objectives must fall within the mandate of local government.

Having developed this framework we will evaluate both cost sharing and revenue sharing to determine which options offer a preferable solution.

The evaluation will take the form or a pass (✓) or fail (×) and we summarize the results using the following exhibit:

| SHARING OPTION | | | | | |
|---|---|---|---|---|---|
| COST EQUITY | ACCOUNT-ABILITY | COST EFFICIENT | COST EFFECTIVE | EASY TO ADMINISTER | MANDATE JUSTIFIABLE |
| ✓/ × | ✓/ × | ✓/ × | ✓/ × | ✓/ × | ✓/ × |

This type of evaluation produces a relative or comparative result that will point us to options that are superior when compared with others.

## WHY COST SHARING WORKS

When we apply the evaluation framework to the various forms of benefit-based cost sharing we see, in general, the following result:

| BENEFIT-BASED COST SHARING | | | | | |
|---|---|---|---|---|---|
| COST EQUITY | ACCOUNT-ABILITY | COST EFFICIENT | COST EFFECTIVE | EASY TO ADMINISTER | MANDATE JUSTIFIABLE |
| ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |

We conclude that cost sharing is an inter-municipal financing solution that passes all of the hurdles inherent in the evaluation framework:

- **Cost – equity** – benefit-based cost sharing is by definition a cost equity approach. Those who receive the service pay for the service. This approach has the capability to introduce a high level of precision into the agreement: units of service cost per unit of service, number of service recipients, etc.

  Benefit-based cost sharing offers the highest level of cost equity.

- **Accountability** – a benefit-based, cost-sharing agreement (a public document under FOIP) details what the service is, who is providing the service, who is receiving the service, who is paying for the service and how much is being paid.

  Benefit-based cost sharing offers the highest level of accountability.

- **Cost Effective –** a benefit-based, cost-sharing agreement is generally cost effective in that there is typically choice in terms how a service will be delivered and what level of service will be delivered to municipal residents. A benefit-based, cost-sharing agreement spells outs the level of service desired and the price (the value) the municipality is willing to pay to receive that service.

  Benefit-based cost sharing offers the highest potential for cost effectiveness.

- **Cost Efficient –** a benefit-based, cost-sharing agreement is cost efficient in that the lowest cost provider will ultimately be the provider of choice. There is a built-in incentive for municipalities to be the low cost provider of services to each other since it will lower the unit cost to themselves as well as to the residents of the other municipalities.

  Benefit-based cost sharing offers the highest potential cost effectiveness.

- **Ease of Administration** – benefit-based, cost-sharing agreements are typically easy to administer in that there is: a benefit or service defined, an agreement that spells out the financially obligation and what it is based on. In the absence of any evidence that the service is not being delivered, no further administration is required. Contrast this with a properly constructed revenue agreement that indicates what the revenue will be spent on and the need to report, monitor and audit to ensure that the funds were, in effect, spent on the object of the agreement.

  Benefit-based cost sharing provides the easiest to administer solution.

- **Mandate justifiable** – benefit-based cost sharing falls clearly with the role definition and obligations of local government within this province. Section 3 of the Municipal Government says that the purpose of a municipality is three fold:
  - to provide good government
  - to develop and maintain safe and viable communities and
  - to provide facilities, services and other things that in the opinion of council are necessary or desirable for all or a part of the municipality.


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Benefit-based cost sharing provides a solution well within the mandate of local governments.

In summary, AAMDC sees benefit-based cost sharing as a preferred and desirable solution that can be tailored to local conditions and situations without altering the fundamental principle of paying for services received.

## WHY OTHER FORMS OF SHARING DO NOT WORK WELL

**Tax sharing as compensation** is a surrogate form of cost sharing in which an unrelated measure (percentage of industrial assessment for example) is used to calculate the number of dollars that will be handed over (granted) by one local government to another.

In summary, when we apply the evaluation framework, we see the following result:

| TAX SHARING AS COMPENSATION | | | | | |
|---|---|---|---|---|---|
| COST EQUITY | ACCOUNT-ABILITY | COST EFFICIENT | COST EFFECTIVE | EASY TO ADMINISTER | MANDATE JUSTIFIABLE |
| ✗ | ✗ | ✗ | ✗ | ✓ | ✓ |

We see this sharing arrangement as an inferior solution to benefit-based cost sharing.

**Tax sharing as wealth sharing** has little appeal from virtually any perspective. Equity is in the eye of the beholder and this type of proposition can only result in a situation where there are winners and losers. Equity for some and inequity for others.

When we apply the evaluation framework, we the following result:

| TAX SHARING AS WEALTH SHARING | | | | | |
|---|---|---|---|---|---|
| COST EQUITY | ACCOUNT-ABILITY | COST EFFICIENT | COST EFFECTIVE | EASY TO ADMINISTER | MANDATE JUSTIFIABLE |
| ✗ | ✗ | ✗ | ✗ | ✗ | ✗ |

This type of proposition inevitably leads to the necessity of provincial government intervention to set the rules, set the tax rate, collect the money and apportion the shares. This solution totally ignores accountability, provides disincentives for cost efficiency and cost effectiveness, and cost equity is not measureable.

We see this solution as one that undermines the whole premise of local government and would result in local governments becoming advisory councils to the minister similar to the improvement district approach. Not a particularly appealing picture.


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## CONCLUSION

Benefit-based cost sharing works.

Benefit-based cost sharing has served Alberta municipalities well in the past and continues to offer the best solution for sharing the burden of financing both the cost of municipal infrastructure and the operating cost of providing regional services.

