

Chief Financial Officer's Report to
Combined Meeting of Council
2022 February 15

ISC: UNRESTRICTED
C2022-0093
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Response to Motion Arising – Reassess projected Local Access Fee and Franchise Fees (from Report C2021-1436)

RECOMMENDATION(S):

That Council direct Administration to maintain the current budget in Program 857 Franchise Fees & Municipal Consent Access Fees and not revise the 2022 Budget.

HIGHLIGHTS

- **Reasons for Recommendations:** Franchise Fees and Local Access Fees revenue reduces the need for property tax funding. While strong energy prices are expected to push Franchise Fees revenue above budgeted levels in 2022, use of this additional revenue to offset property taxes in 2022 would amount to a one-year rebate and just result in a delayed effective property tax increase in 2023. Franchise Fee revenue is expected to recede to the current budgeted levels in the next cycle. Maintaining the current budget will provide additional capital funding at a time when Provincial grants are expected to be more constrained.
- **What does this mean to Calgarians?** Maintaining Franchise Fees revenue budgets at the current 2022 level will reduce the volatility in the property tax rate over time for service funding.
- **Why does this matter?** Maintaining property taxes as low as possible needs to be balanced with stability and predictability in the property tax. The Financial Task Force included improving certainty and predictability around property taxation and limiting one-time mitigation tools as two of the 35 recommendations.

On 2021 November 24, Council adopted a motion arising with respect to C2021-1436 that directed “Administration to reassess the projected Local Access Fee and Franchise Fee and direct that 35 per cent of the projected variance be allocated to the 2022 budget and report back to council on the impact to the overall budget.”

- Strategic Alignment to Council’s Citizen Priorities: A well-run city
- Background and Previous Council Direction is included as Attachment 1.

DISCUSSION

Franchise Fees and Local Access Fees are revenues derived from residents’ natural gas and electricity bills. These revenues are used in the budget to reduce the level of property tax revenues required to fund any given level of operating expenditures. Recognizing the inherent volatility in commodity prices, to minimize the volatility in property taxes, budgeted Franchise Fees and Local Access Fees are set conservatively at the beginning of each budget cycle, then maintained throughout the cycle. Council Policy CFO003 Franchise Fee/MCAF Revenue Budgets and Variances set out the process for the conservative estimates. This minimizes the risk of revenues being lower than budgeted and the associated tax increases or expenditure reductions required to balance the budget during adjustments, although as noted in Attachment 2, this does not eliminate the risk of unfavourable variances. Any favourable variance in these revenues is transferred to the Reserve for Future Capital as per Council Policy CFO003, representing the only funding source for The City’s main capital contingency reserve. Over the last 10 years \$133 million has been contributed to the Reserve for Future Capital.

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As noted in Attachment 3, the energy charge for the natural gas franchise fees is based on the Gas Cost Flow-Through Rate while the energy charge for the Local Access Fees is based on the Regulated Rate Option price for electricity. Both energy charges vary on a month-to-month basis and exhibit the volatility consistent with commodity prices. Revenues are also determined in part by the volume of energy consumed. While volumes tend to be more stable than prices, they add to the variability in revenues.

Administration has updated the forecast for Franchise Fees and Local Access Fees revenues for 2022 based on current forecasts of energy prices and consumption volumes, as shown in Attachment 4. While Franchise Fees revenues are anticipated to be slightly below the current budget, the Local Access Fees revenues are expected to be significantly above the current budget, resulting in total expected revenues exceeding the budget by \$26 million.

If 35 per cent of this expected variance was used to reduce property taxes, the result would be a one-year rebate equivalent to an approximately 0.53 per cent reduction in the tax increase approved by Council in 2021 November. This represents about \$10 on the annual municipal property tax of \$2,268 for the typical single residential property owner. As a one-year rebate, this effectively defers that part of the overall tax increase one year, creating a gap between the property tax decision and the impact. This delayed impact is referred to as a "bow wave."

| | 2022 Property Tax Impact | 2023 Property Tax Starting Point Impact* |
|-------------------------|--------------------------|--|
| Budget approval | 3.87% | - |
| Franchise Fees increase | -0.53% | 0.53% |
| Total | 3.34% | 0.53% |

*"Bow wave" created by a one-year rebate.

Revenues are expected to trend back close to the current budget level by 2024, indicating that a permanent reduction the property tax is not feasible. As a result, Administration does not recommend revising the 2022 budget at this point.

It is worth noting that using the methodology set out in CFO003, the budget for 2022 if it were set now would be lower than the 2022 budget set at the beginning of the current budget cycle.

STAKEHOLDER ENGAGEMENT AND COMMUNICATION (EXTERNAL)

- Public Engagement was undertaken
- Public Communication or Engagement was not required
- Public/Stakeholders were informed
- Stakeholder dialogue/relations were undertaken

Public Communication or Engagement was not required

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IMPLICATIONS

Social

Not Applicable

Environmental

Not Applicable

Economic

The ability to deliver necessary services and infrastructure balanced against maintaining property taxes at a low level is key to remaining competitive and attracting private sector investment and in-migration necessary to drive economic growth. While revising the Franchise Fees and Local Access Fees budget would reduce the tax rate for 2022, this would likely be temporary and act more like a one-time rebate rather than a permanent reduction. This would subsequently reduce capital funding that could be available for investment during the upcoming planning and budgeting cycle. Although a minimal amount relative to the total size of the capital budget, it is anticipated that capital funding in general will be much more constrained for the cycle.

Service and Financial Implications

Existing operating funding - base

\$9.1 million

The current projection for Franchise Fees and Local Access Fees revenue in 2022 is \$215 million, which is \$26 million above the 2022 budget. If 35 per cent of this was applied to increase this budget, property taxes could be reduced by \$9.1 million, which translates to an approximately 0.53 per cent property tax decrease for 2022. However, it is expected that revenues will fall back close to current levels, by 2024, resulting in either higher tax increases or expenditure reductions.

If the budget is left as is, the \$9.1 million, if realized, would be transferred to the Reserve for Future Capital and be available for capital projects in the future.

RISK

Energy prices are inherently volatile and can change quickly. Increasing the Franchise Fees and Local Access Fees revenue budget increases the risk that an unfavourable variance in Program 857 will result. There is a risk that the resulting bow wave for 2023, which would push the starting point for the 2023 tax rate to a 0.53% increase, could limit new investment in the 2023 service plans and budgets. With inflationary pressures already expected to be significant and labour settlements unknown at this point, this could impact the ability to include some new initiatives to address Council's priorities. Reduced capital funding beyond the current expectations for funding reductions could result in some infrastructure investment being delayed.

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ATTACHMENT(S)

1. Attachment 1 – Background and Previous Council Direction
2. Attachment 2 - Franchise Fees and Local Access Fees Revenue Budget and Actuals 2012 – 2021
3. Attachment 3 - Franchise Fee Update – December 2021
4. Attachment 4 - Franchise Fees Revenue - Budget vs. Forecast

Department Circulation

| General Manager/Director | Department | Approve/Consult/Inform |
|--------------------------|------------------------------------|------------------------|
| Carla Male | Chief Financial Officer Department | Approve |
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