Toward a New Fiscal Framework for New Brunswick Municipalities

Final Report

Dr. Craig Brett
Professor of Economics, Mount Allison University
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Executive Summary

In the decades leading up to municipal restructuring in New Brunswick, two long-term trends reshaped local finance. A steady reduction in the real value of unconditional grants from the province made municipalities more reliant on the property tax base to pay their bills. In addition, the residential portion of this tax base grew faster than the non-residential portion. These two trends combined to shift the municipal tax burden toward residential property owners and their tenants. At the same time, gaps emerged in the ability of municipalities to fund infrastructure investments, leading to a sizable backlog in asset renewal and modernization.

One could hope that the recent upswing in residential property assessment will allow municipalities to grow themselves out of fiscal difficulty. Such hope is predicated on a current short-term phenomenon morphing into a sustained trend. Moreover, doubling down on the property tax as the nearly exclusive source of municipal money leans into the long-term trend of asking the residential sector to pay more.

Reliance on a single source of finance exposes all municipalities to the whims of property markets and forces municipalities with less buoyant property markets to either make do with less or tax their citizens more. A second source of finance is needed to ensure long-term adequacy of infrastructure finance and to help level the municipal playing field. A dedicated portion of provincial HST revenue is a reasonable choice.

Considerable uncertainty over the size and scope of regional service commissions makes detailed analysis of their effect on municipal coffers infeasible. However, the proposed funding formula for RSCs features implicit equalization by basing charges to municipalities on their respective tax bases. This form of equalization would not be necessary if a robust dedicated equalization scheme were in place.

A conservative estimate of the amount of infrastructure financing needed beyond current levels is approximately $120 million, or ten percent of current municipal operating expenses. An equalization program of approximately $85 million would go a long way toward leveling the playing field.

Recommendations include dedicating one percentage point of the HST (currently 10% of HST revenue), mirroring recent agreements in the provinces of Quebec and Saskatchewan. This revenue should be used to fund transfers to municipalities including a tax-base equalization scheme and an infrastructure renewal fund.

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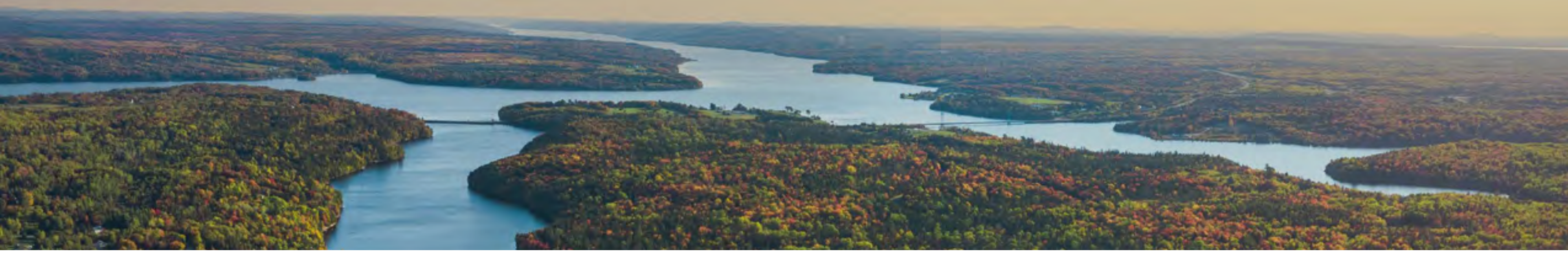
Introduction



When multiple orders of government operate in an area, there are many public finance issues to iron out. There must be a mechanism to decide which level of government is responsible for which function. (Who does what?) Likewise, the issue of which levels have the power to levy taxes and fees and on which bases must be addressed. (Who taxes what?) It is unlikely that the answers to these two questions align in the sense that the taxation powers assigned to each order of government generate exactly the amount of money needed to carry out its functions and that this distribution of taxation is both efficient and equitable. Systems of intergovernmental transfers can fill gaps arising but this alignment is not perfect. (So that who pays for what is not the same as who taxes what.) In Canada, significant amounts of money flow from Ottawa to the provinces via health, social, and equalization transfers. New Brunswick's Community Financing Grant and the Canada Community-Building Fund provide provincial and federal money for municipalities to spend.

New Brunswick's municipal restructuring of 2023 was a significant shift in who does what in the province, including a shifting traditionally provincial responsibilities to municipally financed regional commissions. At the time, the questions of who taxes what and who pays for what in the long-term were left to one side. Whatever long-term fiscal relationship comes into being will have to be an effective and fair way to divide the bill for municipal services. It will also need to respond to pressures that arose before restructuring and to be resilient to future events.

It is likely that the property tax base will continue to be an important part of municipal revenue, so it is important to understand the evolution of this tax base and how this evolution compares to other tax bases and the overall economy. Questions about the appropriate level, composition, and funding of grants to municipalities also arise.

This report hopes to provide evidence and context and to help develop feasible, defensible paths forward.

The Tax Base

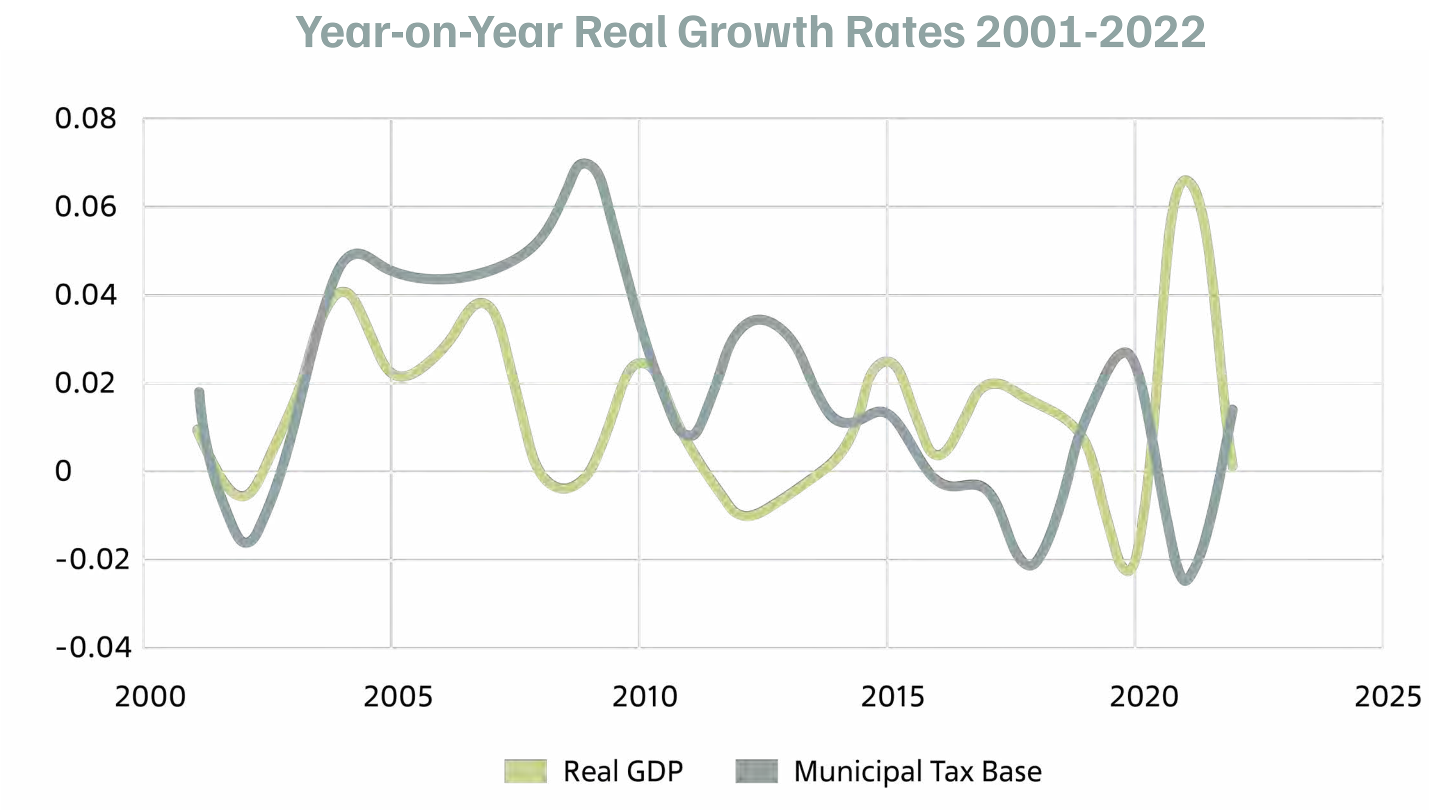


Figure 1: Growth in municipal tax bases

In 2023, property tax collections accounted for 84% of all municipal revenue. In 2001, the comparable number was 72.2%. Increased reliance on property taxes points to the need to understand how this base has evolved and will continue to evolve.