Our evaluation points out the desirability of this approach over others, specifically tax-sharing arrangements, that attempt to re-distribute the 'wealth' of a region without regard to the benefit received or the obligation to be accountable to the tax payer.

From the tax payers' perspective, knowing where the money comes from is easy—it comes from them. More importantly it is knowing where the tax dollar goes; what benefit do they receive and that the benefit is provided in an efficient and effective manner. Benefit-based cost sharing provides these answers.


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## INTRODUCTION

Much has been written and discussed about the financial condition of local government throughout Canada and the United States. For the most part the discussion focuses on how and why local municipalities are debit ridden and unable to sustain the range and level of services that are demanded by their communities.

The solutions that are proposed to address these problems vary dramatically depending upon what vested interest is at stake. These positions are well documented and it is likely redundant to repeat them all here. It is worthy of note, however, that the solutions are often contradictory and in some case diametrically opposed as is, for example, the position on the raising or lowering of property taxes.

What is worth taking a look at and the reason for presenting this position paper, is the relative merit of solutions that embrace principles that are generally accepted by all stakeholders. To this end, the Alberta Association of Municipal Districts and Counties (AAMDC) has looked at what local governments in this province are empowered to do under legislation and what other local governments throughout North America have attempted successfully in meeting the challenges of financing local government. This perspective embraces financing both operating requirements and capital investment needs.

More specifically, AAMDC has evaluated solutions that focus on regional cooperation as a basis for funding services that are accessed regionally. Rural municipalities in this province and their urban neighbours have a long and rich history of finding local solutions for local problems. AAMDC, through this position paper, wishes to endorse this principal and use it as one criterion among several others to state our preferred approach to sharing among municipalities in this province.

In Alberta, as in other provinces, there is considerable debate concerning the relative merits of revenue sharing and/or of cost sharing. One of the difficulties of this discussion is the lack of a clear definition of what is meant by the two terms. For purposes of this paper, cost sharing means: two or more municipalities jointly contributing capital and/or operating dollars to have common access to some benefit (service). Revenue sharing, on the other hand, means one municipality sharing access to their assessment base for the purpose of generating revenue for one or more other municipalities. We will examine each of these definitions and what conditions give rise to their use.

AAMDC recognizes and appreciates that one solution does not always provide the best solution for all situations; however, we also recognize that there are a great number of success stories based primarily on one form of regional sharing – benefit-based cost sharing.

## AAMDC'S POSITION ON COST SHARING

AAMDC has researched and evaluated various models of sharing throughout the province and has come to the conclusion that the residents of communities that are served regionally are best served by cost sharing arrangements that are based on payment for benefit received.

Local conditions and circumstances will dictate the type of cost sharing arrangement that best fits the needs of the local situation and that the fundamental rationale for sharing will always be



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that the region as a whole will benefit. Regional financing and regional cost sharing is appropriate for regional services.

AAMDC does not support revenue (tax) sharing among local governments as a desirable means of addressing regional financing of capital initiatives or the funding of service delivery, especially if the tax sharing is in the form of a grant from one local government to another.

Similarly, AAMDC does not support the concept or practice of one municipality permitting other municipalities' access to its taxpayers for the purpose of generating revenue to fund initiatives and services that may or may not be accessible by the taxpayer.

In the following sections of this paper we present: background on why this discussion is occurring; how the various forms of sharing work; a framework for evaluating the various forms; and an explanation of why cost sharing works and revenue sharing does not.

As well, we have included a number of examples of successful cost-sharing arrangements in Appendix A. In addition, we present some thoughts about other sources of municipal revenue as outlined in Appendix B.

## BACKGROUND

Local governments in this province deal with a myriad of complex problems on a day-to-day basis. Most significant among these issues is how to finance the hard infrastructure that is key to the economic growth and viability of the municipality and by extension, the on-going prosperity of the province. In a report to the Minister of Municipal Affairs in March 2007, the Minister's Council on Municipal Sustainability noted that:

> "The challenges facing Alberta municipalities vary dramatically across the province. Some municipalities face extreme growth pressures, while others face shrinking populations and a declining local tax base. Many municipalities confront not only aging hard infrastructure (roads, water and sewer) but also deteriorating soft infrastructure (such as recreation facilities). Others maintain thousands of kilometres of local roads in the face of heavy and growing use by the resource extraction industry, with only limited opportunity to recover the costs of upgrading and maintain these roads from the industrial users. No single approach is likely to provide solutions to this tremendous diversity of challenges and needs." MCMS (2007, 4)

What makes this situation even more desperate is the fact that municipalities have very limited means to raise the funds necessary to meet the required expenditures. Property taxes are the single most important source of revenue and are based on an assessment of real property. As the Canadian Tax Federation notes in its annual *Finances of the Nation* report:

> "The property tax rate for any given property may be made up of several different components because the same base is often used to raise funds for local ... municipal governments (and) school authorities...Municipalities and school authorities set their property tax rate so as to recover costs not met from other revenue sources or transfers from the federal and provincial governments. The property tax therefore provides a means to allocate the net cost of local government among all taxpayers: it is based on wealth as measured by the assessed value of property owned." Treff & Ort (2008, 6:1)



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From our perspective there are several important points brought forward in this statement. Primary among these is the observation that property tax is borne by local industry, local business and local residents. As a tax, it comes out of the pocket of tax payers as opposed to other revenue streams that are available to other orders of government that flow from the sale of goods or services such as royalties. Collecting a tax raises the bar on accountability for municipalities and makes accountability a primary consideration when expending these funds.

