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Capital Improvements Planning

A capital budget involves different criteria and a longer time frame than does an operating budget. As discussed in Chapter 19, the annual operating budget describes costs incurred in the normal operations of county departments responsible for delivering services that benefit the citizenry in the current fiscal year, and these operating costs are financed out of current-year revenues. Capital costs, on the other hand, usually are incurred in the acquisition of equipment and in the construction of facilities and infrastructure that may benefit residents of the county well into the future. Since capital purchases involve long-term benefits, they are classified as capital improvements and may be funded through the issuance of bonds, proceeds of the special purpose local option sales tax (SPLOST), or other forms of borrowing (see Chapter 21). Capital budget decisions, then, are made separately and usually are handled in a multiyear capital improvements plan (CIP).

The CIP outlines a recommended schedule of public improvements to be accomplished over a multiyear period, usually four to six years. In the same manner as the annual operating budgetary process, the CIP is developed with a calendar, instructions and guidelines, and standardized forms. Each department submits a capital projects request, with justification and cost estimates. The governing authority assesses the requests based upon a ranking of projects submitted by the departments and, when the assessment is complete, acts on the proposed capital improvements plan.[1]

While capital budgets and CIPs are important elements of sound financial management, historically they were not widely used in Georgia counties. However, a recent survey of county officials conducted by the Georgia Department of Community Affairs (DCA) revealed that 44.7 percent of the counties surveyed prepared a capital budget in 2008, a 17 percent increase from the 27.7 percent of counties using capital budgets in 2000.[2] This finding would seem to indicate that many Georgia county officials have come to recognize the capital budget and CIP as essential policy tools for communicating the county's long-term infrastructure needs to the public.

The purpose of this chapter is to emphasize the importance of long-range capital planning to the financial future of Georgia counties, to outline the steps involved in the process of developing a capital budget and CIP, and to review financial policy issues that county commissioners need to address as they plan for the future of their county's investment in capital assets.

THE CAPITAL IMPROVEMENTS PLAN

A discussion of capital budgeting should begin by first distinguishing between the terms "capital improvements plan" and "capital budget." Typically, the CIP is a plan identifying needed capital expenditures projected for some period of time into the future. The capital budget is the first year (i.e., the most current year) of the CIP and normally is incorporated into the annual operating budget. It provides resources for specific facilities, improvements, and equipment. The relationship of the CIP and the capital budget is important. The CIP identifies the capital needs, and the capital budget indicates which capital needs will be completed in the current year's operating budget.

A CIP indicates which capital assets to purchase, construct, renovate, or repair, presented in order of priorities; the estimated cost of the capital assets; the year in which the required capital expenditures should occur; and the method that will be used to finance the cost of the capital assets. Usually a CIP will improve a county's capital asset purchase and replacement program. Benefits from developing a CIP include the following:

- *Providing for orderly comprehensive replacement of capital facilities and equipment*. The lack of a coordinated process for considering and approving capital projects can result in undisciplined, uncoordinated approval of capital projects. Such ad hoc procedures inevitably waste public resources, fail to consider available information, and sometimes result in poor project timing. Optimal results require an orderly process that considers all projects at the same time and produces a planning document that considers available financing sources and reasonable schedules for project completion.

- *Ensuring continuity*. Changes in county commissions can affect continuity. A capital improvements plan, however, will allow county personnel to continue to purchase, replace, and/or construct capital assets in an orderly manner.

- *Assisting with long-range fiscal planning*. Counties that do not engage in long-term financial planning may be unaware of how county capital needs will accumulate over future years. Consequently, they may defer needed maintenance on buildings and equipment and delay capital replacement projects in order to balance the current year's operating budget. The CIP process can help identify financial imbalances and begin the steps necessary to assure sound, long-term operations and capital financing strategies.

- *Planning and timing projects adequately*. Using a CIP can help governing authorities avoid installing capital facilities only to discover later that the facilities need to be changed or replaced. Good planning can ensure that efforts are coordinated and costly duplications avoided.