On the aggregate, the municipal tax base grew slightly faster than provincial GDP over the first two decades of the millennium, but there were periods when GDP outpaced property assessments.

Given the considerable change in the amount of the province within municipal boundaries brought about by restructuring, it is impossible to extend Figure 1 with comparable figures for 2023 and 2024.

Figure 2: Aggregate effects of local government reform on municipal population

		2022	2023
Number of Municipalities		95	77
Population in Municipalities	Total	493,330	721,215
	Yearly Growth (%)		37.98
Note: Population estimates are from the 2021 census, as reported in the Local Government Statistics for New Brunswick.			

Figure 2 shows that many residents were municipalized during the recent restructuring, over 200,000 of them. The total population served by municipalities increased by 37.98%.

Figure 3 contains actual values of residential assessments for 2022-24 and an imputed 2023 value of assessments for properties that were inside municipal boundaries both before and after the reform. Taking the increase in population into account, municipal assessments grew at 4% per person in real terms from 2022 to 2023. The areas inside municipal boundaries both pre- and post-reform experienced larger tax base growth in 2023, at 7.92% per capita after adjusting for inflation. Thus, the properties newly added to municipalities contributed a tax base that grew more slowly than the original.

Comparing Figures 1 and 3 shows that the considerable growth in the property tax base over the last couple of years is unprecedented in this century. It was only a decade ago that property assessments grew more slowly than the economy. Thus, one should use caution when basing long-term policy decisions on data from the past two years alone.

The size of municipalities

The restructuring of 2023 lowered the number of very small municipalities and added many municipalities with a population between 5,000 and 10,000.

Figure 3: Residential Assessment within Municipalities

	2022	2023	2023 imputed	2024
Total ($ million)	39,370.1	62,484.0	44,447.8	69,950.2
Yearly Growth (%)	9.69	46.19	12.13	11.29
Real Total (2022$ million)	39,370.1	59,903.6	42,612.3	65,457.4
Real Growth (%)	2.41	41.49	7.92	8.41
Real per Capita (2022$)	79,805	83,059	86,377	90,343
Real per Capita Growth (%)	-2.34	4.00	7.92	8.41

Notes:

1. Population estimates are from the 2021 census, as reported in the Local Government Statistics for New Brunswick.
2. Tax base figures for 2022 exclude LSDs, Rural Communities, and Rural Municipalities; tax base figures for 2023 and 2024 exclude Rural Districts
3. All percent changes are calculated using the first difference of logarithms.
4. Growth rates for 2022 are calculated using data from 2021 as the base year.
5. 2023 Imputed figures are based on removing the tax bases of parts of former LSDs, Rural Communities, and Rural Municipalities from the overall municipal total for 2023. This is an estimate, as detailed changes in boundaries were not considered.

Figure 4 shows that the growth in non-residential assessments was less extreme than for residential assessments. Indeed, per capita non-residential assessments fell from 2022 to 2023. This could be because much of the property added to municipalities during restructuring was residential or because of non-residential base growth lagging that of the residential base. Both the imputed 2023 and 2024 growth rates are significantly below the comparable figures for residential assessments found in Figure 3.

The final row of Figure 4 illustrates the effect of the residential base growing faster than the non-resident base: the ratio of residential to non-residential assessments is rising. Figure 5 illustrates that this phenomenon is a one-time accentuation of a long-run trend. The tax base has become increasingly residential since the year 2000 and there is every indication that this will continue to be the case.

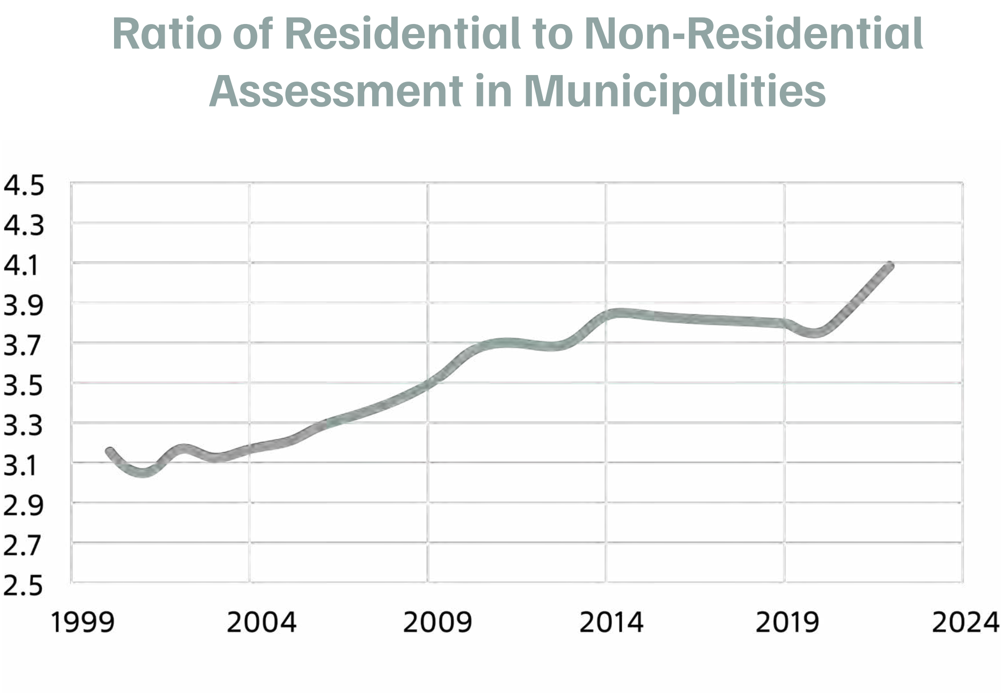
Figure 4: Non-residential Assessment within Municipalities

	2022	2023	2023 imputed	2024
Total ($ million)	9,617.1	11,975.2	10,329.0	12,469.1
Yearly Growth (%)	5.02	21.93	7.14	4.04
Real Total (2022$ million)	9,617.1	11,480.6	9,902.5	11,614.7
Real Growth (%)	-2.27	17.71	2.92	1.16
Real per Capita (2022$)	19,494	15,918	20,072	16,140
Real per Capita Growth (%)	-7.01	-20.26	2.92	1.16
Ratio of Residential to Non-residential Assessments	4.09	5.22	4.30	5.61

Notes:

1. Population estimates are from the 2021 census, as reported in the Local Government Statistics for New Brunswick.
2. Tax base figures for 2022 exclude LSDs, Rural Communities, and Rural Municipalities; tax base figures for 2023 and 2024 exclude Rural Districts
3. All percent changes are calculated using the first difference of logarithms.
4. Growth rates for 2022 are calculated using data from 2021 as the base year.
5. 2023 Imputed figures are based on removing the tax bases of parts of former LSDs, Rural Communities, and Rural Municipalities from the overall municipal total for 2023. This is an estimate, as detailed changes in boundaries were not considered.
6. Non-residential assessments include heavy industrial assessments.