Additionally, property taxes are based on assessments of real property. This touches on the concept of equity and the premise that local taxpayers, of the same class of assessment, are all treated the same when it comes to paying taxes. The concept of equity and the ability of local governments to deal effectively with this issue are addressed later in this paper.

This statement also makes reference to other sources of revenue for municipal governments. In Alberta, there is a limited source of additional revenue streams available to local government made up primarily of user fees associated with the provision of services. This is money collected to recover the cost of providing a service and in most cases it is likely to be a break-even proposition at best.

Finally, the statement refers to transfers from other orders of government. While this funding is appreciated, it is often unsecured, that is, it may be withdrawn at any time, and as such makes long-term planning for infrastructure even more challenging.

As we alluded to earlier, the scenarios vary from one area of the province to another but the bottom line remains the same: there is a gap between the amount of dollars municipalities can generate from limited revenue sources and the cost of adding or replacing needed infrastructure and funding service delivery.

The provincial government recognizes this problem and has implemented the Municipal Sustainability Initiative (MSI) that provides significant grants to municipalities to partially close the existing funding gap for infrastructure. But MSI is not a complete solution, and it is a commitment with an expiry date.

While the dialogue continues on new municipal revenue sources, AAMDC recognizes the need for municipalities to re-commit themselves to finding local solutions to local problems.

## LOCAL SOLUTIONS

Local governments in Alberta have responded to these challenges with local initiatives that, from the perspective of AAMDC, are both positive and negative. As noted earlier, there is a rich heritage in this province of municipalities in the same region working cooperatively to finance ventures that they, as individual municipalities, would not have been able to undertake. The Capital Region Waste Water Commission, for example, is the coming together of 13 local municipalities to cooperatively finance and operate a public utility that is beyond the means of a single local government. This cost-sharing arrangement has been in place for several decades and serves as a model of thinking regionally for local benefit.

Local governments have also sought to increase the level of economic activity within their borders and as a consequence increase their assessment base. These types of endeavours provide spin-off benefits to communities within the region and increase the use of public facilities among regional communities. In response to the need for access to one municipality's


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services by the residents of another municipality in the region, various forms of sharing agreements have been negotiated.

Other positive actions by local government include streamlining of local operations to improve efficiency and changing how they deliver services to ensure the effectiveness or value of the services delivered. A lot of this activity has focused on providing low cost solutions; a double edged sword; when addressing major investments in public infrastructure.

And finally, local governments have negotiated successfully with other orders of government to access financial support beyond short-term grant programs. These include the agreement on the transfer of Federal Gas Tax Revenues under the New Deal for Cities and Communities 2005 – 2015. This type of agreement and the provincial equivalent, the City Transportation Fund of the Alberta Cities Transportation Partnership, have broken new ground in providing access to federal and provincial revenues sources. This type of revenue-sharing arrangement among different orders of government makes sense in that the programs are province wide and are distributed on an equitable basis. It is worthy of note that both the provincial and federal government have the mandate and means to revenue share; that is, the provincial government for example, has an obligation to ensure that all Albertans participate in the province's prosperity. This mandate obliges the province to, in effect, share the wealth. Complementing this mandate is the ability to create new and different sources of tax revenue to fund revenue sharing. Municipal governments have neither the mandate nor the means to match the actions of the provincial or federal government and as a consequence do not have the obligation to share revenue.

These positive measures have made a significant contribution to addressing how municipalities are currently financing their affairs. There are however some practices that have not served municipalities well and need to be addressed as part of this discussion. These actions include the other edge of the sword of low cost solutions. Investment in the capacity of public utilities has for example, seen some municipalities under build infrastructure such that they have sacrificed long-term effectiveness for short-term economy. Lack of funding or lack of secure funding is the major driver for this type of action that in some cases could be avoided by some form of regional action. We will examine this further in a moment.

The other negative reaction to the financial challenges facing local government is the practice of avoiding taxing at a level sufficient to replace and maintain public infrastructure. Financing of public infrastructure is done through tax dollars. Avoiding or deferring tax increases that will imperil the future ability of a municipality to provide services, for whatever reason, should not be considered an acceptable practice.

## REGIONAL SOLUTIONS

If we look at what local governments have done on a regional basis, we again see both positive and negative responses to the financial challenges.

On the positive side, we have seen regional cooperation expand and extend to virtually all types and levels of service delivery. We see major rural municipalities such as Parkland County with over 100 cost-sharing agreements with their neighbours. We see the growth of commissions, authorities, boards, agencies, not-for-profit companies and for-profit companies across the



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province as local governments act regionally in determining local solutions to meet their individual challenges.

Local governments are acting regionally because they see the benefit of being able to offer services and/or a level of service that is unavailable if the municipality acted alone. They also see the benefit of sharing the cost and sharing the risk of making investments in recreational facilities and other 'soft' infrastructure.

These good news stories are many and varied but unfortunately they are not the complete story of how regional communities have acted to address the challenges. There are still situations where municipalities will seek to annex the assessment base of an adjacent municipality or one municipality will enter into a revenue-sharing agreement with another municipality where the revenue sharing is contingent on the rural municipality approving all annexation measures. These regional disputes may result in some form of agreement; however, the agreements tend to create long-term animosity as opposed to regional partnerships.

For the most part we see regional partnerships working within local agreements tailored to meet local needs that the partners view as fair, equitable and appropriate. While these agreements do not always meet the full criteria of benefit-based cost sharing, they are typically transparent in nature and accountable by design.

