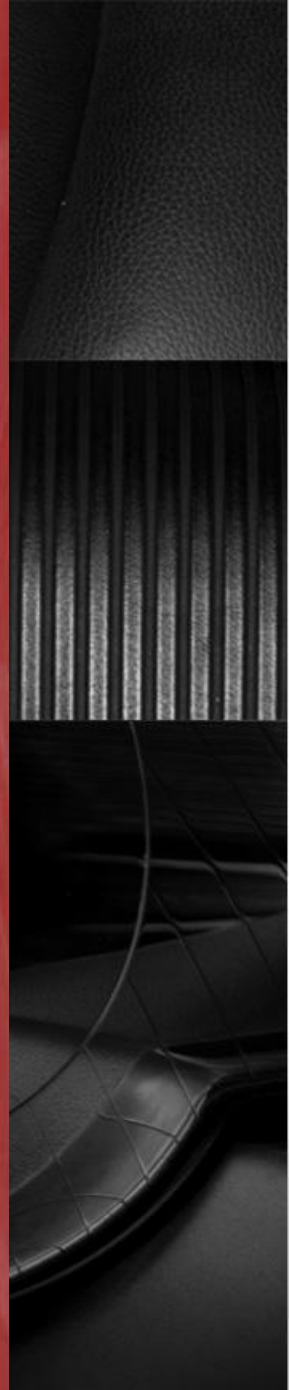


Capital Budgeting

Yadkin County

November 30, 2012





Key Terms

- **Capital expenditure:** expenditure of significant value (\$5,000 or more) to acquire or build property that lasts for more than one year (usually for many years).
- **Capital budgeting:** the overall process of planning, financing, authorizing, and implementing major capital projects and acquisitions. “Major” is defined in terms of project cost, and varies depending on jurisdiction size. The cost threshold is usually much more than \$5,000; it ranges from \$25,000, or so for smaller local units to \$100,000, or more for larger localities.
- **Capital improvement program:** multi-year forecast of major capital projects, their capital costs, financing sources, & the impact of the projects on future operating budgets.



Importance of Capital Budgeting

- **Large amounts of money are at stake** in many capital project decisions.
- **Debt** is often needed. Debt involves long-term commitments.
- Capital infrastructure & facilities are needed to meet or spur **economic growth**.
- **Annual budget process is not designed** for planning and budgeting major projects.



Scope of Capital Budgeting

- **Major infrastructure, facilities & equipment**
- **Multi-year:** CIP usually spans 5 or 6 years. Some CIPs extend 10 years into the future. Master planning to identify needs usually project ten years or more. Arrangement of financing can span years. Major project design & construction is multi-year.
- **Multi-phased:** planning, finance, authorization, & implementation.
- **Operating budget impact as well as capital costs** of projects, a new recreation center requires additional staff.



Capital Planning: Overview

- Capital improvement program (CIP)
- Identification of capital project & equipment needs: replacement & rehabilitation, new needs
- Prioritization of capital project needs & requests
- Project evaluation: determination of project benefits, scope, design, and cost



Capital Improvement Program (CIP)

- Multi-year forecast, e.g., five years
 - Major building, equipment, & infrastructure needs
 - Capital costs related to those needs
 - Sources of capital financing
 - Impact of projects on future operating budgets
- Essentially a plan with first year becoming capital budget
- Update annually
- Most projects enter CIP in later planning year



Identification of Capital Rehabilitation & Replacement Needs

Too often neglected



Prioritizing Capital Project Requests: Approaches

- Judgment based on experience
- Program goals and priorities among them, e.g., Public safety goals may be ranked ahead of goals for other services, and this drives capital as well as operating budget priorities.
- **Urgency of need criteria:** legal mandates, public health and safety, service or facility deficiencies, consistency with goals, community support, etc.



Determining Project Benefits, Scope, Design, & Costs

- **Occurs in stages over time:** Should become more specific as project moves through CIP.
- **Benefits:** Implicit in “urgency of need” ranking factors; quantitative & qualitative; financial for utility or enterprise projects.
- **Project scope:** Avoid scope creep—addition of features during design & construction phases.
- **Design:** Communication with engineers/architect is vital. Allow sufficient time. Do not short change testing. Use of special fund & reimbursement agreement.
- **Project costing.** Some projects (renovation) can be difficult to cost.



Capital Financing Strategy for a Local Government

Foundations

1. Assess & forecast a jurisdiction's financial condition
2. Governing board adoption of policies for capital finance

Pay As Go Financing

1. Maintain adequate operating fund balance (s)
2. Fund recurring or "low cost" capital equipment from annual budget
3. Create & fund capital reserves for expensive equipment, down payment for projects, etc.

Debt financing

1. Determine & remain within debt capacity.
2. Balance debt & pay-as-go financing. Balance can vary with needs, capacity, etc.
3. Select suitable debt option (s) for major projects
 1. GO bonds, capital lease debt, revenue bonds, limited or special obligation debt, variable rate demand debt
4. Maintain or improve bond ratings




Capital Financing Strategy for a Local Government cont.

Financing economic development

1. Impact fees
2. Tax increment debt
3. Incentives

Leveraging outside capital: grants, public-private projects

Financing economic development: impact fees, tax increment debt, incentives



Fund “Low Cost” Equipment/Projects in Operating Budget

Preserve debt capacity for large projects & equipment acquisitions. **Bond rating agencies** recommend that local governments develop and use pay-as-go financing sources .