

FINANCIAL MANAGEMENT FOR GEORGIA LOCAL UNITS OF ADMINISTRATION

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NATURE AND PURPOSE

A capital improvement program (CIP) is a multi-year planning instrument used by local units of administration (LUAs) to identify needed capital projects and to coordinate financing and timing improvements in a way that maximizes the return to the public. A CIP is a plan indicating:

- Which capital assets to purchase, construct, renovate or repair, presented in priority order.
- The estimated cost of each project.
- Planned length of project.
- The planned year in which the project would begin.
- The financing method to fund the expenditures.

Because capital assets are expensive, often they are deleted from budget requests in order to balance the budget. These capital expenditures are deferred to subsequent years' budgets or funded with the Special Purpose Local Option Sales Tax. School board members typically focus on the annual budget. If a capital improvement plan is not developed, school board members will not have the information needed to consider long-term budgetary needs and to plan for renewal and replacement of capital assets. Fortunately, in Georgia, LUAs are required to develop and submit to the Georgia Department of Education (DOE) a "Local Facilities Plan." This plan includes the LUA's facility requirements for the subsequent five years. A CIP along with this facilities plan will improve a LUA's capital asset purchase and replacement program.

Benefits of a CIP

- Provides an orderly comprehensive replacement of capital facilities and equipment – A CIP plan will provide a listing of all projects anticipated for completion so coordination and proper planning can occur. The listing will include available financing and time frames for completion. Since all projects are included in one document, it is easier to coordinate the time at which each project should be completed.
- Ensures continuity of planned projects – School board members may change because of expiring terms. A CIP will allow projects to continue through this transition period and allow new board members to evaluate priorities set by the previous board in making future decisions.
- Assists with long-range fiscal planning – A CIP will assist LUAs in preparing long-term financial plans that include capital financing requirements for future years. The CIP should be considered in allocating annual resources to ensure needed maintenance and replacement occurs when needed.
- Provides adequate project planning and timing – The CIP will assist LUA's in coordinating multiple projects thereby avoiding costly duplications and potential mistakes.
- Enhances the LUA's bond rating – Investors and bond rating agencies stress the value of a CIP for a LUA seeking to borrow funds. The absence of rational, long-term planning can weigh heavily against the credit rating issued by the rating agency. The result can be a higher interest rate on bond issues sold by LUAs.
- Provides the LUA a public relations tool – Most capital improvement planning processes include opportunities for public input. Typically, such exposure is received favorably by civic groups, who view the process as an important link between LUAs and their constituencies. The press particularly appreciates opportunities to receive background information in an orderly fashion. Many school board members find that by providing opportunities for public input early in the capital planning process, they can minimize later opposition to specific projects.

This chapter provides an overview of how a LUA can develop a CIP.

DEVELOPING CIP FINANCIAL POLICIES

The first step in developing a CIP is for the school board to adopt a capital improvement policy. The policy should include the following -

- Definition of a capital project
- Length of a CIP
- Criteria to prioritize the capital projects
- CIP funding each year

Defining Capital Projects

Capital expenditures are different from operating expenditures due to their estimated useful lives and cost.

Estimated Useful Life. According to Governmental Accounting Standards Board Statement 34, an asset must have a useful life of at least one year to be considered a capital asset. The Governmental Finance Officers Association (GFOA) has recommended a minimum two year life to be considered capital.

Cost. An LUA should set a threshold above which the purchase of an asset will be considered capital. The level of the threshold depends primarily on the size of the LUA. In larger LUAs, a CIP may not include a purchase unless it costs \$10,000 or more. In addition, the threshold may vary depending on the category of asset purchased. For example, an LUA may indicate buildings greater than \$50,000 be considered capital assets. GFOA recommended and GADOE required practice is a minimum threshold of \$5,000.

A sample LUA's policy defining capital assets follows:

"For the capital improvement program, all land, land improvements and building projects costing \$5,000 or more are classified as capital assets."

