



REGIONAL MUNICIPALITY
OF **WOOD BUFFALO**

**SUBMISSION TO THE
ALBERTA ROYALTY REVIEW PANEL**

PRESENTATION VERSION

June 5, 2007

3:00 p.m.

Oil Sands Discovery Centre

Fort McMurray, AB

Presented by:

Regional Municipality of Wood Buffalo

Review Panel Members: Bill Hunter (Chair); Ken McKenzie; Judith Dwarkin; Sam Spanglet; Andre Plourde; Evan Chrapko.

MR. CHAIRMAN
MEMBERS OF THE ALBERTA ROYALTY REVIEW PANEL

It is my pleasure to appear before you today on behalf of the council and citizens of the Regional Municipality of Wood Buffalo. We respectfully submit the following report, expressing our views on the Alberta Royalty System for oil and gas, for your consideration.

OVERVIEW

We understand the Panel is tasked with the responsibility to determine whether Albertans are receiving a fair share from the resources this province has been blessed with. We believe there is wide agreement that, as owners of Alberta's energy resources, Albertans are entitled to benefit from the development of those resources. We in the Regional Municipality of Wood Buffalo respect the right of the oil sands industry to make a healthy profit. Our concern is that the individuals living in the communities that support such development are experiencing an increasingly unacceptable deterioration in their quality of life.

The Regional Municipality of Wood Buffalo is significantly impacted by development in the Athabasca Oil Sands right now. In recent years, oil sands development has increased dramatically, creating profits in the billions of dollars for oil sands developers, while at the same time, placing unprecedented pressure on the infrastructure and services in the Region. If the level of monetary support from the Province and Industry remains unchanged, the residents of the Region will continue to experience, and be left with, a legacy of insurmountable environmental, fiscal and social impacts long after the oil sands developers are gone.

Despite Alberta's booming economy, infrastructure deficits are becoming more and more pronounced, indicating an imbalance in the system – both in the *quantity* of revenues generated from royalties, taxes and other costs, and in the *manner* that those revenues are distributed. The Region believes the Province must act now to implement changes that will lay the foundation for a genuine "fair share" for Albertans for the future.

A fair royalty regime is one that provides sufficient revenue to address all of the costs of energy resource development (environmental and social) and provides a fair return to Albertans for the development of their resources. Further, the provincial government must ensure that these revenues are re-invested in the communities that support such energy resource development and where the biggest impacts are felt.

BACKGROUND

The Regional Municipality comprises 68,454 square kilometers in northeastern Alberta and is home to the Athabasca Oil Sands.

The 2006 Municipal Census indicates a population of 79,810 citizens, of which 64,642 reside in Fort McMurray. As a result of oil sands industry expansion, the Region has experienced an unprecedented annual growth rate of approximately 9% over the past eight years, nearly doubling in size since 1999.

The RMWB recognizes the economic benefits that oil sands development brings to the region. However, at the same time, this explosive influx of people has placed tremendous strain on our ability to provide and maintain the municipal services and infrastructure required to support a healthy, vibrant, and sustainable community. The facilities and services in the region are taxed to their maximum limits. Housing, transportation, health, social, leisure, policing, emergency services, traffic, and education, in addition to our major infrastructure have exceeded current capacity.

In 2002, the Region identified the need for \$563 million in public sector capital infrastructure requirements between 2003 and 2007.¹ By March of 2005, the estimate had increased to \$1.2 billion between 2005 and 2009, including \$353 million in municipal projects.² By December, 2005, just 9 months later, the \$1.2 billion figure had grown to \$1.9 billion, and the \$353 million figure for municipal projects had escalated to \$814 million.³ Part of the reason for the increase in municipal projects was that anticipated funding from senior government was not forthcoming – no grants, other than those offered to all municipalities in Alberta, were received.⁴

Quality of Life

The cumulative impacts of oil sands industry expansion have negatively affected the quality of life for long-term residents of the region. The Federation of Canadian Municipalities has been studying quality of life over the past 10 years in 20 Canadian Cities, based on 11 sectors, including: demographics, affordable housing, civic engagement, community and social infrastructure, education, employment, economy, natural environment, personal and community health, personal financial security, and personal safety. The quality of life in Fort McMurray is deteriorating in all sectors but two – local economy and employment.

¹ RIWG, Wood Buffalo Business Case 2005, March, 2005, p. 26,
<http://www.oilsands.cc/pdfs/Wood%20Buffalo%20Business%20Case%202005.pdf>.

² *Ibid*, p. 5.

³ RIWG Wood Buffalo Business Case 2005 – Update & Progress Report, December 2005,
<http://www.fortmurraychamber.ca/start.htm>, p. 4.

⁴ *Ibid*, p. 10.