- *Enhancing the county's bond rating*. Investors and bond-rating agencies stress the value of a CIP for a county seeking to borrow funds. The absence of rational, long-term planning can prevent a county from receiving a favorable credit rating from the rating agency. A poor credit rating can result in a higher interest rate on bond issues sold by counties that do not document and disclose their long-term capital financing needs and plans.

- *Providing the county a public relations tool*. Most capital programming processes offer the public a chance to raise questions and offer opinions. Typically, this opportunity is received favorably by civic groups as an important link between county government and its constituents and as representing good business practices and management. The press also appreciates receiving background information on capital projects presented clearly in an organized document. Many county commissioners find that by providing opportunities for public input early in the capital planning process they can effectively defuse volatile opposition to specific projects later on. For example, with regard to a SPLOST referendum, having a CIP in place can help build public support and confidence in the proposed capital projects.

What has prevented more counties in Georgia from using the mechanism of capital budgets and CIPs in the past? First of all, capital items are expensive. It is not uncommon to defer certain capital costs to subsequent years in order to balance the operating budget. Because they are central players in the annual operating budget process, county commissioners sometimes find it hard to see beyond the end of the current operating budget year.

Politics may also play a role. The deferment of major capital costs to subsequent years (i.e., the decision *not* to invest in capital), while possibly a good political decision, may be a bad financial decision (i.e., the maintenance costs incurred on an asset not replaced can become excessive). It is important, then, that county commissioners recognize the significance of a capital improvements plan. The adoption of a CIP provides the opportunity for the orderly replacement of capital assets within the financial capacity of the county.

THE CIP PROCESS

The CIP process is as important as the plan itself. In other words, many observers of local government operations believe that the capital improvements plan is as much process as it is product. As with any process, there are clearly definable steps necessary for its completion. Some of the more important steps in a typical CIP process are listed and discussed here.

Step 1. Prepare a CIP Calendar

The CIP calendar is a very useful document for developing and monitoring the CIP process. Like the operating budget calendar, a CIP calendar is simply a chronological list of the tasks that need to be completed in the CIP process. The calendar may include the county personnel responsible for completing those tasks. By regularly consulting it, whoever is responsible for coordinating the capital improvements plan can determine at any point in the CIP process whether or not it is on schedule.

Step 2. Assign Staff to Coordinate the CIP

Practice and experience have shown that a centralized organization for staffing the CIP process works best. A county department or, in the case of smaller counties, a single individual (such as the county clerk or county administrator/manager) should be responsible for coordinating the entire CIP preparation process. This assignment need not include any decision-making or resource-allocating responsibilities; rather, it entails completing technical and procedural tasks. The staff of the regional commission can also be a resource in this process.

Step 3. Establish CIP Policies

The primary role of county commissioners in the CIP process is to articulate the policies that guide the process. Following are some of the CIP policy issues that county commissioners will address: What are capital projects? What is the length of the CIP? What criteria are used to prioritize capital projects? How much of the CIP is funded each year in the operating budget? For accounting purposes, how many capital project funds will be maintained?

Defining Capital Projects. Capital expenditures are different from operating expenditures primarily because of the costs and estimated useful lives associated with capital assets. Capital assets generally are more costly than current assets, and county commissioners often consider them "big ticket" items. In order for counties to classify an item as capital, its cost should be large enough to justify special attention. Generally, this cost amount is classified as a capital asset threshold. The level of the threshold depends primarily on the size of the county. In larger counties, a CIP may not include a purchase unless it costs $30,000 or more. In a large county, items costing less than the threshold may be purchased from the operating budget without causing the operating budget much stress. However, in some smaller counties, an item costing $5,000 warrants special attention and may be capital in nature. Finally, for an asset to be considered capital, it should have an extended useful life, usually at least two years. With the issuance of the Governmental Accounting Standards Board Statement 34 (commonly referred to as GASB Statement 34), many counties, along with their independent auditor, evaluated whether it would be beneficial to increase their existing dollar thresholds of what constitutes a capital asset and a capital project.