Length of the CIP

Before discussing the length of a CIP, the terms "capital improvement program" and "capital budget" must be defined. The CIP typically is a plan for 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, which provides the resources for the 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 the capital projects that will be completed in the current year's budget.

Upon school board approval, those capital projects or costs in the first year of the CIP typically become the capital portion of the operating budget for the next year. While the CIP is the plan for future capital assets, the capital budget is the current year's expenditures for capital outlay authorized in the operating budget. The capital budget comes forward from the CIP and is approved by the school board as part of the operating budget. The resources appropriated for these capital outlays appear in the capital outlay section of the operating budget.

Although a CIP legitimately may include any number of years, the most commonly used time period for a CIP is six years, the current year (i.e., that portion incorporated into the capital budget) plus five years projected into the future. Experience has shown that this is the most realistic and manageable time period to use. Five years projected into the future gives a realistic opportunity to adequately plan and prepare for most capital needs as they arise. A

period of time much longer than six years (there are some capital improvements plans as many as 20 years into the future) has proven to be less valid and useful as a planning tool.

Cost estimates for a project to be funded 20 years in the future most likely be less accurate and therefore less useful than an estimate of cost for a project to be funded in five years.

A period of time much shorter than the suggested five years would tend to negate many of the advantages of having a CIP. For example, two or three years could be too short a time period to recognize the need for, much less plan and build, a major capital facility. Often, the planning and design phase of such a project is two or three years in itself.

An annual review of the CIP guarantees that a regular re-assessment of LUA capital needs will be accomplished. Additions to and deletions from the CIP may be made during this formal review process to insure that the CIP best reflects the LUA's current capital needs. Even if no changes in the CIP are made, annual review at least confirms that those items in the CIP are still legitimate capital needs of the LUA. Each department director, supervisor and school principal should participate actively in the review process. Usually, a simple update of capital needs is made.

A sample financial policy defining the length of the CIP follows:

"A capital improvement program (CIP) will be developed for a period of six years. As resources are available, the most current year of the CIP will be incorporated into the current year's operating budget. The CIP will be reviewed and updated annually."

Establishing Criteria for Prioritizing Capital Projects

The prioritization of requested capital projects is one of the more difficult tasks a LUA has in relation to the completion of the CIP. After the department directors, supervisors and school principals indicate their capital needs by cost and fiscal year, the total cost is determined and it is compared to the resources available. As part of this process, consideration should be given to the impact of the capital project on the operating budget, including additional positions required.

Unfortunately, most of the time adequate funding is not available for all requested projects. Therefore, the requested capital items must be prioritized to determine which receive funding in the current year and which are deferred to subsequent years.

Decision makers will be faced with many "apples versus oranges" kinds of decisions. For example, should the LUA purchase a computer for the instructional program or should the LUA blacktop the playgrounds at three elementary schools? Is it better to build a central warehouse to store school supplies and food or replace a heating system in the high school? The issue is, which project has the highest priority? The choice is subjective and there is no objective formula available. When faced with these kinds of choices, the LUA's school board should adopt a policy for evaluating and making those choices. The policy should address evaluation criteria in the priority setting process.

Evaluation criteria are intended to focus the school board's judgment in a consistent, rational way. They are not intended to replace basic decision-making; rather, the intent is to provide a consistent, rational basis for deciding which projects to fund.

The issue of who develops the evaluation criteria is not clear. Ideally, the criteria policy should be established by the school board. This criteria then can be refined by the LUA's administration. The criteria used by each LUA will vary based upon each LUA's needs.

