

## Town of Nantucket

### Capital Planning Process

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#### I. Purpose/Objectives of Capital Planning Process

The capital planning process is employed by a town/public entity to a) identify and prioritize capital asset expenditures, b) match the list of prioritized projects with the town's long term ability to finance their acquisition, operation and maintenance, and c) manage over time those priorities and the town's financial targets in light of changing circumstances and unexpected events.

##### ***Objectives:***

- To establish explicit *policies* and *procedures* regarding capital improvements and acquisitions.
  - Policies define what constitutes a capital improvement project, how such projects are to be evaluated and prioritized, and how they are to be financed so as to maintain targeted financial ratios and bond ratings over time.
  - Procedures set out the annual budgeting and review process for the Capital Program Committee and Town Departments.
- To monitor the Town's *financial targets and measures* for the capital planning and budgeting process:
  - Maintaining or improving the Town's current bond ratings
  - Minimum and/or maximum percentages of sources of funds to be devoted to capital spending projects
  - Guidelines for debt service as a percentage of the tax levy and/or the Town's balance delete and/or the Town's balance sheet
  - Other measures that might help Town Administration (Admin), The Board of Selectmen (BOS), the Finance Committee (FinCom) and the voters understand and manage the size and impact of capital decisions on Town finances.
- To define the role of the Capital Program Committee.

## **II. Role of the Capital Program Committee (CapCom)**

CapCom's role is to monitor and facilitate adherence to established policies. To fulfill this role, CapCom formulates a long-term (up to 10-year) strategic vision to help guide investment in infrastructure, facilities, and equipment. CapCom takes responsibility for reviewing and refining that strategic vision annually with Town Administration.

CapCom will formulate and recommend a schedule for the expenditure of Town funds for major public capital improvements over the ten-year period, aimed at scheduling essential capital improvements in an orderly way and consistent with the Town's priorities and its financial capability.

Each year, CapCom will refine and then apply its strategic vision to update the Capital Improvement Plan. The update will include recommended priorities for the coming fiscal year and for phased multi-year improvements spanning future fiscal years.

CapCom will accomplish the above by undertaking a well-timed process for obtaining necessary inputs, evaluating and prioritizing projects under consideration, and formulating recommendations for the following fiscal year and for long-term (five- and ten-year) phased capital plans.

## **III. Relevant Definitions**

**Operating budget items** are expenditures that (in general) relate to a single accounting period –i.e. where the assets/materials purchased are “used” or “consumed” within a year. Examples: paper, fuel, salaries and personnel expenses, utility costs, smaller expenditures for operational purposes, etc.

**Capital projects** are larger expenditures where the asset or services purchased has a multi-year useful life to the Town. Examples: buildings, significant renovations or expansion of real property, vehicles, computers, studies of certain types, etc.

A **Capital Asset** is one that (1) has an expected useful life of at least five years, and (2) either has a unit cost of at least \$50,000 or is part of an overall quantity purchase of essentially identical units that totals at least \$50,000.

A **Capital Improvement** is an improvement to a capital asset that may reasonably be expected to either (1) adapt the capital asset to a different use or (2) appreciably lengthen the useful life of the capital asset beyond what may be expected with normal maintenance. Examples are new electric wiring, a new roof or floor, new plumbing, or lighting improvements. Maintenance expenditures where the size of the project meets the policy threshold and where the life of the capital asset is enhanced are

considered capital budget items.

A planned expenditure is included in the capital budget only when it is (1) for a capital improvement or (2) for the purchase or lease of a capital asset or (3) for plans or studies in preparation for (1) or (2).

#### **IV. Sources of Funding**

##### **Town Budget**

CapCom recognizes these sources of funding:

- “Cash” refers to those expenditures that are paid for entirely in the next FY directly from the general fund revenues.
- “Free Cash” is the term used for funds that are available for appropriation. It is generated when actual revenue collections are in excess of estimates, when expenditures are less than appropriations, or both. Free Cash can be a source of funding for capital projects when it is available to be allocated, after certification by the Commonwealth as of July 1 of each fiscal year.
- Borrowing or “Bonds” refers to those expenditures that are financed through borrowing and which therefore obligate the Town to make future payments (“debt service”) over an extended period of time.
- “Other” refers to those expenditures that are financed from sources that do not arise directly from the Town’s tax levy. Such sources may be state and federal grants, user fees, private donations, trust funds, and other non-tax sources.
- Overrides, if approved, are another source for capital expenditures.
- If a Capital Reserve Fund is established by the town supported by excess Free Cash not required each year, it could help finance future capital expenditures and avoid large spikes in borrowing in any one future year.