Figure 5: Changes in the composition of the tax base



Given fixed (or controlled) ratios of tax rates across classes of properties, this trend resulted in heavier tax burdens on residential properties. Excess growth of residential assessments over non-residential assessments since 2000 added an amount of equivalent to 8.1 cents per hundred ($43 million in total) to municipal residential tax bills in 2022.

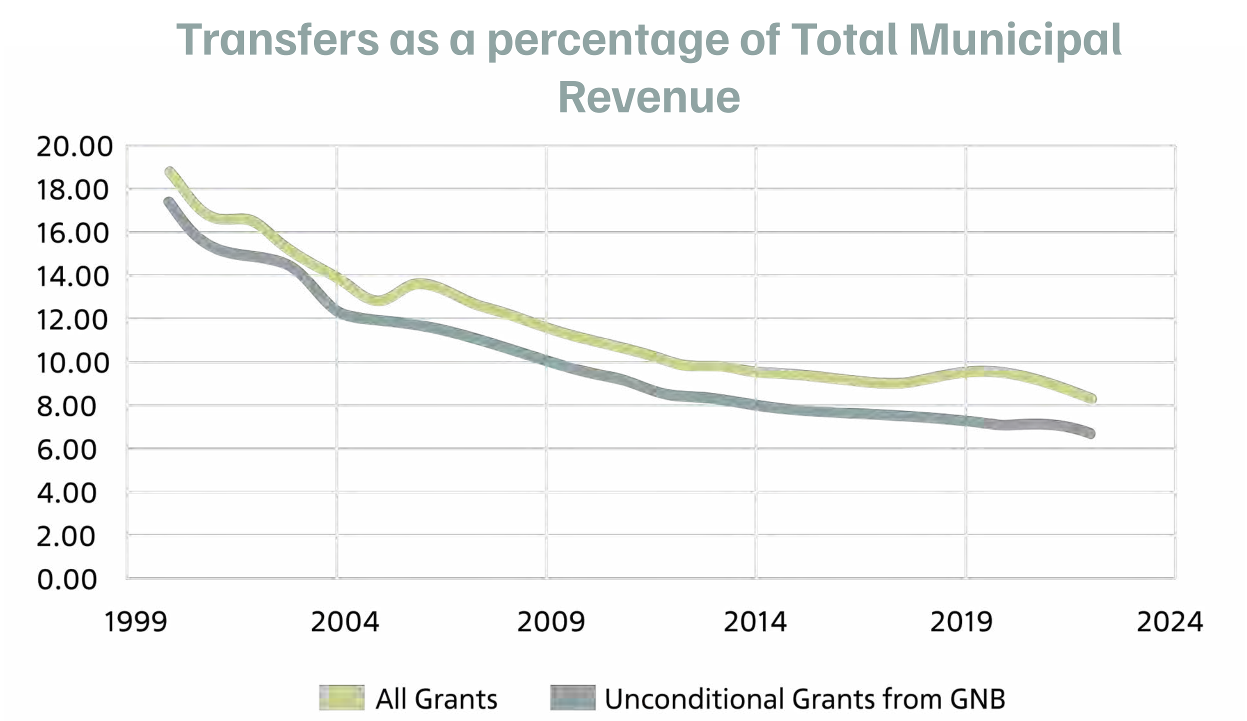
By comparison, the average increase in property tax rates over the same time was approximately 7.4 cents per hundred. Thus, the fact that the tax base has become increasingly residential has led to a noticeable redistribution of the municipal tax burden toward residential property owners and their tenants.

Grants from the Government of New Brunswick

In 2023, the Community Funding Grant accounted for 5.5% of local government revenue in New Brunswick. In 2001, unconditional grants from the provincial government made up just over 15% of municipal revenues. As Figure 6 shows, the share of municipal expenditures covered by provincial grants fell steadily over this period.

The cumulative effect of this trend is that the real value of grants fell by approximately $40 million from 2000 to 2022, an amount equivalent to 7.4 cents per hundred dollar of municipal tax base. Coincidentally, the average rate of increase in municipal taxes over that same span was 7.4 cents per hundred.

Figure 6: Grants as a proportion of revenue



To evaluate this trend, it is important to understand the justification for intergovernmental grants, which include providing equalization, dealing with benefit spillovers, and ensuring an adequate level of overall expenditure. (See Boadway and Shah (2009) for a full discussion of the theory of intergovernmental transfers.)

Equalization is meant to ensure that everyone receives reasonably comparable levels of public services at reasonably comparable levels of taxation, regardless of where they live. This principle is enshrined in Section 36 of the Canadian Constitution in the context of federal-provincial equalization. Without equalization, some municipalities would need to charge higher tax rates per unit of service than others, effectively making the same services more expensive in some areas than in others. Economists view this as a kind of pricing distortion, which can impede overall economic efficiency.

Benefit spillovers occur when the services provided by municipalities are enjoyed by non-residents. Examples include commuters using municipally maintained roads and residents of nearby communities using recreational facilities. Grants provide an indirect means for these non-residents to pay for these services as part of their provincial taxes.

This is especially important where direct user fees are difficult to implement (for example, roads). The grants help receiving municipalities afford services at a level necessary to benefit both residents and those receiving spillovers. (Think of it as the carbon tax in reverse: Instead of charging people for damage done to others, grants pay municipalities for services provided to others.)

An order of government may not have the fiscal tools needed to ensure an adequate level of services, but some other level may have more tools than it requires. The level of government which has an easier time raising money can then transfer some to the other level.

The Residential Tax Base is Paying a Greater Share of Municipal Finance

The combined effects of municipalities becoming increasing reliant on the property tax (because grants from the province are falling) and the tax base itself becoming more residential (because non-residential assessments are growing more slowly) is that tax collections from residential properties have grown from 49% of municipal revenue in 2000 to 62% of revenue in 2023. Over the same period, non-residential (including heavy industrial) tax collections fell slightly from 23% to 22% of municipal revenue.

The Government of New Brunswick can levy more taxes than can its municipalities, so one would expect the provincial government to be a donor government in a vertical fiscal arrangement. Figure 6 shows that the province has traditionally shared some of the proceeds of its more diversified suite of tax instruments with municipalities. The amount of this support has certainly waned over time.

The notion of a level of government not being able to finance itself is contentious. It might be possible, for example for municipalities to fully finance their own operations with a sufficiently high level of the property tax. But this might not be the most desirable or efficient arrangement. Indeed, spillovers and equalization motives suggest that some level of external support to municipalities is justified.

Infrastructure Needs

Canada’s infrastructure deficit is well documented (Khanal et al, 2023). Included in this catalog is accumulated deterioration of municipal assets. There is recognition that more needs to be done to recoup the losses in infrastructure and ensure sustainable infrastructure financing so that the deterioration that has occurred over the past few decades does not repeat itself. While municipalities have been able to backfill the reduction in grant funding to maintain (to an extent) day-to-day operations, infrastructure investment has been postponed. The resulting backlog is significant and can only be addressed with new financing.

The size of the problem

There is no province-wide estimate of municipal infrastructure shortfalls or how much annual expenditures would need to be increased to rebuild and maintain the standards of municipal assets. Such an exercise was carried out by the Financial Accountability Office of Ontario (2021) with reference to municipal assets in that province in 2020. That study reported a backlog of $52.1 billion. Rescaling that number on a per-capita basis and on a per-GDP basis produces estimates of $2.77 billion and $2.12 billion, respectively, for New Brunswick. In 2024 dollars, those numbers are $3.30 billion and $2.52 billion.