## HOW COST SHARING WORKS

Benefit-based cost sharing takes many forms in the context of local government in this province but the essential ingredients stay the same: those who benefit from a service pay for that service. The sophistication and complexity of cost-sharing arrangements ranges from the simplest sharing agreement that can be detailed on a single page, to the formation of for-profit corporations that require the approval of the Minister of Municipal Affairs. Cost sharing is, by far, the most common means of cooperative financing in use by Alberta's municipalities.

The following approaches to cooperative, regional initiatives typically have cost sharing as their primary means of financing:

- **Regional Service Commissions** – The MGA makes provision for the formation of regional service commissions that may provide services to the members of the commission and with the approval of the Minister, outside the boundary of its members. Commissions are separate legal entities with debt limits that are separate from their member municipalities. The commission charges a uniform fee for the services it provides and these fees are paid by the service recipients.
- **Joint Committees –** When municipalities come together and agree to form a committee to deliver services regionally they typically are called authorities or boards. Joint committees are different from regional service commissions in that the authority or board is not a separate legal entity. As well, the debt limits of the participating municipalities are affected by the debt level of the authority or board.
- **Part 9 or Not-for-Profit Companies** – Municipalities may elect to form a not-for-profit company to deliver services on a regional basis. The company charges a fee to the member municipalities to pay for the services. The company is a separate legal entity and the proportional ownership is negotiated by the participating municipalities.


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- **For-Profit Companies** – In certain circumstances it makes sense for municipalities to form for-profit companies that charge fees for their services with the intent of making a profit. One or more municipalities may participate as owners of the corporation.
- **Other Regional Entities** – From time to time, other service-based entities are created by municipalities with the consent and assistance of the province. The latest example is the Capital Region Board, formed by regulation and involving 25 municipalities in the Capital Region.
- **By Agreement** – Perhaps the most common form of regional service delivery is by contractual agreement when one municipality provides services to another municipality for a fee or municipalities in a region plan the acquisition of infrastructure jointly and agree how the costs will be shared prior to committing to a capital spending program.

## ONE RECENT EXAMPLE

Perhaps one of the best illustrations of how cost sharing works can be found in the recent agreements between the Town of Peace River and Northern Sunrise County. In October 2009, the two municipalities entered into an 'Inter-municipal Cooperation Initiative' that recognized the need to put into place sharing agreements with following purpose in mind:

> " . . . to provide the opportunity to better provide quality of life to and serve, the residents of the respective Signatory Municipalities through the sharing of the operating costs of regional assets, programs and services that have mutual benefit." (2009, Sec 4.1)

A similar purpose is presented in a separate 'Capital Cost Agreement.' The two agreements form the basis for all cost-sharing arrangements and currently address the sharing of operating costs for ten separate services as well as the funding of a 'Joint Future Facilities and Infrastructure Reserve Fund.'

When the two municipalities first sat down to discuss the possibility of starting this initiative they issued a joint press release that contained these words:

> "Recognizing that their common interests are far greater than their differences and that the advancement of the region will benefit all communities, the Town of Peace River and Northern Sunrise County have agreed to enter into a facilitated discussion process in a good faith attempt to address the wants, needs and interests of each municipality. In particular, they want to create a long-term, flexible and responsive agreement related to financial contributions and other topics of mutual benefit that will ultimately ensure and, in many cases, enhance the quality of life available to residents of this vibrant and progressive region."

This is a classic example of benefit-based cost sharing where two equals sit down at the table to jointly determine, in advance, how they can cooperatively address the need to share the burden of providing an adequate level of services to their residents.

Further examples of the various approaches to cost sharing are attached in Appendix A.



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## HOW OTHER FORMS OF SHARING WORK

Up to this point we have spoken almost exclusively about cost sharing and why AAMDC believes it is a superior solution. But a superior solution compared to what? The other form of sharing that has some received some attention of late is revenue sharing, or as it is more accurately described, tax sharing.

## REVENUE SHARING

Like cost sharing, tax sharing comes in a variety of forms, some more desirable than others. In Alberta, there appears to be three versions which should be identified and discussed:

1. **Tax sharing in Transition.** Section 124 of the Municipal Government Act (MGA) discusses revenue sharing as a means of cushioning the loss of revenue for a municipality that has undergone annexation. This definition of revenue sharing is limited and focuses exclusively on compensating one municipality for a loss of revenue. For our purposes here, this definition has little to do with an on-going solution for inter-municipal financing.
2. **Tax sharing as Compensation**. Section 55(1) of the MGA states that a municipality may enter into an agreement with another municipality to share grants under section 366 (grants in lieu of taxes) or taxes. Of the revenue-sharing agreements in place in Alberta today this appears to be the most prevalent. Typically this type of agreement is between large rural municipalities that have a significant non-residential assessment base and a small population.
3. **Tax sharing as Wealth Sharing.** The MGA makes no reference to this form of revenue sharing; however, it is included here for purposes of completeness. The argument for wealth sharing is based on the premise that regional sharing should include regional assessment and regional taxation such that the total tax revenue of a region should be pooled and then allocated based on some criteria of need. This argument is predicated on the belief that municipal governments have the mandate, means and obligation to share revenue.

Putting aside tax sharing in transition, we will evaluate the remaining two alternatives to examine the potential desirability of each approach to sharing.