The Municipal Debt

The RMWB debt is the highest in the province. In Alberta, the provincial government has mandated municipalities to remain within a debt limit of 1.5 X annual revenue. Because of its unique circumstances, the Regional Municipality of Wood Buffalo was granted provincial approval for a debt limit that equals two X annual revenue, joining Calgary, Edmonton and Medicine Hat as the only other municipalities in the province with that distinction.

In 2007, our municipal debt is projected to be \$335 million, giving the municipality a debt limit ratio of 67% of our cap. By 2008, and for the foreseeable future, the municipal debt will exceed 85% of the legislated debt limit, but, RMWB has set that 85% as a threshold to maintain a financial cushion, giving the municipality the flexibility to deal with its changing environment and emerging issues and service demands.

Unfortunately, the unique pressures Wood Buffalo, faced with the pace of oilsands development, is creating a situation whereby the municipality soon will not be able to borrow the funds necessary to provide for new capital projects and infrastructure.

RECOGNITION THAT CURRENT FUNDING IS INSUFFICIENT

Current provincial funding mechanisms are not adequate and have not been modified to reflect the unique nature and magnitude of the challenges faced by this municipality and the region's strategic importance to the Alberta economy. We believe the cumulative impact of growth, and our ability to fund the growth, to be a leading cause of the decline in the quality of life for our citizens.

The sole source of revenue for a local government is the property tax. In 2005 the RMWB received support for two resolutions from both the Alberta Urban Municipalities Association (AUMA) and the Alberta Association of Municipal Districts & Counties (AAMDC) to petition the Province to amend the legislation concerning Machinery and Equipment assessments, our largest assessment class.

The first resolution called for the abolishment of the legislative discount on Machinery and Equipment assessments to 77% of market value. The second resolution asked for the repeal of MGA Section 354 (3.1) which restricts the municipality to taxing the Machinery and Equipment assessment class at the same rate as the non-residential assessment class. In addition to the 77% discount, the assessed value of Machinery and Equipment is subject to an immediate 25% depreciation factor, which further diminishes the assessed value at which Machinery and Equipment is taxed in comparison to the other property assessment classes.

If the Provincial Government, by legislation, refuses to allow the municipality to collect full property taxes on an oil sands industry, and if the Province is not collecting enough in Royalties to transfer the funds necessary to support a high-growth community, then the Royalty on oil and gas should be increased to allow them to do so.

The financial return to the provincial and federal governments from Alberta's energy resources is significant. While it is the RMWB that provides the roads, water and other services that facilitate resource development in the region, our economic return is marginal compared to the senior levels of government. The RMWB receives property taxes from oil sands developers and their workers, but that is miniscule in terms of the share of the resource wealth that is extracted from this region. In 2005 to 2006, the provincial government received \$950 million in oil sands royalties.⁵

The RMWB has been falling behind in its struggle to keep pace with the nature and rate of the current development, not to mention the impact of new and future projects. This has created serious deficits in infrastructure and gaps in municipal services. Development in the region has reached a critical stage. Our Council has taken the position that, before any additional oil sands approvals are issued, the Region requires immediate funding to address these serious issues, together with a commitment by senior government and industry to long-term planning for growth in the Region.

The Radke Report and the Ministers Council on Municipal Sustainability have recognized the need for increased funding for municipalities experiencing high population growth, and that the Province and Industry should have an expanded role in this. The RMWB fully supports these suggestions, and believes that companies who extract resources and wealth from the region should contribute in a meaningful, planned manner to the communities which they depend on and which they impact the most. This includes providing funding to pay for the infrastructure and services that are required to support the development. Adjusting the royalty regime to achieve this is an option that makes sense.

While the Radke Report recognized the need to fund some \$800 million in critical municipal infrastructure projects in the RMWB⁶, the province has not yet developed a plan to respond.

One of the recommendations coming out of the Council on Municipal Sustainability Report was that the Government of Alberta should reconsider the concept of "economic rent" to include the direct costs imposed upon municipalities as a result of resource development and provide municipality's access to revenues from industry to offset these costs. One of the options for achieving this was increased provincial resource royalty rates, with the increase earmarked for allocation to directly affected municipalities.⁷ The RMWB fully supports this recommendation.

⁵ Alberta Ministry of Energy, 2005-2006 Annual Report, p. 18,
<http://www.energy.gov.ab.ca/docs/aboutus/pdfs/AR2006.pdf>.

⁶ *Ibid*, p. 75.

⁷ *Ibid*.