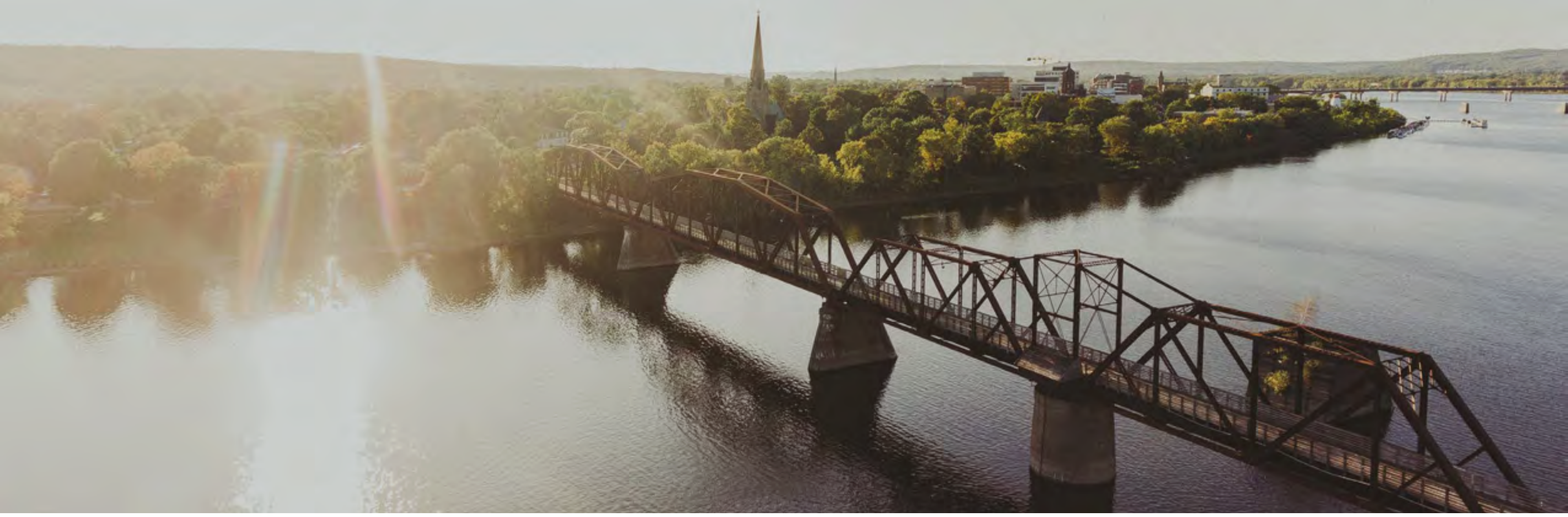
What does a $2.5 billion shortfall mean in annual terms? If one were to borrow that amount of money at 4% interest (the current coupon rate on provincial bonds), the interest payments alone would be $100 million per year. Alternatively, building $100 million worth of new infrastructure per year would eliminate the shortfall in 25 years, assuming no further deterioration of existing assets. This is an untenable assumption, of course. Thus, if the New Brunswick situation is anything like Ontario’s, it would take at least $100 million per year in additional funding to get on the road to sustainable infrastructure.

Ground-truth

A review of selected municipal asset management plans (AMPs) provides confirmation that the infrastructure backlog is at least a $100 million per year problem.

Despite provincial mandating of municipal asset management plans, there is no consolidated data stemming from these plans. The current review uses data from a handful of urban municipalities that made their plans available, and a selection of smaller municipalities.

The bottom-line numbers in Miramichi’s AMP from 2023 are an infrastructure backlog of $97.5 million, with an estimated $4 million per year, on average, needed to clear that backlog over fifteen years. This additional expenditure is equivalent to approximately 9.4% of the city’s budget. In 2023, total municipal expenditures across the province were approximately $1.2 billion. If Miramichi’s needs are representative, it would take an inflow of an extra $113.4 million per year to close the infrastructure gap for all municipalities in the province.



Lessons from an Asset Management Plan

The City of Miramichi's Asset Management Plan provides estimates of additional infrastructure investment over a long horizon. The first fifteen years of that recommend front-loaded expenditure. This illustrates two things: (i) that there is a sizable backlog of infrastructure projects requiring immediate attention, and (ii) that meeting the average expenditure targets in the plan requires an immediate source of funds.

The Miramichi calculation should be taken as a rough estimate. On the one hand, Miramichi's AMP calls for spending on average 4.1% of its backlog per year. This relatively small pay-down rate is effective because spending in the early years of the plan is much higher than in later years. In the absence of significant one-time funding, the city would incur additional financing costs that would push the total well above the $4 million estimate. On the other hand, Miramichi's overall asset portfolio had a relatively low ratio of book value to historical cost (0.50) in 2022, which means its infrastructure is more fully depreciated (older) than in other cities. Thus, its infrastructure backlog might be proportionally higher than the provincial norm.

Dieppe had a relatively higher book value to historic cost ratio (0.68) in 2022, reflecting the relative youth of its assets. Nevertheless, its AMP from 2021 reports additional funding requirements of $7.5 million per year, approximately 10.5% of its 2023 expenditure. Scaling Dieppe's requirements up to the provincial level of expenditure would cost $127.1 million per year, even higher than the Miramichi-based estimate.

Saint John reports a $346 million infrastructure backlog in its 2022 AMP, with a total annual capital spending need of $52.3 million. The city's capital budget for 2024 is $33.3 million, suggesting a shortfall of $18.9 million, equivalent to 10.7% of its budget, a number slightly higher than Dieppe's. Saint John's book value to historic cost ratio in 2022 (0.56) was between those of Miramichi and Dieppe.

Saint John's AMP shows a higher annual expenditure per unit of infrastructure deficit than does Miramichi. Its $18.9 million per year represents 5.4% of the infrastructure backlog.

In 2022, Edmundston reported a $57.9 million infrastructure shortfall. Assuming this backlog can be cleared by spending between 4.1% and 5.4% annually, it would cost the city between $2.4 million (6.0% of its budget) and $3.1 million (7.8% of its budget) to address the issue.

Moncton's last published AMP is from 2018, and the city's economic situation has changed substantially in the meantime. A recent update provided by the city's General Manager and CFO gives the current backlog of $230 million, with a yearly spending gap somewhere between $10 million and $20 million.

This estimate represents between 5.3% and 10.6% of the city's current overall operating expenditure.

Based on these reports, a ten percent increase in overall municipal expenditure is likely needed to clear the infrastructure backlog in larger centres.

Figure 7 provides an attempt to compute an overall infrastructure backlog for the province from the limited information available. Imputing a shortfall of 20 times the annual expenditure requirements for Dieppe (implicitly using a 5% investment per year rule) gives at total shortfall of $881.4 million for the five cities. Scaling this up using the aggregate share of these cities' expenditures in the provincial expenditure gives an estimated shortfall of $2.0 billion. It would take $100 million per year to fund 5% of this shortfall. A 5% pay-down rate is very conservative. Hence, this should be seen as a lower bound on the estimate of the additional expenditure requirements.

