CAPITAL IMPROVEMENT PLANNING

By Kate Lawton

When local officials take office, they assume a variety of responsibilities on the public's behalf. One of those responsibilities is to ensure that the public's capital assets are maintained, and in many cases, developed further according to specific plans. Capital assets includes all infrastructure (roads, waters, sewers, stormwater drainage, sidewalks, curb and gutter, lights, and information systems), buildings (government buildings, museums, treatment plants, libraries, recreation and civic centers), equipment, and lands (parks, gardens, waterfronts, and others). Any expenditure above a certain amount, such as $10,000, is often considered a capital expenditure.

Capital expenditures require significant budget outlays. Capital outlays are often beyond the means of the local government's current operating budget. This is true even in cases where a fund has been established to save a portion of the current year's operating budget for future capital expenditures. Hence, local governments often incur debt to finance all or a portion of their capital expenditures.

This paper summarizes the process of capital improvement planning, covering the basic steps involved in the process. Since debt is an integral part of capital improvement planning, debt management will also be briefly discussed.

Capital Improvement Planning Process

The planning process for capital improvements, like any plan, has several steps, including laying out the process in advance. While a board may decide to undertake the task itself, public input should be a requirement somewhere in the process since it involves the investment of a significant amount of public funds. The process involves inventorying current assets and future planned purchases to get a big picture of the community's needs. As part of the inventory process, an examination of appropriate and available funding is undertaken for each capital project. Prioritizing projects is a step that involves making choices and scheduling projects according to need and funds. Finally, the plan is put together and examined each year during budget development to affirm prior choices, look at funding, and shift priorities as necessary.

Participation

There are a number of ways to involve citizens as a part of the capital improvement process. One way is to establish a citizen's committee charged with overseeing the project and making recommendations to the board. All or a portion of the citizen membership can be chosen based on the expertise they would bring to such a project, members directly affected by projects, or citizens with no particular interest in any given project. Membership may include one or more board member, even designating the board member as the chair.

As steps are completed, the board may choose to involve the citizenry to solicit their input on the plan. For example, the board may decide to hold an informational meeting when the capital inventory is complete to determine whether certain desires have been overlooked. Also, the board may choose to hold a hearing after an initial draft of project funding and scheduling has been completed. Citizens are informed of what the board is contemplating in terms of project importance and funding. The citizens can provide input on whether the draft schedule meets their priorities and whether the amount of debt that will be incurred is consistent with their desires.

Since citizens are unlikely to keep the capital plan firmly in mind for however long the plan exists, it may serve the board well to have an annual informational meeting prior to the budget hearing. That would give the board an opportunity to discuss the plan again, as well as any other plans that affect the budget, the local government's financial position, and all decisions that went into drafting the proposed budget.

In larger local governments, department heads often play a key role in supplying information to the board or the committee on assets under their care. These staff can be utilized further in public informational meetings to bring the citizens up to date on their inventory, funding, and future expenditures.

Inventory of Assets and Needs

After establishing the planning process - who will be involved, the type of involvement, when tasks will be completed, when meetings and hearings will be held - the board or committee needs to compile an inventory of its capital assets and future acquisitions. The inventory is not just a list, but includes a description of current condition, estimated replacement time or necessary upgrades, estimated replacement cost or purchase price, and any associated increased maintenance costs.

For example, a local government may decide to replace an existing engineering copier for large plat maps. The inventory will note the useful and remaining life, the estimated replacement cost, and the cost of any maintenance contracts. Or a town may have designated the purchase of certain lands for a park and recreation area in one of its land use plans. Estimated projections on cost for various purchases may be listed, along with different scenarios of improvements (baseball diamond, shelter, audience stands, lighting, concession stand, nature trail, tennis courts, and swimming pool). Various acquisition and cost projections would include different levels of maintenance costs.

Most towns have few capital assets outside of their roadway system, town hall, voting machines, and road and fire equipment. These officials often state that because of this, they have no need for capital improvement plans. Not so! While 99% of the value of their capital assets may be tied up in roadways, most towns systems are multi-million dollar investments. Having a good capital improvement plan to maintain that system will keep costs down over the life of the pavement. Maintenance is much cheaper, even over the long-term, than reconstruction.

The UW Transportation Information Center has developed a system called PASER that establishes a simple road inventory system. Once the 10-scale inventory is completed, local governments can see what appropriate measures, and their cost, should be undertaken to maintain the roadway. This allows local governments to prioritize their roadway projects according to objective criteria, need, and available funds. It is both an invaluable capital planning and budgeting tool.

