RMA
RURAL MUNICIPALITIES of ALBERTA

Local Government Fiscal Framework

RMA Allocation Formula Reaction

January 19, 2024

Introduction

On December 15, 2023, the Government of Alberta (GOA) released the allocation formula for the Local Government Fiscal Framework (LGFF). The formula determines how LGFF funding will be distributed among all municipalities in the province aside from Edmonton and Calgary.

Throughout 2022 and 2023, RMA undertook significant analysis and negotiation with ABMunis and the GOA to develop a formula that could be supported by all municipal stakeholders. Unfortunately, the parties could not agree on a formula, mainly due to competing views on how to properly measure capital funding “need” and the extent to which the formula should recognize municipal fiscal responsibility in the form of maintaining existing assets as opposed to focusing solely on infrastructure growth or expansion.

Throughout the formula development process, RMA took the position that need is multi-faceted and varies based on municipal type – while need may be driven by expanding infrastructure networks to accommodate population growth in some urban municipalities, in others need may be more linked to remaining viable or ensuring core infrastructure remains operational. In rural municipalities, capital need is often unrelated to population, and is instead based around supporting a new or expanding industrial base. No single metric can account for these very different definitions of need, so in RMA’s view, an effective formula must include proxies for all while recognizing that a single grant program with a limited funding amount will not solve the problems of any municipality, whether it is too much growth or not enough growth.

RMA emphasized the principle of “fiscal responsibility” as a defining feature of an effective allocation formula. Rather than restrict local autonomy, including the fiscal responsibility principle and designing the formula around it ensures that the formula recognizes the reality that in many cases, the most effective use of capital grant funding is on maintaining or upgrading existing infrastructure. While rapid growth may necessitate major investments in new infrastructure, most municipalities are focused on determining how to take good care of what they have, and ensure it serves the needs of residents and industry for as long as possible. Including the fiscal responsibility principle and corresponding factors to recognize asset maintenance within the formula would not only support a more efficient grant program, but also encourage municipal asset management.

The GOA’s formula reflected some RMA priorities but is lacking in other areas. This reaction document summarizes the ways in which the allocation formula does and does not align with RMA’s LGFF allocation approach and proposes opportunities for further review and improvement of the formula in the coming years.

The document includes the following sections:

- The Final Formula: An Overview
- RMA’s Proposed Formula
- Population: Purpose and Long-Term Impacts
- Recognizing Capital Maintenance Costs and Older Assets
- Opportunities for Improvement

The Final Formula: An Overview

The allocation formula is as follows:

- Population: 65%
- Tangible capital assets (TCA): 15%
- Amortization of TCA: 10%
- KMs of local roads: 10%
- Capacity-support: municipalities with populations of less than 10,000 who sit below a certain threshold of equalized assessment per capita (for urbans) or per km of road (for rurals) receive additional funding. Three percent of total funding is set aside for this before the rest of the formula is applied.
- Base: each municipality receives $150,000, summer villages receive $60,000

The Government of Alberta has also released detailed program guidelines, as well as municipal-specific allocations for 2024 and 2025.

RMA's Proposed Formula

Over nearly two years of analysis and negotiation, RMA's proposed formula underwent multiple changes based on new data and consideration of priorities and perspective put forward by ABMunis and the GOA. In September 2022, RMA submitted a formal proposal to the GOA. The proposed formula grouped allocation factors into four categories intended to demonstrate how the various factors align with or balance one another:

Allocation = [(Capital Stock) + (Capital Maintenance) + (Growth Pressure)] x (Fiscal Capacity)

Capital Stock		Capital Maintenance		Growth Pressure		Fiscal Capacity
The more capital assets that a municipality has, the greater allocation of grant funding should be apportioned.	+	The more investment that is required to maintain a municipality's capital stock, the greater allocation of grant funding should be apportioned.	+	The greater the relative impact of factors external to the municipality's control manage capital expenditures, the greater allocation of grant funding should be apportioned.	x	The lower the ability that a municipality has to generate revenue to invest in capital projects relative to other municipalities, the greater allocation of grant funding should be apportioned.

Within each category are specific factors assigned various weightings. These factors, along with a minimum amount and a fiscal capacity modifier, comprised the RMA's proposed formula. The RMA placed great importance on balancing the weighting of the larger formula categories, as well as ensuring that as a capital grant program, LGFF allocation is most heavily weighted by capital stock and capital maintenance:

Allocation = [(Capital Stock) + (Capital Maintenance) + (Growth Pressure)] x (Fiscal Capacity)

Minimum Amount: $175,000 ($58,000 for Summer Villages)

40%		20%		40%	
Capital Stock		**Capital Maintenance**		**Growth Pressure**	
TCA (Book)	15%	Five-year average annual TCA amortization OR Five-year average annual Asset management Plan Spend	20%	Population	38%
Kms of local road	25%			Three-year average value of development permits issued	2%

x

Fiscal Capacity

1.43 Low Capacity

EA/pop
EA/km
Distribution by Municipal Type

0.7 High Capacity

While detailed rationales for the selection and weighting of factors in RMA's formula is beyond the scope of this reaction, the most important comparisons to consider are the very different weighting and purpose of the population factor in RMA's proposal compared to the final formula, as well as the use and weighting of kilometres of road and TCA amortization in each. The following sections will delve into these comparisons.