## COST AND INCREMENTAL TAX SHARING

We have talked about cost sharing and revenue sharing as separate approaches to financing services. There are additional approaches and one in particular that is worthy of note since it combines cost and revenue (tax) sharing into one approach. This is a relatively new phenomenon in Alberta and is one that likely will be considered more frequently in the future. This arrangement involves, for example, a rural municipality and an urban municipality jointly developing some form of infrastructure where the rural may contribute the land and the urban contributes the servicing and they agree to share the tax revenue in proportion to their investment. One of the examples we are aware of involved the development on a proposed industrial park where the municipalities have jointly agreed to develop a site for the purpose of attracting new industry to the region.



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The agreement provides for the sharing of costs to develop the site and the on-going sharing of the tax revenue that flows from the use of the park by businesses they have attracted. In this specific example, the approach is similar to a 'for-profit' corporation except that the flow of revenue is tax revenue and not user fees. What distinguishes this from other forms of revenue sharing is that the participants have, in effect, created a new, incremental source of revenue rather than simply re-distributing the existing flow of tax dollars. It is the incremental tax revenue from the joint venture that is shared, not the existing revenue base of one of the participating municipalities.

## EVALUATION FRAMEWORK

AAMDC's position on cost sharing was arrived at after carefully examining the alternatives for regionally financing, especially those alternatives associated with revenue sharing. To assist in this process we examined what literature exists on inter-municipal cooperative financing and the conclusions of others on this topic.

Much of what we found centered on the work of Kitchen (Kitchen 2006) and Slack (Slack 1997, 2004) both of whom have written extensively about local government and about the challenges of financing local government. Fundamental and consistent through the material we reviewed was the concept of services being paid for by those who access the service.

Kitchen makes the point that:

> "The most important point is that municipal infrastructure should be financed, as far as possible, by the residents who benefit from it, because this provides the surest guide to how much should be invested in what. The underlying principle of benefits received is straightforward: those who benefit from local infrastructure and services it provides should pay for it." Kitchen (2006,17)

We concur with this position and his conclusions that:

> "Whenever a direct link exists between the users of a service and its funding, a more efficient use of resources ensues. Accountability, transparency and fairness also result." Kitchen (2006, 18)

These factors form the basis of our evaluation model and share many similarities to the model used by Slack in her examination of inter-municipal cooperative financing. Slack (1997, 3).

- **Cost equity** – is the concept of fairness; those who benefit from accessing municipal services should pay for the services.
- **Accountability** – is the concept of transparency; tax payers can easily determine who was paid how much to deliver what service.
- **Cost-effective** – there is a value for money in terms of the cost of a service and the level of service provided.
- **Cost-efficient** – resources are not wasted and the services are delivered using the least cost possible.

These four factors are the 'mandatory' evaluation criteria that we will use to look at what we consider to be the alternative methods of addressing Inter-municipal financing challenges. We would add two additional factors that are significant to our discussion on cost sharing:

- **Ease of administration** – the sharing agreement should be easy to understand, easy to carry out and easy to audit.
- **Mandate justifiable** – the sharing objectives must fall within the mandate of local government.

The first factor, of Ease of Administration is self-explanatory and without controversy on its merit as a factor for evaluating regional sharing alternatives. The second point addresses whether or not the sharing activity in question is within the Mandate of local government. There is a serious question in our mind, for example, about the obligation of one municipality to address inequities of wealth among other municipalities within a region. It is our position that this is beyond the role of local government and is better addressed by other orders of government. Sharing agreements that call for 'equity' in terms of 'sharing-the-wealth' are not within the mandate of local government.

Having developed this framework we will evaluate both cost sharing and revenue sharing to determine which options offer a preferable solution. The evaluation will take the form or a pass (✓) or fail (✗) and we summarize the results using the following exhibit:

| SHARING OPTION | | | | | |
|---|---|---|---|---|---|
| COST EQUITY | ACCOUNT-ABILITY | COST EFFICIENT | COST EFFECTIVE | EASY TO ADMINISTER | MANDATE JUSTIFIABLE |
| ✓/ ✗ | ✓/ ✗ | ✓/ ✗ | ✓/ ✗ | ✓/ ✗ | ✓/ ✗ |

This type of evaluation produces a relative or comparative result that will point us to options that are superior when compared with others.

## WHY COST SHARING WORKS

When we apply the evaluation framework to the various forms of benefit-based cost sharing we see, in general, the following result:

| BENEFIT-BASED COST SHARING | | | | | |
|---|---|---|---|---|---|
| COST EQUITY | ACCOUNT-ABILITY | COST EFFICIENT | COST EFFECTIVE | EASY TO ADMINISTER | MANDATE JUSTIFIABLE |
| ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |

We conclude that cost sharing is an inter-municipal financing solution that passes all of the hurdles inherent in the evaluation framework:

- **Cost – equity** – benefit-based cost sharing is by definition a cost equity approach. Those who receive the service pay for the service. This approach has the capability to introduce a high level of precision into the agreement: units of service cost per unit of service, number of service recipients, etc.


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Benefit-based cost sharing offers the highest level of cost equity.

- **Accountability** – a benefit-based, cost-sharing agreement (a public document under FOIP) details what the service is, who is providing the service, who is receiving the service, who is paying for the service and how much is being paid.

  Benefit-based cost sharing offers the highest level of accountability.

- **Cost Effective –** a benefit-based, cost-sharing agreement is generally cost effective in that there is typically choice in terms how a service will be delivered and what level of service will be delivered to municipal residents. A benefit-based, cost-sharing agreement spells outs the level of service desired and the price (the value) the municipality is willing to pay to receive that service.