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

- Mandatory project (e.g., an additional school building must be built as a result of litigation)
- Security issues
- Maintenance project (e.g., a project that is necessary to preserve an asset)
- Project improves efficiency (e.g., a new printer which saves 50% of the operator's time)
- Project provides a new service (e.g., building renovations for an after-school program)
- Policy area project (e.g., an LUA's policy is to transport all pupils, regardless of distance to their schools - thus a purchase of two busses will enable the LUA to meet this policy)
- Extent of usage (e.g., so all students in a school building can use a specific piece of equipment)
- Project's expected useful life (e.g., if the equipment lasts longer, it could receive a higher priority)
- Effect of project on operation and maintenance costs (e.g., a new lighting system might provide better lighting at reduced electric costs)
- Availability of state/federal grants (e.g., some equipment might be grant funded)
- Elimination of hazards (e.g., add sidewalks on school grounds to provide a safe-way for students)
- Facility use (e.g., a new building will be used by citizens and students)
- Prior commitments (e.g., if the LUA has signed a construction contract and only one-third of the contract is complete)

Often, a numerical point system is used to determine which project receives the higher priority.

A sample project evaluation criteria policy follows:

"Projects and/or capital asset purchases will receive a higher priority if they meet some or most of the following criteria:

- Mandatory project
- Security issues
- Maintenance project
- Project improves efficiency
- Project provides a new service
- Policy area project
- Extent of usage
- Project's expected useful life
- Effect of project on operation and maintenance costs
- Availability of state/federal grants
- Availability of local funds
- Elimination of hazards
- Facility use
- Prior commitments"

Allocating Resources to the Capital Budget

Some school boards have adopted policies which specify what percentage of the operating budget to allocate for capital assets. The allocation does not include those resources necessary to build additional school buildings or major additions or renovations to buildings, all of which normally are financed from resources available both from the State of Georgia, locally approved general obligation bonds, and special purpose local option sales tax.

To determine an applicable amount to allocate to a capital budget, review the percentage of general fund expenditures that have been incurred in prior years (e.g., for the last five years). As prior experience is reviewed, care must be taken to insure that unusual capital

expenditures (e.g., large increases in student enrollment or the purchase of equipment for a new building which was opened) have not occurred, thereby distorting the percentages.

There is no "right answer" to how much of the budget should be allocated to the purchase of capital assets because in each LUA circumstances can differ. A sample capital budget allocation policy follows:

"The school board will attempt to allocate approximately 8% of their annual general fund budget for additional and replacement capital assets."

In addition, the school board could specify a portion of the millage rate be dedicated to construction in order to accumulate necessary funds.

DEVELOPING A CIP

Some contend that the CIP is as much a process as a product and with any process, there are several steps necessary. The most important steps in a typical CIP process are listed and discussed below.

1. An activity calendar should be prepared listing the required activities, the personnel responsible and dates to complete the activities. Included in this step should be communication to the citizens and press that a plan is being established.
2. Assign responsibility to LUA personnel.
3. Establish CIP policy.
4. Develop data gathering forms.
5. Establish criteria to prioritize projects.
6. Solicit project requests and proposals from departments and schools.
7. Evaluate and prioritize projects and capital assets requested from departments and schools.
8. Develop funding plan.
9. Solicit public input.
10. School board adoption.

Step 1 - Prepare a CIP Calendar

A very useful document to develop and monitor the CIP process is a CIP calendar. A CIP calendar is simply a chronological listing of the tasks which need to be completed in the CIP process. The calendar should include LUA personnel responsible for completing those tasks. At any point in the CIP process, the CIP coordinator can determine whether or not the process is on schedule.

As most LUA administrators realize, laxity by any participant during the process tends to create subsequent problems. For example, if some school principals are late in submitting their capital requests, it can become progressively more difficult to complete the other steps in the process. Accordingly, many LUA administrators refuse to honor requests for consideration that are not submitted within the required time frame.

The easiest way to develop a CIP preparation timetable is to begin with the end of the process and work backwards. Thus, after the date for school board adoption is selected, then the time necessary for public hearings is calculated, and finally, a date is selected for the beginning of public hearings. Continuing backwards, the school board might need two or three weeks to receive and study the CIP document; before this step, the LUA superintendent might be allowed two months to review internally generated materials, arrive at a balance and prepare the document. Before this step, hearings might be held at the department and school level and so on.