Length of the CIP. Although a CIP legitimately may encompass any number of years, the most commonly used time period is 5 years, the current year (that portion incorporated into the operating budget) plus 4 years projected into the future. Time and experience indicate that these are the most realistic and manageable periods to use. A 5-year period projected into the future provides a realistic opportunity to adequately plan and prepare for most capital needs as they arise. A period of time much longer than that has proven to be less useful as a planning tool. Cost estimates for projects to be funded 20 years in the future tend to be less accurate and therefore less useful than 5-year estimates. However, for environmental improvements, such as water and sewer systems, a CIP of 20 years may be appropriate. Anything less than 5 years generally is considered too short a time in which to recognize the need for, much less to plan and build, a major capital facility.

Although set up on a multiyear basis, a CIP should be reviewed annually. An annual review of the CIP guarantees that a regular reassessment of county capital needs will be accomplished. Additions to and deletions from the CIP may be made during this formal review process to ensure that the CIP best reflects the county's current capital needs. Even if no changes in the CIP are made, an annual review confirms that those projects in the CIP are still legitimate capital needs of the county. Each department director and constitutional officer should participate actively in the annual review process.

Establishing Criteria for Prioritizing Capital Projects. Ranking requested capital projects in order of priority is perhaps the most important and one of the more difficult tasks involved in the completion of the CIP. After the department directors and constitutional officers indicate their proposed capital items by cost and fiscal year, the total cost of all capital needs requested is determined and compared with the resources available. Unfortunately, most of the time, adequate funding is not available for all requested projects. Therefore, these capital items must be weighed and ranked to determine which will receive funding in the current year and which will be deferred to subsequent years.

Decision makers will be faced with many "apples versus oranges" kinds of decisions. For example, should the county purchase a computer for the tax assessor's office, or should the county resurface two miles of paved roads? Is it better to build a garage used to repair public works vehicles or replace a heating system in the county courthouse? At issue, then, will be which project has the highest priority. The choice is subjective; there is no objective formula available. However, in order to address these kinds of choices, a county commission needs to adopt a policy that will incorporate evaluation criteria in the priority-setting process.

Evaluation criteria can focus the county commission's judgment in a consistent, rational way. They are not intended to replace basic decision making but to provide a rational basis for deciding which projects in the CIP to fund. Ideally, the evaluation criteria policy should be established by the county commission and then be refined by the county administration before adoption. The criteria used by each county will vary, based upon each county's needs and priorities.

Examples of evaluation criteria in the CIP prioritization process could include any or all of the following:

- Mandatory project—The project will fulfill a judge's order that a county build a new facility.
- Maintenance project—The project is necessary to preserve an asset such as the county courthouse roof.
- Project improves efficiency—A new computer system could substantially reduce the amount of time spent on tax billing.
- Project provides a new service—A newly established senior citizen program requires building renovations to house it.
- Policy area project—Purchasing two passenger vans will enable the county to fulfill its policy of transporting senior citizens to obtain medical treatment.
- Extent of usage—A new walking trail that will be used by a great percentage of the county's residents could warrant higher priority than projects affecting fewer people.
- Project's expected useful life—Certain long-lasting equipment could receive a higher priority rating than shorter-lived equipment.
- Effect of project on operation and maintenance costs—A new lighting system could provide better lighting in the county courthouse at reduced electrical costs.
- Availability of state/federal grants—Some equipment could be grant funded.
- Elimination of hazards—Adding a stoplight to a county road will allow for better traffic control and reduce traffic accidents.
- Prior commitments—Only one-third of a construction contract that the county signed has been completed.

Often, numerical values are added to criteria to provide an objective evaluation. However, this priority-setting process should be considered a "first cut" with additional analysis required.

Allocating Operating Budget Resources for Capital Items. Some counties have adopted policies that indicate what percentage of the operating budget they try to allocate for capital items. The allocation does not include those resources necessary to build additional buildings or major additions or renovations to buildings, all of which normally are financed from either locally approved general obligation bonds, revenue bonds (i.e., for enterprise fund projects), or SPLOST.