COMMENTS ON THE EXISTING ROYALTY REGIME

The current royalty system for oil sands was established in 1997, and was specifically designed to encourage investment, recognizing the significant risk to oil sands developers. At that time, the technology was new, there were a limited number of companies involved, and there was no certainty that the extraction of oil from the oil sands would be economically viable. Compounding the risk was the low price of oil (about \$27 per barrel) and the high cost of producing oil (about \$15 per barrel).⁸ This strategy proved to be successful. Between 1998 and 2005, investment in the oil sands increased by 300%.⁹

The circumstances that were in place when the generic royalty regime was implemented have all changed, contributing to an environment where there is now certainty that oil sands development will be not only economically viable, but highly profitable. The RMWB believes that the existing royalty system could be more sensitive to market conditions. When the price of oil increases, making oil sands development highly profitable for industry, royalty rates could increase accordingly, so that Albertans receive their fair share of that benefit.

There are several indications that the existing royalty regime is not achieving an optimal balance:

- There are insufficient revenues available to the Alberta Government to address the infrastructure and service deficits that have been created by energy resource development across the Province and to also provide a fair return to Albertans as the owners of the resources.
- Even if there were sufficient revenues, there is not sufficient and accessible funding available to the municipalities that support such development to ensure that the quality of life of the residents of those communities is maintained and provided for in the future.
- The existing royalty regime, in conjunction with all of the other factors favourable to oil sands development, has resulted in a number of oil sands projects being constructed and operated simultaneously. This has led to an overheated economy, including severe shortages in labour, materials and equipment, dramatic increases in costs, and project cost overruns.
- There is some concern that the existing royalty regime lends itself to manipulation by energy companies. The 1% royalty rate until project payout is an incentive for oil sands companies to reinvest profits into *expansions* of existing oil sands projects, so that the timeline for project payout is delayed. As a result of this practice, increased royalties can be delayed for significant periods of

⁸ Government of Alberta, "Royalties in Alberta, Background Information", http://www.albertaroyaltyreview.ca/more_info/background.pdf, p. 6.

⁹ *Ibid*, p. 8.

time, thereby reducing the amount of return to Albertans for the use of their resource.

WORKING WITH INDUSTRY

The Regional Municipality submits this paper for the purpose of ensuring that we have the resources necessary to develop and maintain a community that will provide our citizens, and oil patch employees, with a reasonable quality of life. Our residents expect no less than that of other Albertans. We believe Industry would agree with this statement and, in this competitive economy, believe a viable community to be critical to their success in attracting the thousands of workers necessary to develop their projects and to keep them here as the projects mature.

We further believe any disagreement would come from interpretation. In our discussion with Industry, they argue governments have a clearly defined mandate to provide services and already collect the revenue necessary. From a municipal perspective, we submit to the Panel that we're not the experts in establishing an economic principle like a royalty regime. We know that we can't provide a quality of life for our community with the current funding formula provided to us. We say that, if the province is not raising the money necessary to support us, they need to raise more. If it's a matter of reallocating the funds necessary for that support and they don't need to amend the royalty formula, then they should do that. In the end, for us it comes down to providing the funds in a reliable, planned manner that allows the RMWB to proceed with surety into the future.

We understand that the Industry submissions to the panel will oppose any changes to the existing royalty regime; however, should the Province make changes, we know there is industry support to see **predictable, annual royalty revenues** returned to producing regions for infrastructure support, rather than industry stepping forward with dedicated infrastructure contributions paid directly to municipalities.

SUMMARY AND RECOMMENDATIONS

The RMWB recognizes that the royalty regime must strike a balance between providing a fair return for Albertans and providing sufficient incentive for development of Alberta's energy resources that allows Alberta's economy to prosper. The RMWB makes the following recommendations to the Alberta Royalty Review Panel:

1. We believe it prudent to re-visit the generic royalty regime for oil sands in light of the vastly different circumstances that exist today, including increased oil prices, improved technology, and better return on investment. In particular:
 - a. Revise the definition of "economic rent" to include the direct costs imposed upon the RMWB as a result of the development of the Athabasca Oil Sands.
 - b. If necessary to provide funds to support high-growth municipalities, increase the percentage payable before "payout", which was common in

the individual arrangements prior to the implementation of the generic royalty regime and after “payout” to an *ad valorem* rate higher than the current 25%. Although, as more plants mature and actually pay at the 25% level, this may provide the income necessary to allow the province to adequately transfer the funds necessary for high-growth municipalities to maintain their infrastructure.

- c. Implement a new system for calculating royalties that reflects the price of oil so that higher royalties are payable when profits are higher. This way, higher royalties are paid when profits are high, but can remain relatively low during cost recovery and when profits are lower.
2. Dedicate a predictable, annual portion of royalty revenues received from oil sands projects to the RMWB and other municipalities where the development occurs and which are most directly affected by development to help finance infrastructure and services required by the new growth.

That's our presentation Mr. Chair. We thank the Alberta Royalty Review Panel for the opportunity to make these submissions.