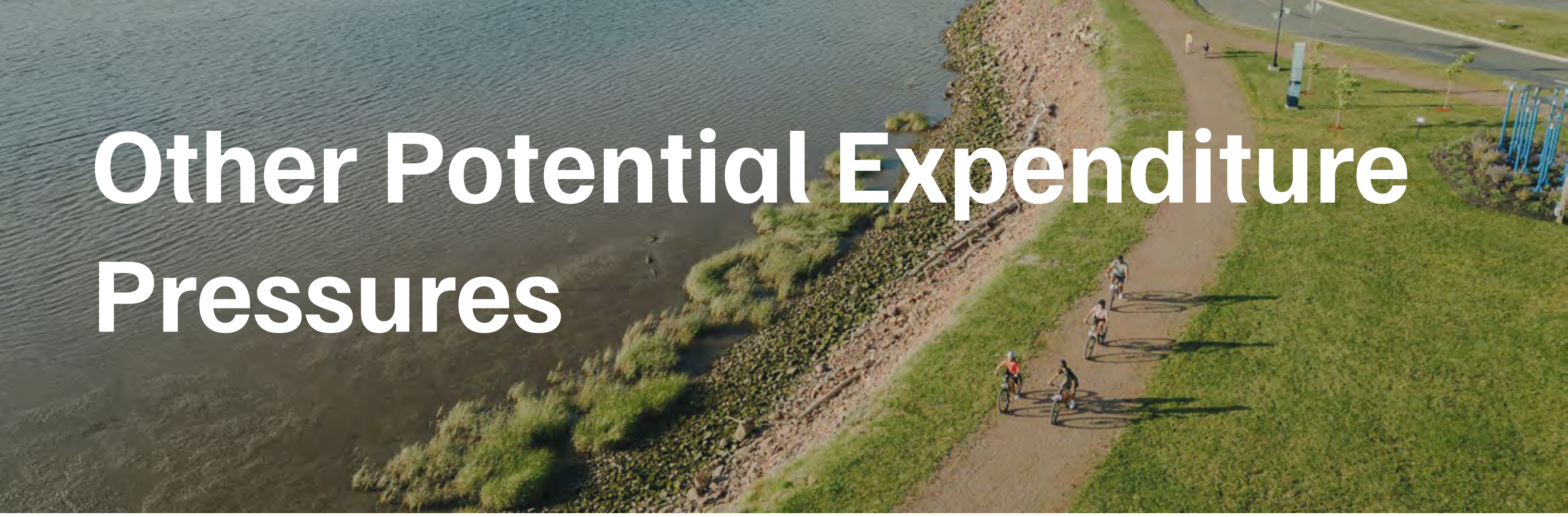
The AMPs for some smaller municipalities confirm that the estimates given here are a lower bound. In 2018, Saint Andrews reported needing $1.1 million per year in additional investments to maintain infrastructure needed for water, transport, storm water, and its sanitation network. With a $4.5 million budget for 2018, the infrastructure deficit would demand nearly a 25% increase in the town's funding. Grand Bay - Westfield's 2018 AMP reports that an additional $1.1 million per year of investment is needed to meet their infrastructure requirements. This figure is nearly 18.4% of their 2018 operating budget. Southern Victoria estimates its 2022 infrastructure backlog at approximately $5.2 million. A $5% pay-down on this would represent an additional $260 thousand per year, which is roughly 8.4% of the municipality's budget.

In the end, it does appear that the infrastructure backlog is a $100 million per year problem, at the very least. For a crude approximation, paying 5% per year on $2.5 billion (the rough estimate based on detailed information from Ontario), yields an annual spending requirement of $125 million.

Given that many AMPs for cities estimate an additional revenue requirement of approximately 10% and we have limited information suggesting that needs are likely to be proportionally greater in smaller municipalities, $120-180 million (from 10% to 15% of current expenditure) is probably more reasonable.

Figure 7: Estimated infrastructure shortfalls

City	Infrastructure Shortfall	Notes
Dieppe	150M	Imputed with 5% per year
Edmundston	57.9M	From AMP
Miramichi	97.5M	From AMP
Moncton	230M	Imputed with 5% per year
Saint John	346M	From AMP
Total	881.4M	
Scaled to Province	2.0B	Using cities share of expenditure



Other Potential Expenditure Pressures

Payments to Regional Service Commissions

The recent reforms led to the regularization of service provision by Regional Service Commissions. The RSCs charge member municipalities and rural districts for services. For solid waste, these payments are per tonne collected. For other mandated services, payments are based on a formula that gives 50% weight to population and 50% weight to tax base. The formula is applied at the RSC level, so that per-capita costs are lowest for communities with relatively low tax bases who happen to be in a region that also has some communities with very high taxes bases.

The cost sharing formula serves to increase the per-capita cost of services for municipalities with higher tax bases. Thus, it acts as an implicit tax on municipal growth. At the same time, it offers indirect equalization by lessening the burden on municipalities with low per-capita tax bases. Unlike traditional equalization schemes that offer additional funding to municipalities in fiscal need without directly affecting others, the cost sharing formula implicitly equalizes both upwards and downwards.

In 2023, the share of municipal budgets paid as fees to RSCs is small on aggregate, totalling $41.6 million, which is approximately 3.45% of municipal expenditure. This share varies from 1.15% to 41.5% but is above 17% in only one municipality that pays for its own policing. Approximately 37.8% of RSC charges to municipalities were for solid waste collection.

Payments to RSCs for services other than solid waste were less than $100 per person, except in Belledune, Saint Andrews, and Fundy Shores. These municipalities all have higher than average per-capita tax bases, which illustrates the (downward) equalization implicit in the cost-sharing formula. At current levels of fees to RSC, the equalizing effect is small. However, this could change if new, costly items are added to the suite of services organized by RSCs or if municipalities are expected to cover a much larger share of RSC expenditures. Indeed, there remains considerable uncertainty as to whether the role of regional service commissions will expand, with ever-increasing charges levied on municipalities.

Policing

There are multiple policing arrangements in New Brunswick. Some municipalities have their own police forces. Others have contracts, either individually or jointly with other municipalities, with the RCMP. The remainder are covered by the Provincial Policing Service Agreement (PPSA) between the province and the RCMP with costs allocated by a provincially determined formula.

The Aggregate Picture

In cities, towns, and villages in 2023, policing costs ranged from 7.3% to 30.8% of municipal expenditure, with an average of 16.8% (for our purposes, we count Tracadie as a town).

From 2000 to 2022, the comparable share for all municipalities ranged from 14.7% to 16.7%. Some simple arithmetic yields that a 5% increase in policing costs will increase overall costs by approximately 0.84% per year, which amounts to approximately $9.75 million across all cities, towns and villages. With a tax base of approximately $80.5 billion among these municipalities, this amounts to 1.2 cents per hundred dollars of taxable value.

Compounded over five years, the total increase over 2023 levels would be approximately $53.85 million by 2028.

More details

As the range in the ratio of policing costs to overall municipal expenditures suggests, there is considerable variation in policing costs along several dimensions.

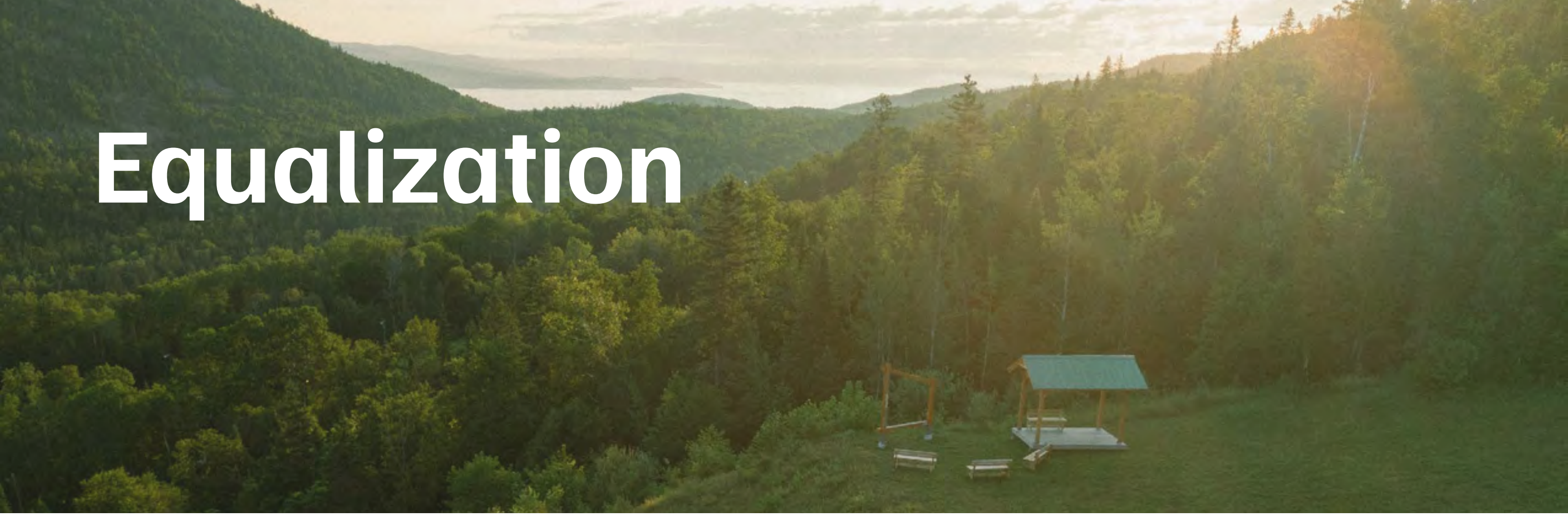
Figure 8 shows how policing costs vary by type of contract for cities, towns, and villages.