To determine an applicable amount of the operating budget to allocate to capital, county commissioners should review the percentage of general fund expenditures incurred in previous years (e.g., for the last five years). As past experience is reviewed, care must be taken to ensure that unusual capital expenditures (such as large equipment purchases resulting from opening a new building) have not occurred, thereby distorting the percentages. This analysis, along with projected capital needs, should provide a basis for establishing a CIP funding policy. There is no "right answer" to how much of the operating budget should be allocated to capital because circumstances can differ in each county.

In addition to general fund resources, other types of funding are available for capital projects. Alternative funding sources include bonds, grants, SPLOST, special assessments, and leases.

Step 4. Develop Data-Gathering Forms

The perfect form to be used to gather CIP data does not exist. The purpose of CIP forms is to collect the information necessary to encourage and facilitate systematic thought and rational decision making in the CIP process. Most counties find that, in developing their capital planning efforts, it helps to keep the initial forms used during the first two or three years simple. If additional information is required, supplemental forms and ultimately revisions in subsequent years' capital documents can be added. The following elements consistently appear in most CIP forms: project name, description, and location; submitting department or office; estimated project costs, with sufficient data to support the estimate (e.g., square feet); estimated cost and financing presented by year; financing sources; and a site location map, as applicable.

Step 5. Solicit Project Requests and Proposals

Instructions from the county commission chair and/or administrator or manager that encourage realistic capital spending and prudent investment of the county's resources generally will result in responsible requests for funding. Soliciting requests for project proposals to include in the CIP might begin with a staff meeting. Usually the personnel responsible for the operating budget are also responsible for the CIP. These persons could include department directors, supervisors, and constitutional officers. During this meeting, personnel responsible for the CIP distribute the CIP forms and explain the process and timetable. Everyone receives instructions at the same time, and questions and concerns can be covered with everyone involved in the CIP process. Topics normally addressed at these meetings include general financial and long-term outlook, policies that affect operations and capital planning, current work in progress, current year's timetable, problems encountered in the previous year and how they will be addressed, explanation of forms and instructions, description of a properly completed request packet, and where to go for help.

Step 6. Evaluate Requested Projects

Who should evaluate the requested projects is an important question. In smaller counties, county commissioners might participate in this process. In other counties, a committee could be formed to review the requested projects as they relate to the established criteria. Another option is for each committee member to evaluate capital requests against one specific criterion. As mentioned earlier, the criteria usually are assigned numeric values that allow for an objective rating, and this rating process would be a first cut with necessary additional reviews.

Step 7. Develop Funding Plan

After the higher priority projects have been determined, the CIP coordinating unit described in Step 2 should evaluate the county's ability to finance requested projects. As already discussed, the amount of the operating budget allocated to capital outlay will affect the amount of capital projects that can be completed. Obviously, larger construction and renovation projects need to be funded from sources other than the operating budget.

The CIP will only be as effective as the plan for financing the proposed projects. The county's ability to finance the CIP generally depends on the level of recurring future operating expenditures, the current level of bonded indebtedness, and the county's legal debt limit. Many projects proposed in the CIP will have an ongoing impact on the county's operating budget. For example, a new facility would result in increased costs for supplies, maintenance, utilities, and personal services. Calculating the operating costs associated with capital projects is a critical step in the CIP process. Analysis of the debt structure of a county is one of the most important parts of the financial analysis of the CIP process. When determining the most appropriate method for funding a capital project, factors to consider include

- Is the financing option legally available?
- Is the financing option politically acceptable?
- Is the financing option administratively feasible?

The two major funding sources are general obligation bonds and SPLOST proceeds. In 2008, DCA reported that almost all of the state's counties (155) were using SPLOST to fund capital projects.[3] Other funding alternatives, which are quite limited, include the use of a capital lease and federal grants for capital outlay. Figure 20-1 shows a sample page from a CIP, which emphasizes cost estimation and the identification of funding alternatives.