Population: Purpose and Long-Term Impacts

When considering how to determine which municipalities most "need" LGFF funding, population is certainly a valid metric. In fact, population was one factor that was jointly agreed upon by both associations, and RMA is not contesting its inclusion in the final allocation formula.

What is it measuring?

However, RMA has several concerns with the 65% weighting in the final formula. RMA's proposed formula used population as a proxy for growth pressures to reflect the fact that population growth does lead to demands for new or expended infrastructure. However, the GOA's extremely high weighting of population suggests one of two things:

- Growth pressure is the primary driver of "need" from the perspective of the GOA, and is much more significant than viability-related need or industrial growth-related need.
- Population is serving as a proxy for drivers of need beyond growth pressure. Statements made by the GOA during the formula development process suggests that they view population as a proxy for existing capital stock.

Either possibility is concerning. Designing LGFF allocation primarily around high growth municipalities overlooks the fact that residential growth is often supported by developer-contributed infrastructure and offsite levies, both options that are much less accessible in low-growth municipalities or for industrial growth.

Using population as a proxy for scope of existing infrastructure is also problematic, as metrics already exist (and are included in the formula) that much more directly measure existing infrastructure. Examples include TCA, kilometres of road, wastewater mains, etc. Given that multiple metrics exist within the formula to measure scope of infrastructure, RMA does not understand the need to lean on a proxy metric that only approximates capital stock and capital maintenance. At best this is an unnecessary inclusion, and at worst is downright misleading. Rural municipalities in particular can maintain significant infrastructure to support industrial and commercial activity in areas with very little population, but significant economic impact.

For this reason, RMA had repeatedly suggested developing a "TCA+" metric that integrated TCA and a combination of direct measures of road and utility infrastructure to capture capital stock as accurately as possible for all municipal types.

Growth Versus Sustainability

At first glance, the use of population is a logical choice to account for growth pressures. In many parts of our province, continued population growth tied to economic development and a low cost of living (including taxation) has been the norm in past years. And undoubtedly, significant or sudden population increases can create challenges for municipalities.

Based on this, population growth is a reasonable, if incomplete, proxy for broader municipal growth pressures. It has considerable strength for measuring residential growth pressures which may be predictive of increased demand for infrastructure-based services that are not directly funded through developer contributions. Unfortunately, the proposed formula does not use *change* in population as a base metric, but rather, total population. Total population levels provide an incomplete linkage to growth pressures as it does not account for the proportion of growth experienced by municipalities of different sizes; a town adding 500 new residents is far more likely to require infrastructure support than a mid-sized city adding 500 new residents. Again, the high reliance on population as a formula factor does not seem to align with the program's stated intention, one of which is to consider municipalities with greatest needs.

More importantly, non-residential growth is not measured through population despite the fact that it is far more likely to require a high level of upfront municipal investment and less likely to be supported through developer contributions. Residential development on the other hand is far more likely to involve developer contributed infrastructure paid for through off-site levies. If "growth should pay for growth" then why should the LGFF formula use a high population weighting to subsidize costs for municipalities that are growing their residential tax base?

Finally, the proposed formula does not adequately balance growth need and fiscal capacity need. Population growth is primarily concentrated in specific regions and municipal types, and most municipalities are either facing fiscal pressures due to stagnant or even negative growth, or primarily support non-residential growth not reflected in a population metric. While the proposed formula does include fiscal capacity metrics, they would distribute just over $56 million in funding in 2024-25, compared to over $183 million allocated under the growth pressure metric based on the population factor alone. Again, this shows a significant imbalance that does not align to the goals of maintaining existing infrastructure and encouraging fiscal responsibility.

Long-Term Impacts of High Population Weighting

Providing any single factor with disproportionate weighting within a formula risks unpredictable long-term impacts on formula outcomes if the value of that factor changes significantly in future years. RMA is concerned that the high weighting of population will result in future grant allocations that redistribute a significant portion of funding to urban municipalities experiencing high levels of residential growth, while smaller urban municipalities that may be experiencing little or no growth, and rural municipalities that may be experiencing industrial growth, will receive a proportionally smaller share of funding. This unpredictable long-term impact of population as the dominant factor within the formula appears to introduce a risk of the formula not being suitable for long-term use.