Step 2 - Assign Staff to Project

Practice and experience have proven that a centralized organization for staffing the CIP process works best. That is, one single unit of the LUA (e.g., or in the case of smaller LUAs, a single individual such as the LUA superintendent), should have the responsibility for coordinating the entire CIP preparation process. It should be remembered that this assignment need not include any decision-making or resource-allocating responsibilities; rather, there are technical and procedural tasks that need to be completed.

Step 3 - Establish CIP Policy

As we discussed above, the school board should adopt CIP policies covering a variety of issues. In addition, these policies should be reviewed annually or as new school board members take office to ensure that the policies are consistent with the views of the current school board.

Step 4 - Develop Data Gathering Forms

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 LUAs find that in developing their capital planning efforts, initial forms used during the first two or three years should be simple. If additional information is required, these needs

can be met through supplemental forms, and ultimately by revision in subsequent years' capital documents.

Experience has proven that the following elements consistently appear in most CIP forms and therefore merit consideration by the LUA in deciding which data to include on the forms:

- Project name, description and location
- Submitting department or school
- Estimated project costs, with sufficient data to support the estimate (e.g., linear feet, square feet, etc.)
- Estimated cost and financing presented by year
- Financing sources should be identified
- A site location map (as applicable)

Step 5 - Establish Criteria to Prioritize Projects

As we discussed earlier, the school board should establish the criteria necessary to evaluate the requested projects.

Step 6 - Solicit Project Requests and Proposals

The solicitation of requests for project proposals for inclusion in the CIP might begin with a staff meeting. Often the personnel responsible for the operating budget are the same personnel that are responsible for the CIP. These personnel could include department directors, supervisors and school principals. During this meeting, the personnel responsible for the CIP distribute the CIP forms and explain the process and the timetable. At this meeting, everyone can receive instructions at the same time and questions and concerns can be covered with everyone involved in the CIP process.

Instructions from the LUA superintendent which encourage realistic capital spending and prudent investment of the LUA's resources likely will encourage responsible requests for funding. Some of the topics which could be addressed at such a meeting could include the following:

- General financial and long-term outlook
- Policies that affect operations and capital planning
- Current work-in-progress
- This year's timetable

- Problems encountered last year and how they will be addressed
- Explanation of forms and instructions
- Description of a properly completed request packet
- Where to go for help

Step 7 - Evaluate Requested Projects

One of the first issues is to determine who should evaluate the requested projects. In some smaller LUAs, the school board might participate in this project. In other LUAs, a committee could be formed to review each of the requested projects as they relate to the established criteria. Finally in other LUAs, each committee member will take one of the criteria and evaluate capital requests only against that criteria.

Usually the criteria are assigned numeric values which allow for an objective rating. Obviously, this rating process would be a "first cut" and additional reviews might be necessary.

Step 8 - Develop Funding Plan

After the higher priority projects have been determined, the CIP coordinating unit should evaluate the LUA's ability to finance requested projects.

The CIP only will be effective as the plan for financing the proposed projects. The LUA's ability to finance a CIP generally depends on the level of recurring future operating expenditures, the current level of bonded indebtedness, and the LUA's legal debt limit. In addition, a Special Local Option Sales Tax (SPLOST) can be placed on a referendum for the purpose of constructing new schools. The length of the tax cannot exceed five years. The rate cannot exceed one percent.

If voters approve the referendum, the SPLOST revenues may be used for the following –

- Specific capital improvements for educational purposes, and/or
- Retirement of general obligation bonded debt previously incurred with respect only to capital outlay projects and /or
- Issuance of new general obligation bonds for specific capital outlay projects to be paid with SPLOST.