Step 8. Provide for Public Input

Opportunities for public input can be provided at various stages of the capital programming process. At some point, the entire CIP, including its timing, could be subjected to public review. In preparing the CIP, county staff members and the county commissioners should be conscious of the need to present the CIP to the public. The following opportunities for public review and input might be considered:

- Accept public input at the outset of the process. Ask department heads, supervisors, and constitutional officers to attend a public hearing before completing their forms so that ideas from the public are incorporated into their submissions.
- Provide for public review of the proposals as submitted to the county commissioners by the county administrator/manager or other responsible CIP official. Other methods such as public hearings, government television channels, and civic group presentations could be used to solicit public input.
- Schedule public review after consideration by the county commissioners and before final adoption.

Step 9. Provide for Adoption by County Commissioners

After the capital document is presented to the county commissioners and reviewed in public, the procedures should provide for a method of adoption. Characteristically, the CIP is adopted as a planning instrument, and the capital budget is adopted separately as a specific authorization in the operating budget. Since 1998, local governments are required to adopt and operate under a project-length balanced budget for each capital projects fund in use by the government.[4]

Depending on how the CIP is integrated into the operating budget, the capital budget usually constitutes approval to proceed with procurement and other administrative actions necessary to implement the first year of the capital program.[5]

Figure 20-1. *CIP Example*

GWINNETT COUNTY, GEORGIA
CAPITAL IMPROVEMENT PROGRAM (modified)

PROJECT: Gwinnett Environmental and Heritage Center – F-0498

DEPARTMENT: Community Services

DESCRIPTION: The Environmental and Heritage Center will incorporate a facility for environmental education, with hands-on exhibits, teaching labs, and classrooms. The site will also provide passive recreational activities such as trails. Phase I completion includes a unique playground adjacent to the building.

JUSTIFICATION: The facility is needed to maximize classroom and family educational efforts on water resources and management, our natural environment, such as animal and plant life, and to provide a trail system that exposes visitors to historical and natural features such as wetlands.

O & M IMPACT: O & M is estimated to be $750,000–$1,000,000 per year. Facility will require full-time and part-time staffing as well as contractual services.

Financing Method	Prior Years	2008	2009	2010	2011	2012	2013	Totals
SPLOST	21,779	1,000						22,779
IR–Dividend[1]	1,795							1,795
Trans In-Stormwater	25	25	25	25	25	25	25	175
Contrib–Private Source	122							122
Other-Misc.	31							31
Totals	23,752	1,025	25	25	25	25	25	24,902
Project Cost								
Construction	12,737							12,737
Land	3,817	1,000						4,817
Equipment/Furnishings	3,816	25	25	25	25	25	25	3,966
Professional Services	3,380							3,380
50,000,000[2]	1							1
Totals	23,751	1,025	25	25	25	25	25	24,901

[1] Interest revenue/dividend.

[2] Represents spending from prior year.

Source: Randy Colvin, Gwinnett County, Financial Services.
Note: Numbers are in thousands of dollars.

NOTES

1. For a detailed discussion of the selection and evaluation of capital projects, see J. Richard Aronson and Eli Schwartz, "Capital Budgeting," in *Management Policies in Local Government Finance*, ed. J. Richard Aronson and Eli Schwartz (Washington, DC: International City/County Management Association, 1987), 400–421.
2. Georgia Department of Community Affairs, *2009 Government Management Indicators Survey* (Atlanta: DCA, 2009).
3. Ibid.
4. Official Code of Georgia Annotated (O.C.G.A.) §36-81-3(b)(2). For a brief summary of this provision, see Paul T. Hardy, Betty J. Hudson, Myra Byrd, Richard W. Campbell, and Paul E. Glick, *Compliance Auditing in Georgia Counties and Municipalities: A Practical Guide to State Laws for Auditors and Local Government Officials* (Athens: Carl Vinson Institute of Government, University of Georgia, 2010), 79–80.
5. For a more detailed description of capital budgeting, see "Planning and Budgeting for Capital Improvements," in *Budgeting: A Guide for Local Governments*, ed. Robert L. Bland and Irene S. Rubin (Washington DC: International City/County Management Association, 1997), 167–95.