This potential impact can be reasonably predicted based on the level of change observed over the past several years of MSI funding. Since 2009, Alberta's municipal districts and counties have lost nearly 2.5% of their provincial share of population (this does not include recent years where population data has not been collected). Aside from cities, every municipal type (villages, towns, specialized municipalities, etc.) has experienced a proportional decline in its share of provincial population since 2009.

If these trends continue, the proposed allocation formula will redistribute a disproportionate amount of funding to cities over time, leaving all other municipal types struggling to build and maintain infrastructure for populations that are generally growing, but at a smaller pace than cities, and for industrial users that are not reflected in the formula as a source of growth-related need.

Further, a formula that so significantly emphasizes population growth may cause communities to neglect core infrastructure for "splashy" projects in an attempt to attract new residential development, which could lead to significant unintended consequences for the program.

Recognizing Capital Maintenance Costs and Older Assets

The Government of Alberta has framed the purpose of the LGFF in part to improve or maintain infrastructure assets, and to facilitate the resiliency and livability of communities. Based on this, RMA supports the inclusion of a higher weighting of kilometres of road in comparison to the LGFF formula, and the inclusion of a new TCA amortization metric.

Kilometres of Road

Kilometres of local road proxies a municipality's total asset base, and in particular older assets they may not be reflected in TCA values but are still in service and require regular maintenance and capital investment. While kilometres of road may be more relevant in rural municipalities, it combines well with TCA to reflect the overall asset base for all municipal types, particularly for municipalities with older infrastructure that may be "aged out" of their TCA values. It should be noted that during the formula development negotiation process with ABmunis, RMA proposed including kilometres of water and wastewater mains as an additional factor to better reflect older assets more common in urban municipalities. This suggestion was opposed by ABMunis. The MSI formula weighted kilometres of road at 4%. The increase to 10% in the LGFF formula is a positive step towards recognizing the importance of older core infrastructure in determining funding allocations.

TCA Amortization

TCA amortization serves as a proxy of a municipality's capital maintenance needs. Amortization reflects the aging and presumably declining condition of a municipality's assets, which coincides with increased maintenance spending. While this metric was included in RMA's proposed formula, and RMA appreciates its inclusion in the final formula, it is important to note that RMA proposed it as an alternative metric to be used to proxy capital maintenance for municipalities that do not have a capital maintenance estimate as part of an approved asset management plan. RMA's approach would allow municipalities to submit their five-year planned maintenance spend identified in an asset management plan for inclusion in the formula. If municipalities did not have an asset management plan or choose not to submit their maintenance spending data, their five-year average annual TCA amortization amount is used.

While the use of TCA amortization as the sole means of proxying capital maintenance costs will not have same impact in encouraging asset management uptake as RMA's proposed approach, it still reflects recognition on the part of the Government of Alberta that capital maintenance of existing assets is a sign of strong fiscal responsibility and should be supported through the LGFF.

Opportunities for Improvement

One thing the RMA team learned in the formula development and negotiation process is that no formula is perfect. The formulas proposed by RMA and ABMunis, as well as the final formula, all include strengths, weaknesses, and flaws, and all will be viewed positively by some municipalities, and less so by others.

With this in mind, RMA will be requesting to the Minister of Municipal Affairs that a provincial commitment be made to reviewing and considering improvements to the allocation formula on a regular basis. Specific future enhancements and areas for improvement that RMA plans to advocate for include the following:

Recognition of Non-Residential Growth

As mentioned, while population is a valid metric for growth, it is far from perfect and much less relevant in some municipal types. Throughout the formula development and negotiation process, RMA emphasized the need for a metric to capture non-residential growth within the formula. RMA's final proposal included three-year average value of development permits issued. While this metric has significant limitations, it is linked to some extent to non-residential growth. While it is disappointing that no non-residential growth proxy metric is included in the initial formula, this is partly due to the fact that no strong data is currently collected from municipalities to measure this type of growth (aside from development permit values, which do include major limitations).

RMA plans to advocate that government collect data relevant to non-residential growth and integrate this metric into the formula in the future.

Incentivization of Asset Management

As mentioned in the previous section, RMA's proposal included an opportunity for municipalities to use planned capital maintenance spends from asset management plans as a formula metric. From RMA's perspective, this approach was innovative in three ways:

- It would directly encourage municipalities to adopt asset management practices.
- It would allow municipalities to contribute to the formula through their own actual expected maintenance costs, rather than through proxy metrics.
- It would introduce a forward-looking metric into the formula, while all other metrics (and allocation for nearly all existing grant programs) are based on data from previous years.

RMA is disappointed that the GOA did not more seriously consider this outside the box idea, and at least work with RMA to discuss in more detail how it could be embedded in the formula. RMA plans to continue to recommend this approach in future reviews of the formula.