Towns and villages that are policed primarily under the PPSA generally pay less, apart from one significant outlier, Belledune. Its policing costs are the highest per person and the highest as a percentage of municipal expenditures in the province. This is because of the cost-sharing formula used to allocate policing costs, in particular the provisions to allocate costs according to an average of population and tax base.

Like the RSC financing formula, the PPSA equalizes both upwards and downwards. Moreover, it applies to some, but not all municipalities, according to their policing contract rather than any underlying similarities or differences. This makes it a rather opaque form of equalization.

Figure 8: Policing costs by type of policing contract, 2023.

Type of arrangement	Per Capita Costs			Percentage of Expenditure		
	Aggregate	Min	Max	Aggregate	Min	Max
Own force	379.63	264.24	420.66	17.14	15.02	30.71
MPSA	327.97	220.05	400.44	16.36	11.80	25.47
PPSA	197.51	80.98	569.81	16.73	7.33	30.78



Equalization

Mounting infrastructure needs and the continual withdrawal of provincial support are felt throughout the province. The more that municipalities are left to fend for themselves, the more disparities in their abilities to finance services will become apparent, perhaps leading to widening differences in property tax rates or levels of service. Equalization grants are a way to reduce these disparities so that all New Brunswickers can enjoy reasonably comparable levels of municipal services at comparable levels of taxation.

There are two reasons why some municipalities may need to charge higher taxes per unit of service: a weaker tax base or higher costs of providing services. Fiscal-capacity based equalization schemes are an attempt to compensate for the former. To address the latter, elements of differential costs of services or differences in expenditure needs need to be introduced. This is why the previous formula in New Brunswick used information on road kilometres as an indicator of cost pressures. Dividing municipalities into groups and applying an equalization formula on a group-by-group basis is also a form of needs adjustment.

Estimates of Fiscal-Capacity Equalization for 2023

Fiscal capacity equalization, as practiced in the federal-provincial context in Canada, aims to make sure that each jurisdiction has per capita revenue equal to what it would raise by charging the average tax rate on the average tax base.

It is an annual program, meant to equalize the ability of provinces to offer services on an ongoing basis. It is not targeted at infrastructure, nor does it take existing differences in infrastructure into account.

If there were a single tax base, the per-capita equalization payment would be the difference between the per-capita tax collection over the entire province and the per-capita collection on that tax base a particular municipality could collect if they had used the average tax rate rather than their own tax rate. Municipalities with a higher-than-average tax collection (which means a higher-than-average tax base) receive zero equalization.

New Brunswick municipalities have three property tax bases (residential, non-residential, and heavy industrial). Fiscal capacities and gaps are computed for each base separately and then added to determine the overall fiscal shortfall relative to the average. If this overall shortfall is negative (that is, there is a surplus relative to the average), the equalization entitlement is zero.

This analysis divides the province into the following groups: Cities, Towns, Villages, Rural Communities. A preliminary analysis of the expenditure patterns of municipalities reveals that towns and villages have on average similar per-capita expenditures across most expenditure categories, but with the share of expenditures on general government and environmental health somewhat higher in villages than in towns.

For their part, cities have a greater per capita expenditure on transportation, policing, and debt service and a significantly smaller share of expenditure devoted to general government and a somewhat higher share of expenditure on fire protection. While expenditure is not a direct measure of cost, differences in shares of expenditure across categories is a likely indicator of differences in relative cost pressures. Thus, to a first pass, the groupings seem reasonable.

All equalization systems are based on standard, which is benchmark amount of tax collections. The standard can also be thought of as a target per-capita fiscal capacity of a municipality. This analysis uses group averages as the standard, rather than the overall provincial average. A municipality's equalization entitlement is the amount of any shortfall relative to the standard for their group. A municipality that can raise more than their standard receives no equalization.

Municipalities are not required to pay into any equalization fund; so that any municipality with a fiscal capacity exceeding the standard maintains its advantage. There is no "equalizing down". These features mimic the previous provincial-municipal equalization scheme and the broad outlines of the federal-provincial equalization scheme.

The assumption is that funds for equalization come from outside, be it the province, or some earmarked source of funding other than the municipal tax base. This is needed to prevent equalization from becoming a zero-sum game pitting municipalities against each other for larger shares of a fixed fund. This also squares with current federal-provincial and provincial-municipal practices.

Applying this logic to the 2023 situation in New Brunswick, Figure 9 gives estimates of Equalization payments to municipalities under a fiscal capacity-based system.

Figure 9: Equalization Estimates

Cities	Towns	Villages	Rural Communities	Total
$44.1 million	$32.5 million	$6.7 million	$4.1million	$87.4 million

The total cost of this kind of equalization system is roughly 7.2% of total municipal expenditures in 2023 (which were $1.2 billion).

Viability

An extreme case of fiscal imbalance occurs when a community is deemed to be nonviable, which indicates that it cannot carry out the functions assigned to it with the fiscal tools at its disposal.

In New Brunswick, viability criteria are based on population and total tax base. Equalization grants can have no direct effect on population, but they can make up for shortfalls in total tax capacity. However, because they are based on shortfalls in per-capita tax base rather than measures of the total tax base, Equalization grants are not the tool to address viability. If grants are the chosen remedy for non-viability, there would need to be a separate grant scheme aimed directly at currently nonviable communities.

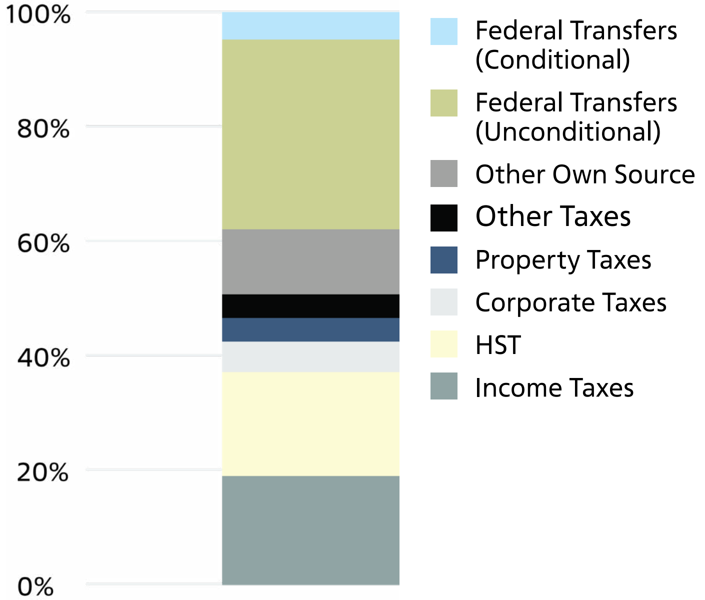
New Ways of Funding Municipalities

Fiscal arrangements are not just about the amount of money to which municipalities have access to finance the services they provide (although that matters). It is also about how those dollars are raised. Put differently, fiscal arrangements determine who pays for these services. The shrinking share of provincial grant support effectively shifted part of the cost of services away from general provincial taxation, which includes income taxes, corporate taxes, and the HST, and toward property. The shift in the composition of assessments meant that residential property is paying an ever-increasing share of municipal expenses.