  Benefit-based cost sharing offers the highest potential for cost effectiveness.

- **Cost Efficient –** a benefit-based, cost-sharing agreement is cost efficient in that the lowest cost provider will ultimately be the provider of choice. There is a built in incentive for municipalities to be the low cost provider of services to each other since it will lower the unit cost to themselves as well as to the residents of the other municipalities.

  Benefit-based cost sharing offers the highest potential cost effectiveness.

- **Ease of Administration** – benefit-based, cost-sharing agreements are typically easy to administer in that there is: a benefit or service defined, an agreement that spells out the financially obligation and what it is based on. In the absence of any evidence that the service is not being delivered, no further administration is required. Contrast this with a properly constructed revenue agreement that indicates what the revenue will be spent on and the need to report, monitor and audit to ensure that the funds were, in effect, spent on the object of the agreement.

  Benefit-based cost sharing provides the easiest to administer solution.

- **Mandate justifiable** – benefit-based cost sharing falls clearly with the role definition and obligations of local government within this province. Section 3 of the Municipal Government says that the purpose of a municipality is three fold:
  - to provide good government
  - to develop and maintain safe and viable communities and
  - to provide facilities, services and other things that in the opinion of council are necessary or desirable for all or a part of the municipality.

  Benefit-based cost sharing provides a solution well within the mandate of local government.

In summary, AAMDC sees benefit-based cost sharing as a preferred and desirable solution that can be tailored to local conditions and situations without altering the fundamental principle of paying for services received.

## WHY REVENUE SHARING DOES NOT WORK WELL

We presented two relevant tax-sharing or revenue-sharing definitions earlier in this paper. In the following sections we have highlighted the reason we see these alternative approaches as being inferior solutions.

A number of the revenue-sharing agreements that exist today are based on the principles established for the Industrial Tax Transfer (I.T.T.) program that was part of the old *Improvement District Act*. Under the *Act*, the Minister of Municipal Affairs could designate an improvement district (I.D.) to be an 'industrial' I.D. and impose an additional industrial tax on the assessment base of the I.D. Then, those dollars would be apportioned to neighbouring municipalities as compensation for use of municipal facilities.

Under the *Act* it is not clear what particular services were being paid for and how the value for money equation played out. However, it is important to note that this was not one municipality sharing revenue with another municipality. This was the provincial government sharing 'special' tax dollars with selected municipalities.

It is interesting to note that Slack in her examples of tax sharing in Canadian municipalities talked extensively about the tax revenue sharing going on in Alberta – all of the examples are former I.T.T. agreements between the province and the municipalities within the boundaries of the I.D.s.

We question whether it is within the mandate of municipal governments to continue this practice. While we recognize and appreciate the significance of these dollars to the receiving municipalities we see additional problems with this form of inter-municipal financing.

To quote Slack:

> "For tax sharing, the main emphasis is on equity since the primary rationale is to share the costs of public services fairly among the recipients. At the same time, accountability is important because consumers of the service should know who levied the charge and who is responsible for service provision. These two principles may conflict: equity may require that taxes levied in one jurisdiction be paid to another jurisdiction. If this is the case, accountability may be difficult to achieve at same time as equity." Slack (1997, 3)

The problem is exacerbated when the agreements spell out in great detail how the revenue to be shared is calculated but has little in the way of monitoring and reporting about how the shared revenue was actually spent. Or in the words of one administrator: "Pick out anything you like and tell people you paid for that."

**Tax sharing as compensation** is a surrogate form of cost sharing in which an unrelated measure (percentage of industrial assessment for example) is used to calculate the number of dollars that will be handed over (granted) by one local government to another. Typically these agreements are in addition to cost-sharing agreements for specific services such as the use of recreational facilities. Presumably the dollars are compensation for access to unspecified services making it difficult to determine if there is cost equity and without adequate monitoring, reporting and auditing there is little or no accountability for those dollars. There is a possibility that they go directly into the general revenue of the receiving municipality and are used to reduce the mill rate. This type of sharing does little to promote cost efficiency or cost


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effectiveness. In fact, it may have the reverse effect in that the dollars are effectively 'free money' that has few, if any, strings attached.

We see potential harm from this type of continued arrangement in that grants from one municipality to another promote a false sense of economic viability and engender a sense of entitlement that is based on a tenuous premise at best.

This type of arrangement was criticized in the past by the Canadian Association of Petroleum Producers (CAPP). To paraphrase their argument, the municipality who has money to spare and share must be taxing at too high a level if they have money to grant to other municipalities. Without conclusive accountability, the optics are poor to say the least.

This type of sharing does fall within the mandate of local government in that the dollars that are shared are for access to services for municipal residents. From an administrative standpoint, these sharing arrangements are easy to administer in that there is typically no requirement to justify the funds or report where the funds were spent. As time goes on we anticipate that the lack of a direct linkage between the calculation of amounts to share and the benefit received will inspire the grant recipients to ask for more.

In summary, when we apply the evaluation framework, we see the following result:

| TAX SHARING AS COMPENSATION | | | | | |
|---|---|---|---|---|---|
| COST EQUITY | ACCOUNT-ABILITY | COST EFFICIENT | COST EFFECTIVE | EASY TO ADMINISTER | MANDATE JUSTIFIABLE |
| ✗ | ✗ | ✗ | ✗ | ✓ | ✓ |

We see this sharing arrangement as an inferior solution to benefit-based cost sharing.

**Tax sharing as wealth sharing** has little appeal from virtually any perspective. Equity is in the eye of the beholder and this type of proposition can only result in a situation where there are winners and losers. Equity for some and inequity for others.