Many projects proposed in the CIP will have an on-going impact on the LUA's operating budget. As discussed above, the amount of the operating budget allocated to capital assets 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.

Analysis of the debt structure of a government is one of the most important parts of a financial analysis in a CIP process. The most obvious major funding source is that of general obligation bonds. In addition, developing a program with capital outlay funding from the DOE is an appropriate vehicle to finance major portions of the CIP.

Step 9 - 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. LUA staff members and the school board should pay special attention to the documentation and presentation needs of 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 school principals to attend a public hearing before completing their forms so that ideas from the public are incorporated in their submissions.
- Provide for public review of the proposals as submitted to the school board by the LUA superintendent or other responsible CIP official.
- Schedule public review after school board consideration and before final adoption.

Step 10 - School Board Adoption

After the CIP is presented to the school board and reviewed in public, the procedures should provide for a method of adoption. Characteristically, the multi-year CIPs are adopted as planning instruments, and the capital budget is adopted separately as a specific authorization as part of the operating budget. Depending on how the CIP is integrated within the operating budget, the capital budget usually constitutes approval to proceed in procurement and other administrative actions necessary to implement the first year of the capital program.

FUNDING ALTERNATIVES FOR CIP PROJECTS

There are many financing alternatives available to LUAs to finance CIP projects. Some of the most common are highlighted below.

Pay-As-You-Go

Under the pay-as-you-go method of financing, capital projects are financed with current revenues. The LUA elects to pay cash for the capital project instead of borrowing against future revenues. The amount available to spend under the pay-as-you-go method is the amount of the operating or capital estimated revenue that can be set aside each year for capital improvements. For SPLOST projects, the budget will be based on the projected sales tax revenues. This method works well where capital needs are relatively small and constant and no major construction renovations or additions are included in the SPLOST referendum or requested through the State.

Some of the advantages of pay-as-you-go financing are:

- Pay-as-you-go financing saves interest costs. On long term bonds, the LUA can pay back two dollars or more for every dollar borrowed over the life of the bonds.
- Capacity to borrow is protected. Borrowing capacity is "saved" for larger capital items which would be beyond the capacity of a single year's capability.
- By avoiding bond issues, considerable costs associated with bond issues are avoided.

Some of the practical and theoretical disadvantages of pay-as-you-go financing are:

- Since inflation is driving construction costs steadily upward, it could be less costly to borrow and pay at present price levels than to wait and accumulate sufficient funds for the project and pay a greater amount at a later date.
- In a LUA where capital projects are undertaken on an infrequent basis, the pay-as-you-go approach may place a heavy cash flow burden on the project year(s) by creating uneven, fluctuating expenditure patterns. These patterns could be avoided with long term debt financing and its traditional level debt service payments.
- Theoretically, an asset which has a long useful life (e.g., a school building) is best paid for by the users of that asset over its expected useful life.

Pay-as-you-go financing places a premium on advance planning. The CIP requires not only careful scheduling of capital improvements, but it also requires prudent matching of financing in order to optimize resource availability.

General Obligation Bonds

One of the major alternatives to pay-as-you-go financing is to borrow the money to finance the project. A common form of LUA borrowing to finance capital projects is to issue general obligation bonds.

A general obligation (G.O.) bond is a full faith and credit obligation of the issuing LUA (i.e., the full taxing power of the LUA guarantees this debt). The source of repayment for G.O. bonded debt is a portion of the millage rate earmarked for this repayment. This collateral (i.e., the full faith and credit of the LUA) results in greater security and stability for G.O. bonds. G.O. bonds normally result in the lowest interest rates available.

In order for a LUA to issue this type of debt, there must be a referendum, or vote, in which a majority of the voters must approve the bond issue. The disadvantage to this type of financing is that many voters are hesitant to vote themselves a tax increase.

Lease-Purchase

Much has been written recently about the many alternatives available to LUAs in the leasing area. Recent changes in Georgia law have removed some of the constraints under which Georgia LUAs have operated in recent years with respect to lease financing.