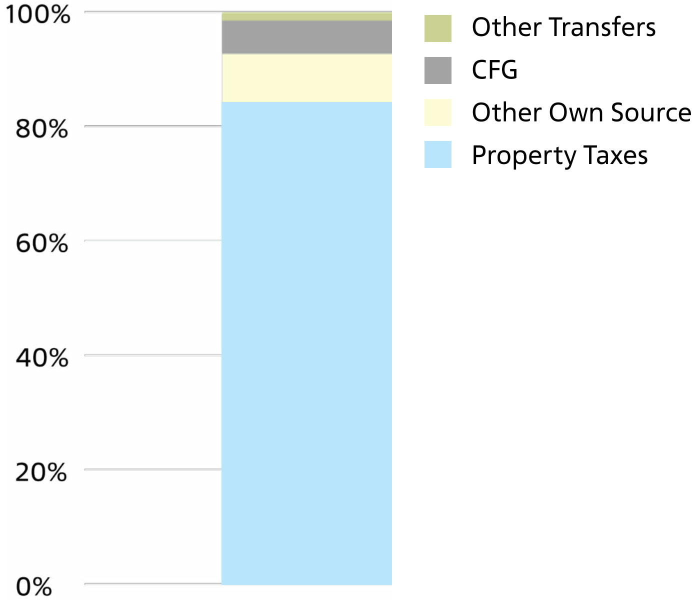
Provincial Revenue Sources versus Municipal Revenue Sources

The Government of New Brunswick receives revenue from many sources, including 38% via grants from Ottawa. Municipalities are almost solely reliant on property taxes with grants making up 7% of their revenue.

Government of NB Revenues Fiscal 2023-24



Municipal Revenues 2023



Increased reliance on residential property taxation can be reversed by providing municipalities access to other revenue sources. One simple solution would be to diversify the property tax base itself by allowing municipalities more flexibility in the amounts they charge to different types of property. Another solution would be to increase the dollar amount of Community Funding Grant or a similar program.

Recent history has shown that a one-time increase in provincial funding could prove unstable. What would prevent grants from falling in real terms when provincial governments revisit the level of support in each year's budget? A more stable solution would include transferring a tax power or a dedicated portion of some tax levied by the province to municipalities. Two candidates for such a transfer are the provincial property tax and the HST.

Changing How Municipalities Tax Property

Until quite recently, municipalities were required to set their non-residential tax rate at exactly 1.5 times their residential tax rate, with the factor 1.5 called the tax ratio. Starting in 2023, municipalities can set their tax ratios between 1.4 and 1.7. In addition, a heavy industrial tax base has been created from part of the former non-residential base. Could this increased flexibility in setting tax rates be enough to reduce reliance on residential taxation?

While increasing the tax ratio on non-residential properties must shift some of the tax bill away from residences, it is not clear how significant that shift can be. Despite 44 of 77 municipalities increasing their tax ratios in 2023 and 34 of them using the maximum ratio of 1.7, the share of municipal property taxes collected from residential properties increased from 73.2% in 2022 to 73.8% in 2023. This reflects the fact that the residential base is both larger (84% of assessments) and grew considerably faster over that time.

Indeed, it would have taken a tax ratio of approximately 1.9 across the province for the share of residential tax payments to remain 2022 levels.

The total of non-residential and heavy industrial assessments across all municipalities in 2023 was approximately $12 billion. From 2000 to 2022, the non-residential tax rate grew on average by 11 cents per hundred dollars. Applying this increase to the 2023 non-residential and heavy industrial tax bases would raise around $13.3 million, hardly making a dent in new expenditure requirements. Increasing reliance on what is now a mere 16% of municipal property assessments is a step toward fiscal rebalancing, but it can only be a small one.

Provincial Property Tax

In the 2023-24 fiscal year, the Province of New Brunswick raised $464.4 million in real property taxes. Approximately $42.9 million of that was used to finance services in rural areas administered by the Ministry of Local Government. Presumably, the remaining $421.5 million formed part of provincial general revenue. There are two ways to make all or part of this money available to municipalities: the provincial government could vacate the property tax field, or it could commit to use its property tax collections to fund municipalities.

Ceding the provincial property tax

In 2023, the total municipal warrant was approximately $1 billion. The $421.5 million in property tax revenues flowing to provincial general revenue would be a 42% increase in municipal collections and an overall 35% increase in municipal funding! Of course, replacing the provincial property tax with a municipal one would not work out that way.

The province taxes property quite differently from municipalities. The province does not charge taxes on owner-occupied properties, taxes non-owner-occupied properties at a rate of $0.5617 per hundred, taxes other residential property at a rate of $1.0345, and taxes non-residential property at a rate of $1.8560. Thus, it taxes non-residential properties at 3.3 times the rate it taxes non-owner-occupied residential properties.

By comparison, municipalities set their own residential property rates, which apply equally to all residential properties. They tax non-residential properties at a rate between 1.4 and 1.7 times the residential rate. This scaling factor is called the tax ratio. Figure 10 compares the implied tax ratios applied by the province with the municipal ones.

Figure 10: Tax Ratios, relative to non-owner-occupied properties.

Type of property	Provincial Tax Ratio	Municipal Tax Ratio
Residential owner-occupied	0	1
Residential non-owner-occupied	1	1
Residential Other	1.84	1
Non-residential	3.30	1.5-1.7

The tax ratios show that in a relative sense the province taxes residential property, especially owner-occupied residences, less heavily than do municipalities. If the province were to simply cede this tax base to municipal governments without any changes in the municipal ratio structure, it would result in further shifting of the tax base toward the residential sector. In the absence of data on owner-occupied versus non-owner-occupied tax assessments, it is impossible to quantify how large this shift might be. But it would undoubtedly be in the same direction as current trends toward greater reliance on residential taxation.

The province's additional flexibility in setting tax rates allows it to collect proportionately more revenue from the non-residential sector than do municipalities. Municipalities only recently received the power to alter their tax ratio from 1.5 to anywhere between 1.4 and 1.7. It would take a sizable change in municipal ratios to achieve the same flexibility the province has used.

Transferring property tax collections

It is certainly feasible to use provincial property tax collections to fund a grant pool for municipalities. If the province were to commit to a sizable percentage of this revenue source, a secure stream of extra municipal funding would be available. However, this stream is no more stable than municipalities' current source of revenue. By replacing grants financed by general taxation to one financed by property taxes, it would tie municipal coffers ever more tightly to the oscillations of property markets. Likewise, it does nothing to counteract the increasing tax burden on residential property.

A full transfer of the money from a provincially set property tax could have other pitfalls. The overall level of tax collections would be out of municipal control, unless municipalities had a say in the tax rate. It is unusual for one level of government to set the level of taxes collected by another. A partial transfer would protect against the province abandoning the tax because the province would have significant revenue to lose if it let the rate fall artificially low.