We also further definitional difficulties such as what is a region; is it the existing municipal boundaries of adjacent municipalities, or is it targeted economic areas? What will be the basis of apportionment; will be it population, current assessment, equalized assessment or some other factor? What will the tax rate be and who will set it? This has the potential to be an administrative nightmare.

This type of proposition inevitably leads to the necessity of provincial government intervention to set the rules, set the tax rate, collect the money and apportion the shares. This solution totally ignores accountability, provides disincentives for cost efficiency and cost effectiveness, and cost equity is not measureable.


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When we apply the evaluation framework, we see the following result:

| TAX SHARING AS WEALTH SHARING | | | | | |
|---|---|---|---|---|---|
| COST EQUITY | ACCOUNT-ABILITY | COST EFFICIENT | COST EFFECTIVE | EASY TO ADMINISTER | MANDATE JUSTIFIABLE |
| ✗ | ✗ | ✗ | ✗ | ✗ | ✗ |

We see this solution as one that undermines the whole premise of local government and would result in local governments becoming advisory councils to the minister similar to the improvement district approach. Not a particularly appealing picture.

## WHY INCREMENTAL TAX SHARING COULD WORK

**Incremental tax sharing** has appeal from a number of different perspectives. There is cost equity in that the tax payer is the beneficiary of the service being provided. There is cost efficiency and cost effectiveness since all participating municipalities have a vested interest in making the venture either profitable or at least as cost effective as a solution they had attempted on their own. There may be some issues of accountability or transparency from the standpoint of determining who is providing the service since presumably only one tax notice will be presented for payment, yet more than one municipality is involved.

When we apply the evaluation framework, we see the following result:

| INCREMENTAL TAX SHARING | | | | | |
|---|---|---|---|---|---|
| COST EQUITY | ACCOUNT-ABILITY | COST EFFICIENT | COST EFFECTIVE | EASY TO ADMINISTER | MANDATE JUSTIFIABLE |
| ✓ | ✗ | ✓ | ✓ | ✗ | ✓ |

For want of a better definition, this is a benefit-based, revenue-sharing arrangement where the only drawback is the unpredictability of revenue to share. From an ease of administration standpoint there is some possibility that this type of arrangement will require specialized reporting and independent assessment or audit to ensure that the allocation of cost and revenue are in accordance with the agreement.

Where these types of agreements are win-win propositions, we see them as a viable complement to benefit-based cost sharing.



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## CONCLUSION

Benefit-based cost sharing works.

Benefit-based cost sharing has served Alberta municipalities well in the past and continues to offer the best solution for sharing the burden of financing both the cost of municipal infrastructure and the operating cost of providing regional services.

Our evaluation points out the desirability of this approach over others, specifically tax-sharing arrangements, that attempt to re-distribute the 'wealth' of a region without regard to the benefit received or the obligation to be accountable to the tax payer.

From the tax payers' perspective, knowing where the money comes from is easy—it comes from them. More importantly it is knowing where the tax dollar goes; what benefit do they receive and that the benefit is provided in an efficient and effective manner. Benefit-based cost sharing provides these answers.


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## Appendix A: Examples of Benefit-Based, Cost-Sharing Agreements

There is a wealth of cost-sharing arrangements to choose from when looking for examples of cost-sharing agreements that work. The following examples are neither exhaustive in number nor comprehensive in scope of the available sources.

- **Regional Service Commission – Alberta Capital Region Wastewater Commission (ACRWC)** is, to quote from its website:

  > "The ACRWC is a model of regional cooperation providing wastewater transmission and treatment services to 13 municipalities in the Alberta Capital Region".

  The Commission has been in place for 25 years and continues to provide an excellent level and quality of service to its members. As the 2009 Annual Report indicates, the benefits are clear, and the members are charged based on usage:

  > "The ACRWC funds its revenue requirements primarily through the collection of rates from its members. Our members pay a unit rate based on their bulk water consumption. In 2009 the rate was $0.71 per cubic meter." (ACRWC Website)

  This is an example of regional cooperation where 13 municipalities can afford to do (with provincial assistance) what one municipality alone cannot. This type of cost sharing achieves a high degree of equity in that all members receive the same level of service and pay the same price.

- **Joint Committees (Authorities and Boards) - Leduc and District Regional Waste Management Authority** is made up of five municipalities who have come together to share the cost of solid waste management. The City of Leduc is the manager of the authority and oversees the delivery of services from a contract operator.

  The Authority provides a uniform level of service to all participating municipalities and charges a uniform schedule of tipping fees to all users of the facilities.

- **Part 9 or Not-For-Profit Company – Tri-Leisure Centre (TLC)** is, to quote from their website:

  > "...operating as a Part-Nine, not for Profit Corporation, is well established as a defining element within the Tri-Region. Designed to service the communities of Parkland County, Spruce Grove, and Stony Plain, the TLC celebrated its opening in June 2002. Meeting the recreational, social and wellness needs of all residents remains a core focus of the TLC." (TLC Website)

  The facility openly advertises the fact that this is a cooperative service facility, open to all residents of the region.

- **For-Profit Companies - Aquatera Utilities Inc.** is a multi-functional, public utility company:

  > "Aquatera Utilities Inc. is the first regional utility corporation in Alberta.