##### **School Budget**

Same as Town budget except no there is no separate Reserve Fund.

##### **Enterprise Funds**

Enterprise Funds draw on these same sources of funding. However, all moneys for direct purchases and debt service must come from the enterprise fund’s revenue. Some enterprise funds are partially subsidized by the General Fund of the Town.

## **V. The Annual Capital Planning Process**

The annual process begins in July with a letter from the Town Manager to departments outlining the information required on the forms to be filled out and the time frames required.

Departments then submit their project requests to Town Administration. The requests should cover the next ten-year period. Emphasis should be placed on the next five years, with the first year potentially being presented to the next Annual Town Meeting or Special Town Meeting for approval, and the last five years being large projects which the department heads expect to be needed in the long term capital plan.

The requests are then reviewed by the Town Manager and the BOS, and submitted to the CapCom. The requests should include the estimated number of years to pay back this expenditure. This process will normally occur between August and October.

Subsequently, each Department reviews the need and justification for each of their projects with the CapCom in October-November.

CapCom then prioritizes the capital projects, includes any estimated debt finance costs, and prepares a report for the FinCom's review in December-January. The Fin Com then assembles the capital projects and debt payments with the operating budgets and prepares the Town budget in January-February, items of which are presented to and voted at the ATM.

## **VI. Prioritizing Capital Projects**

CapCom reviews requests for capital plan funding that meet several criteria. Successful capital planning facilitates postponing some capital expenditures in favor of others as part of the planning process. CapCom has adopted the following guidelines for prioritizing capital projects, with examples listed in parentheses. The guidelines themselves are not listed in priority order:

- Imminent threat to health and safety of citizens, employees or property (police cruisers and communications equipment, breathing apparatus for fire-fighters, building and road repairs, etc.)
- Maintenance and improvement of capital assets (major repairs of buildings, replacement of vehicles and equipment, park and play area renovations, marine facilities)
- Requirement of state or federal law
- Improvement of the infrastructure (streets, sidewalks, bike paths, water and sewer systems)
- Improvement/maintenance of productivity (equipment replacement, computer hardware/software)

- Improvement of an overburdened situation (Government or School classroom facilities)
- Newly identified need (recreation fields, bike paths)
- Priority assigned by Department (High, Medium, Low),
- Consistency with and in furtherance of long term capital planning objectives of the Town (Master Plans, Open Space and Recreation Plan, Energy Plan, Historic Preservation, Disability Access Plan)
- Fiscal impact of the proposed project and Town's ability to finance it
- Cost savings for the Town (Hummock Pond Bike Path)
- Operating efficiencies
- Revenue generation (Children's Beach facility)
- Community benefit (new park, bowling alley)

## **VII. Integrating Debt Service in Capital Planning**

Any capital project should be evaluated on its total cost to the Town over its useful life. This should include design and planning costs, operating and maintenance costs, disposal costs, and financing costs.

Debt is issued on behalf of Enterprise Funds, but those Funds are expected to cover 100% of their debt service. In some special instances (e.g. major infrastructure projects) the debt of Enterprise Funds may be borne, in part, by the General Fund. Some Enterprise Funds are partially subsidized by the Town.

It will be the policy of the CapCom to recognize all projected future debt service as an explicit element of the Capital Improvements Program and to evaluate anticipated future debt service levels against the Financial Metrics in VII.

## **VIII. Financial Metrics**

Prudent capital planning matches a list of desired capital projects with the Town's ability to finance those projects while maintaining a stable and prudent financial position. Through careful planning and scheduling, municipalities seek to avoid "surprises" in large capital commitments, minimizing any adverse affects on town budgets and financial flexibility.

In reviewing the capital planning programs of other Massachusetts towns, CapCom has observed a wide range of financial metrics and policy options. At this stage of the Town's capital program, the metrics are:

- To maintain or improve the Town's AA3 bond rating. Any fiscal year's capital expenditures must be financed from available current revenue sources and net new borrowing that does not negatively affect the bond rating.
- Minimize, as much as possible, overrides to Prop 2 ½.

- A minimum amount equivalent to 1% of the prior year's net revenue is allocated to capital improvements.
- Free Cash may be used to finance capital projects when available.
- Debt Service:
  - Annual debt service expenses shall not exceed 12% of the General Fund budget (excluding enterprise funds, except for those already using general funds for specific projects).
  - Debt financing shall be reserved for capital projects and expenditures of \$100,000 or more, or have anticipated 5 year or more useful life spans, or are expected to prolong the useful life of a capital asset by five years or more.
  - Bond maturities shall not exceed the anticipated useful life of the capital project being financed.