Transferring part of the property tax base

The province has recently divided the non-residential base into the heavy industrial base and the non-residential base (which now excludes the heavy industrial portion). It is natural to ask whether transferring this "new" tax base to municipalities could address their fiscal concerns. One advantage of this move would be to take some of the fiscal pressure off the residential portion of the current tax base. However, this is a small tax base, with approximately $1.4 billion in assessments in 2024, compared to $11.4 billion in non-residential assessments and $73.6 billion in residential assessments. Applying the current provincial non-residential rate to this base would raise only $26.8 million province-wide, an amount that would barely put a dent in the infrastructure shortfall. Moreover, the heavy industrial tax class is very unevenly distributed across the province.

Only 28 of the 77 municipalities have any heavy industrial properties at all. Part of this inequality could, of course, be offset by including the extra money in equalization calculations.

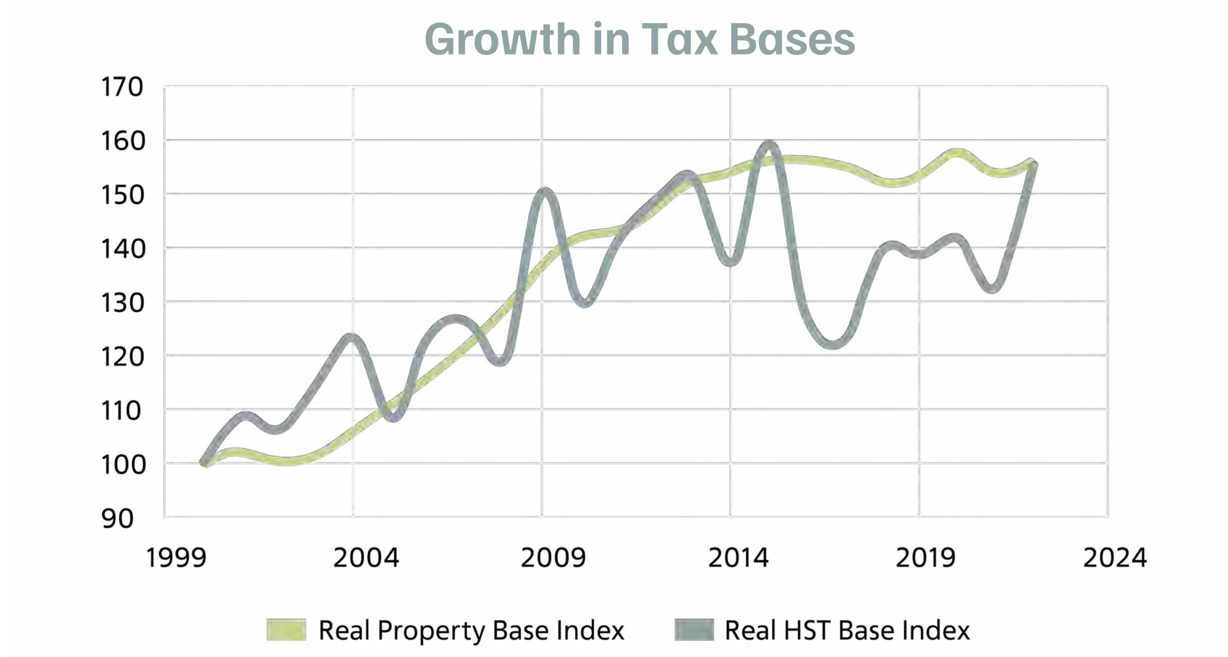
A Portion of the HST

During the 2023-24 fiscal year, the Government of New Brunswick collected $2.25 billion via the HST. Earmarking some of this money to municipalities is another way to address municipal revenue needs. The main advantage of using HST revenue to fund transfers to municipalities is precisely that it is not the property tax. As such, the revenues from the HST are not directly contributing to the decades-long build-up of pressure on the residential tax base. Moreover, a second source of tax revenue provides some diversification. Diversification would allow municipalities to smooth out the ups and downs of tax base growth. This is especially important because municipalities cannot directly issue debt to smooth out revenue fluctuations in the same way that other governments can. Figure 11 shows that the HST and municipal tax bases do not always grow in lock step, demonstrating that access to a portion of the HST would, indeed, provide some diversification. The larger the amount of this additional revenue source allocated to municipalities, the greater the potential diversification.

Figure 11 also shows that the overall municipal tax base grew at roughly the same rate as the HST tax base over the first two decades of the millennium, each being approximately 55% higher in 2022 than they were in 2000. Thus, tying municipal grants to the HST is not likely to change the long-run growth rate in municipal revenue. Rather, the short-term fluctuations may be somewhat different. Indeed, the HST base seems more variable than the property tax base. Thus, some smoothing of revenue may be required, either by basing grants on multi-year averages of HST collections or through using a portion HST-generated revenue to fund infrastructure projects rather than year-to-year operations.

While transferring a portion of HST revenue is a way to fund municipal grants going forward, there are many details to be sorted out on how to divide the money. The mechanisms should be formula-based and transparent. Recent agreements in Quebec and Saskatchewan provide possible models for New Brunswick.

Figure 11: Growth in the property tax base, HST collections, and the HST base



Conclusions

Fiscal reform is about ensuring that municipalities have stable and secure funding to carry out the services they provide. It is also about deciding whether we want more of the tax burden to fall on residential property owners and their tenants. In the absence of fiscal reform, long term trends in the composition of the tax base will result in municipalities becoming increasingly reliant on the residential tax base.

The property tax base is currently growing at unprecedented rates. It is too early to call this a long-term trend and to base long-term fiscal arrangements on the assumption that the property tax base will always be as buoyant as it has been in the last two years.

Evidence from municipal asset management plans and comparisons with recent findings in Ontario suggest that addressing municipal infrastructure backlogs requires a sustained increase in municipal revenue of approximately ten per cent ($120 million). The requirements identified here are likely a very conservative estimate of municipal needs. While the municipal asset plans recognize the need to meet the challenges posed by climate change and the continued need for greener infrastructure, dollar estimates are primarily tied to the costs of replacing existing assets. Moreover, the asset management plans feature relatively low ratios of annual expenditure to the estimated total infrastructure need, implicitly assuming very low financing costs.

There is considerable uncertainty about the future path of municipal payments to regional service commissions. The proposed financing model, which has some similarities to the PPSA formula, requires higher per capita fees from municipalities with larger tax bases, thereby enacting implicit equalization.

Unlike traditional equalization schemes, equalization is both downwards and upwards.

Estimates show that in 2023 approximately seven per cent of municipal revenue ($87.4 million) would have been sufficient to finance a traditional tax-base equalization scheme. With an equalization scheme in place, all municipalities would be on a similar fiscal footing; that is, they would all have similar abilities to pay for their services. Thus, there would be no need to resort to implicit equalization through differential per-capita pricing at the regional level.

Over the past two decades, the HST base and the property tax base have grown at roughly the same rate. Transferring HST revenue to municipalities would provide a more diversified revenue stream, not necessarily a faster growing one. Moreover, the security of tying the revenue stream to an observable target like HST collections would shelter municipal transfers from the slow and steady decline experienced in recent decades.

This report makes no attempt to quantify the cost pressures associated with recent population growth, to anticipate the costs of additional services that may end up in the purview of regional service commissions, nor to help so-called nonviable communities.

Estimated infrastructure needs and estimated equalization total approximately $200 million per year, just less than one percentage point of HST (currently 10% of HST revenue). It seems reasonable, therefore, to allocate one percentage point of New Brunswick's HST to fund a stream of revenue to municipalities. This revenue stream can be used for unconditional grants and new infrastructure spending.

Recommendations

01 That one percentage point of current ten provincial points of the HST be earmarked for municipal finance.

02 That no more than half of the revenue from this HST allocation be used to finance operational grants including an equalization scheme. Any equalization scheme should be formula-based.

03 The remaining funds from the HST allocation should be used to fund municipal infrastructure renewal.

04 That except where there is an obvious case for differentiated fees (for example in solid waste collection) that municipal contributions to Regional Service Commissions be funded on an equal per capita basis.

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