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> Aquatera provides the City of Grande Prairie with water and wastewater treatment, garbage collection and recycling services. We also provide water and wastewater treatment services to the Hamlet of Wedgewood, Hamlet of Clairmont and some areas within the County of Grande Prairie, and Town of Sexsmith." (Aquatera Website)

As the 2009 Annual Report indicates:

> "Aquatera Utilities Inc. is the regional provider of water, wastewater, and solid waste services, and is a model of regional cooperation. Shareholders are the City of Grande Prairie, County of Grande Prairie and the Town of Sexsmith. Since 2003 Aquatera Utilities Inc. returned $21 million to the City, County and Town through cash dividends and franchise fees." (Aquatera Website)

This is a profit-sharing model that is fundamentally based on sharing the cost of public utilities and then being able to share in the profits of a successful operation.

- **Other Regional Entities - Capital Region Board** is a recent model of regional cooperation for the planning and deliver of regional services:

> "*The Capital Region Growth Plan: Growing Forward* was submitted to the Honourable Ray Danyluk, Minister of Municipal Affairs on April 2, 2009. This date marked the successful completion of an unprecedented undertaking by the municipal leaders of the twenty-five participating member municipalities of the Capital Region Board. Having demonstrated commitment and leadership throughout the process of developing the Capital Region Growth Plan, they now look forward to ensuring the Capital Region is a model for regional co-operation in Alberta." (CRB Website)

The CRB has worked out two cost-sharing formulas, one designed to address transit initiatives and the other for all non-transit services.

It is interesting to note that in the development of the transit initiatives cost-sharing model, the CRB set out the principles under which the cost-sharing model would be developed. The principles include among others the following statement:

> " The Working Committee developed a cost-sharing formula for Regional Transit Projects that was fair and equitable for participating municipalities, one that considered both their ability to pay and their benefit received from Regional Transit Projects. All municipalities in the Region will benefit from an integrated Regional Transit Network, and, therefore, all need to invest in its future. Wherever possible, direct and indirect benefits should be taken into consideration along with the existing investment in transit by municipalities."
>
> CRB (2010, 31)

The attention to benefit-based cost sharing is significant to us in this regional venture.


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## Appendix B: Other Sources of Municipal Revenue

We have talked almost exclusively about local solutions for local financing of regional services. AAMDC's position on benefit-based cost sharing does not preclude other forms of financing that involve other orders of government.

The Federation of Canadian Municipalities (FCM) in its policy statement of Municipal Finance and Intergovernmental arrangements makes the statement:

> "Although Canadians expect municipal institutions to act as though they constitute an order of government, the Constitution does not recognize municipal governments as such, nor do most provinces and territories. Because of this, municipal governments do not have the autonomy required to exercise adequate powers or to command adequate resources to meet local needs."
>
> FCM (2009, Section B: Intergovernmental Arrangements, Introduction)

This position find supports from other researchers that have come to the conclusion that municipalities need access to a wider variety of taxes:

> "Access to revenues from a mix of taxes would give ... more flexibility to respond to changing expenditure needs ... (and) ... allow them to benefit from economic growth." Slack (1997, 1)

Across the country, individual provinces provide differing access to the provincial tax mix. The following summary highlights the provincial revenue source and the provinces where municipalities have access to that source.

- **Land Transfer Tax** – or property purchase tax is levied in all provinces except Alberta, Saskatchewan and Rural Nova Scotia. Provinces where municipalities can access this tax are: Nova Scotia, Quebec and Manitoba.
- **Amusement Taxes** – a tax on the admission price for a game, show, performance etc. Provinces where municipalities can access this tax are: Nova Scotia, Manitoba, Saskatchewan and British Columbia.
- **Hotel Taxes** – or accommodation tax is levied on temporary stays in rental facilities. Provinces where municipalities can access this tax are: Nova Scotia, Saskatchewan, British Columbia, Quebec, Manitoba.
- **Poll Tax** – an annual tax on non-property owners available to municipalities in Newfoundland.
- **Parcel tax** – a direct service related tax that may be imposed by a municipality to pay for a specific service. British Columbia allows municipalities to impose a parcel tax.
- **Revenue Sharing of Income Tax** – Manitoba appears to be the only province which revenue shares provincial income tax.
- **Revenue Sharing of Gaming Revenues** – Manitoba appears to be the only province which revenue shares gaming revenue.
- **Provincial Sharing of Fuel Tax** – British Columbia, Alberta, Ontario and Quebec share provincial revenues from fuel taxes.


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The Minister's Council on Municipal Sustainability made specific reference to the need for additional municipal revenue sources and recommended in-part that:

> "9. The Government of Alberta should enact legislation to authorize municipalities, at their discretion, to levy and collect additional, own-source revenues as a means of strengthening municipal capacity to address ongoing operational pressures. The specific own-source revenues recommended are:
>
> a. Amusement Tax
> b. Tourism Tax
> c. Property Transfer Tax
> d. Vehicle Registration Tax
> e. Expanded Scope for Development Levies in support of Directly Related Local Services and
> f. Limited Split Mill Rates within the Non-Residential Property Class."
>
> MCMS (2007, 3)

This recommendation appears reasonable in-light of the availability of access to these taxes in other jurisdictions in this Country. AAMDC sees this type of revenue sharing as a viable means of addressing financial needs where it is within the mandate and capacity of other orders of government to extend access.

We view this broadening of the revenue generation options for municipalities as a key factor in reducing the tension in regional relationships brought on by unilateral attempts to redistribute the wealth of the region. Other orders of government have the capacity, the mandate and the obligation to address local government revenue needs across the province. Revenue sharing through access to other forms of taxation addresses this obligation.



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