Matching Projects to Appropriate Revenue Sources

Part of the task of inventorying capital projects is to determine their appropriate funding source. There are a variety of funding sources available for capital projects that a local government may wish to consider: grants (parks, sanitary facilities), general obligation bonds, revenue bonds, tax incremental financing districts, special assessment, user fees, cost-sharing with other local governments, room taxes for tourist facilities, private gifts, performance contracting, bank loans, leasing all or a portion of a facility, current operating revenues, revenues from a capital reserve fund, and citizen volunteer assistance (installations, expertise, review).

Some funding sources will be appropriate to a project, while others will not. Where improvements will benefit specific property owners, for example, a special assessment may be the most appropriate source for funding all or a portion of the project. For land acquisitions for parks, a grant from the DNR may be appropriate to fund a significant portion of the project. For local government buildings that are not used around the clock, officials may decide to rent out the space for community and family occasions.

Long-term debt may be appropriate if the life of the facility is long and future residents will enjoy its benefits. By spreading the repayment over a twenty or thirty year period, current residents only pay a portion of the cost while new residents are included in the repayment. Tax incremental financing districts may be used to pay back debt on infrastructure development for a business or industrial district.

A projection of local government revenues and expenditures should be included in this step for the life of the plan. A revenue/expenditure projection will help local governments determine what is affordable and when, which will assist in the prioritizing and scheduling of projects. For example, some projects are likely to increase costs above projected revenues, drawing on the local government's operating budget. For example, a park will require maintenance and perhaps additional staff to tend it and staff the recreational facilities, such as a life guard positions for the swimming pool. A new development may increase maintenance costs for roads, water and sewer lines, and place heavier demand on existing services, such as schools, libraries, fire and ambulance, and police. While the local government may increase its tax base, it is likely that the development will not pay for increased maintenance costs and services. This will strain existing revenues in the operating budget and may take away from monies dedicated for other purposes, including the capital reserve fund.

Whatever funding mix is assigned to each project, and it is often a mix, these should be included in the inventory. In addition, any projects contingent on outside funding should be noted. For example, a town may consider a park and recreation area if it can obtain a grant to fund at least 50% of the acquisition price.

Prioritizing and Scheduling Projects
When the inventory has been completed, projects have to be prioritized according to need, available funding and citizen input. In the short manual entitled "Developing a Capital Improvement Plan and Budget," Eilrich et. al lay out a number of sample questions that could be used as criteria for establishing priorities. These are laid out along four lines of inquiry: policy, financial, planning, and engineering concerns. To quote, these are:

<u>Policy Concerns</u>
- ❑ Does the project require immediate attention?
- ❑ What is the impact if the project is not carried out?
- ❑ Is the project the most economical solution for addressing the need?
- ❑ What is the proposed project's impact on the public?
- ❑ Does the project have significant community support?
- ❑ Does the project satisfy all of the applicable legal requirements?

<u>Financing Concerns</u>
- ❑ What are the financing options available to fund the project?
- ❑ When will those options become available?
- ❑ Do the sources conform to the community's fiscal policy?
- ❑ Is a portion of the funding already allocated to other uses?
- ❑ Does the project have a positive cost/benefit ratio?
- ❑ Will the project encourage other capital investment or generate other revenue producing opportunities?
- ❑ Can the operational and maintenance needs of the project be met?

<u>Planning Concerns</u>
- ❑ Is the project consistent with existing community and regional plans?
- ❑ What is the proposed project's contribution toward the community's goals and objectives?
- ❑ Is the timing of the proposed project appropriate, or should other projects be completed first to support it?
- ❑ Does the project require other actions, such as modifications to existing infrastructure, future acquisitions, and traffic lights?
- ❑ Is the location of the project suited for the surrounding environment?
- ❑ What is the expected length of time that the project will supply benefits to the community before planning or modification is again required?
- ❑ Have other governments been consulted about the project who either may be affected by it or use it?

<u>Engineering Concerns</u>
- ❑ Is the project required to prevent structural deterioration?
- ❑ How extensively will the project be used and are the specifications adequate to satisfy the need?
- ❑ Does the design comply with all legal requirements?
- ❑ Are there any remaining risks or uncertainties?
- ❑ Is further study required to determine feasibility?

Once local governments determine the appropriate criteria to prioritize projects, they can establish a number of systems to rank the projects. Some officials may decide to qualitatively judge each project and assign a priority, others may decide to establish a numeric system of weighting, while still others may combine the systems. Whatever system is developed, the method should address concerns from a number of angles and provide a thorough understanding of the project, its importance, and any concerns that need to be addressed in the present and in the future.

Monitoring the Plan

Capital improvement plans are typically laid out for a certain forecasted period, such as 5 to 10 years. Local officials should formally adopt the plan and use it in their annual budgeting process. Like any plan, it is a guide and best estimate, which will be tested and shifted by the vagaries of life. Even though a local government may not stay in lock step with the plan given immediate crises and needs, it is a valuable tool to guide decision-making and purchases. Furthermore, it is a valuable connection between the board and the community.