In Georgia, LUAs may enter into lease-purchase agreements which at the end of the lease-term, the leased capital assets become property of the LUA. The Georgia School Boards Association, Inc. sponsors a "Direct Lease Financing Program."

The LUA, in considering this alternative, should satisfy itself that their cash flow will be sufficient to make the agreed lease payments over the term of the lease. This can be accomplished by ensuring there is sufficient capacity between the current millage rate versus the maximum. The lease payments become a binding obligation on the LUA. By using this alternative, and not issuing bonds, bonding capacity is "saved" for other capital projects.

State and Federal Grants

The possibility of obtaining state/or federal assistance in funding capital projects should be explored thoroughly. Since most state and federal grants require a LUA to match the grant funds or pay a portion of the project, care should be exercised in the acceptance and use of federal and state grant funds. As discussed earlier in this chapter, the capital outlay grants provided by the DOE are the most feasible alternative because the LUA has to fund a small percentage of the project cost.

Special Purpose Local Option Sales Tax

The Georgia Constitution, Article VIII, Section VI, Paragraph IV states the following.

- a) "The board of education of each school district in a county in which no independent school district is located may by resolution and the board of education of each county school district and the board of education of each independent school district located within such county may by concurrent resolutions impose, levy, and collect a sales and use tax for educational purposes of such school districts conditioned upon approval by a majority of the qualified voters residing within the limits of the local taxing jurisdiction voting in a referendum thereon. This tax shall be at the rate of 1 percent and shall be imposed for a period of time not to exceed five years, but in all other respects, except as otherwise provided in this Paragraph, shall correspond to and be levied in the same manner as the tax provided for by Article 3 of Chapter 8 of Title 48 of the Official Code of Georgia Annotated, relating to the special county 1 percent sales and use tax, as now or hereafter amended. Proceedings for the reimposition of such tax shall be in the same manner as proceedings for the initial imposition of the tax, but the newly authorized tax shall not be imposed until the expiration of the tax then in effect.

- b) The purpose or purposes for which the proceeds of the tax are to be used and may be expended include:
- 1) Capital outlay projects for educational purposes;
 - 2) The retirement of previously incurred general obligation debt with respect only to capital outlay projects of the school system; provided, however, that the tax authorized under this Paragraph shall only be expended for the purpose authorized under this subparagraph (b)(2) if all ad valorem property taxes levied or scheduled to be levied prior to the maturity of any such then outstanding general obligation debt to be retired by the proceeds of the tax imposed under this Paragraph shall be reduced by a total amount equal to the total amount of proceeds of the tax imposed under this Paragraph to be applied to retire such bonded indebtedness. In the event of failure to comply with the requirements of this subparagraph (b)(2), as certified by the Department of Revenue, no further funds shall be expended under this subparagraph (b)(2) by such county or independent board of education and all such funds shall be maintained in a separate, restricted account and held solely for the expenditure for future capital outlay projects for educational purposes; or
 - 3) A combination of the foregoing.”

Most school districts utilize the SPLOST tax to fund the majority of the capital improvements.

Other Considerations

Once capital projects are underway, it is important to provide all staff involved with periodic reports of progress. The reports should include actual to budget comparisons for expenditures, the percentage of the project completed, explanations for any changes in scope, and concerns regarding timing of completions.

When budgeting, consideration should be given to possible cost overruns and proposed means of financing. Often this is addressed by including additional reserves in the project budget.

SUMMARY

Proper planning is essential for the acquisition, construction, or replacement of capital assets. All levels of personnel should be included in the process from the school board, administration, and school principals. Planning includes evaluating potential projects using established criteria to prioritize timing. Financing of the projects should consider whether grant revenue or tax revenues will be used or if issuing bonds is the best alternative. Once the capital projects listing has been approved, periodic reports of progress are essential for everyone involved.