Summary

Local governments are well advised to develop a capital improvement plan to avoid crisis management, increase their financial options, and further develop a rapport with the citizenry. Seemingly small governments, such as towns and villages, often balk at the need for such an effort. Yet, they too have assumed the public trust to maintain the municipality's capital assets for the current generation and for those that come after. These same municipalities have multi-million dollar systems just within their roadways, which should be maintained carefully to more efficiently and cost effectively, spend their revenues.

Recent levy limits, coupled with reduced aid and double-digit increases in healthcare and energy, have motivated some local governments to cut or delay capital expenditures. A one-year strategy meant as a stop-gap measure can easily turn into a 3-5 year strategy with the result of increased costs and a greater burden of capital replacement.

DEBT

Local governments often issue debt, or assume a long-term loan, to cover a portion of their capital improvement projects. One form of local government debt is a general obligation bond, which are backed by the government's authority to tax. In Wisconsin, the constitution limits the amount of general obligation debt to 5% of equalized taxable property value within the local government's jurisdiction. This limit helps to ensure that local governments will not incur more debt than local taxpayers can support.

Chapter 67 of the Wisconsin Statutes lays out the guidelines for municipal borrowing and bonding. Towns must gain approval for issuing general obligation bonds at the annual meeting or at a special town meeting and a referendum. Cities and villages may be subject to a referendum under certain circumstances. Section 66.0621 regulates the use of revenue bonds, which is a form of debt that is backed by the revenues a particular project will generate, rather than the taxes of a local government.

In Subchapter II of Chapter 24 of the Wisconsin Statutes, the state has established a trust fund that issues loans to local governments for their public projects, called the State Trust Fund Loan Program." Since rates are subject to change, a call should be made to determine the going rate and eligibility requirements. See the contact number and website under "Resources."

It is not the intent of this brief paper to outline the different forms of debt, the necessary procedures to secure them, or when a particular form of debt may be more desirable. That discussion falls within the province of the local government's board and financial adviser.

Capital Expenditures and Debt Policy

Capital improvement planning requires local governments to identify and determine which revenue sources are appropriate for each project. Often, a large public project will have a package of revenue sources associated with the life of the project. A capital improvement plan lays out the funding sources for each prioritized project over a number of years. Funding sources may include current operating revenues, accumulated revenues from a reserve fund, special district taxes, impact fees, charges for service, special assessments, revenue or general obligation bonds, grants, performance contracting, and other short and long-term debt.

Without a plan, local governments place themselves in a position of managing capital improvements on a crisis basis. Crisis management is usually more costly to local governments in the long run, as it usually consists of running down assets in the short term and assuming large amounts of debt at a higher interest rate. A case in point is that it is more expensive to reconstruct a road than have a good maintenance plan. By taking the long view through capital planning, local governments position themselves to structure their debt according to their needs and capacity while enjoying a greater opportunity to choose financial instruments.

In identifying funding sources for capital projects, local government official should establish parameters on debt in a formal policy. A debt policy will often include the following components:

- Acceptable levels of short-term debt.
- Purposes for which debt will be issued.
- Use of tax-supported, general obligation bonds versus self-supporting revenue bonds.
- Use of special tax districts, such as tax incremental financing districts.
- Use of special assessments and charges.
- Mix of pay-as-you-go (current revenues and capital reserve savings) and debt financing.

The governing body should formally adopt the local government's debt policy, which places limits on the amount and use of debt.

There are many advantages in establishing a debt policy. First, it integrates financial and public project planning. Second, it provides a guideline in determining current and future revenue sources and for evaluating current debt. Third, credit institutions look positively upon local governments with debt policies and capital improvement plans, as it indicates both foresight and controlled borrowing practices. This may result in a higher bond rating or lower interest rates for the local government.

Sources and Resources

"Developing a Capital Improvement Plan and Budget," by Fred Eilrich, Gerald Doeksen, and Jack Frye, Oklahoma State Cooperative Extension, May of 1995.

"Capital Improvement Programming: A Guide for Smaller Governments," by Patricia Tigue, Government Finance Officers Association, 1996.
"An Elected Offical's Guide to Debt Issuance," by Patricia Tigue and J.B. Kurish, Government Finance Officers Association, 1993.

State Trust Fund Loan Program at (608)266-0034 or http://bcpl.state.wi.us/asx/index.asp?target=LOANPROG

UW Transportation Information Center at http://tic.engr.wisc.edu/

DOR's Website under "Reports/Data." The report listed as Muncipal and County Indebtedness lists all of the local governments that exceed the constitutional debt limit. The Department's site is http://www.dor.state.wi.us/

Use the Local Government Center's website to access many useful sites, including DOR's site http://lgc.uwex.edu/