

CAPITAL IMPROVEMENT PLANNING GUIDE

DEVELOPING A COMPREHENSIVE COMMUNITY PROGRAM

AUGUST 2016



DLS

DIVISION OF LOCAL SERVICES
MA DEPARTMENT OF REVENUE

PREPARED BY:

DLS | Technical Assistance Bureau
100 Cambridge Street, Boston, MA 02114
www.mass.gov/dls

INTRODUCTION

The Technical Assistance Bureau prepared this guide to assist Massachusetts municipalities in carrying out their responsibilities in planning, financing, and implementing capital improvements. It outlines the ten steps needed to establish a comprehensive capital improvement program (CIP) and includes an appendix with a sample bylaw, policies, and calendar helpful for implementing a CIP. Although the language in this guide is oriented to town governments, the information and forms presented can be readily modified for cities as well. The guidelines provide a framework to enable any municipality to make planned decisions about the construction and maintenance of its infrastructure and equipment. We encourage municipalities to tailor the CIP outline and procedural forms to fit local circumstances, such as organizational structure, budget timetable, or bylaw/charter authority.

WHAT IS A CAPITAL IMPROVEMENT PROGRAM?

A capital improvement program provides a blueprint for planning a community's capital expenditures and is one of the most important responsibilities of local government officials. It coordinates community planning, financial capacity, and physical development.

A CIP is composed of two parts—a capital program and a capital budget. The capital program is a community planning and fiscal management tool that spans five to ten years. The capital program identifies capital items, which are typically defined as tangible assets or projects that cost more than a certain threshold (e.g., \$25,000) and that have a minimal useful life span (such as five years), provides a planning schedule, and offers financing options. The capital budget is the upcoming year's spending plan for capital items that is presented to the legislative body for approval.

Developing a CIP that will ensure sound fiscal and capital planning requires effective leadership and the cooperation of municipal departments. For this reason, responsibility for overseeing the CIP process should rest with a community's chief executive, the board of selectmen. If a town employs a town administrator or a similarly empowered administrative officer, that person could be assigned the duty to coordinate the CIP, in conjunction with a CIP committee as a local option. The role of a CIP committee is to objectively analyze capital proposals and make recommendations to the selectmen on the annual capital budget and the ongoing capital program.

A complete, properly developed CIP has the following benefits:

- Facilitates coordination between capital needs and operating budgets
- Enhances the community's credit rating and control of its tax rate
- Deters sudden changes in debt service requirements
- Identifies the most economical means to finance capital projects
- Increases opportunities for obtaining federal and state aid
- Relates public facilities to public and private development plans
- Focuses attention on community objectives and fiscal capacity
- Keeps the public informed about future needs and projects
- Reduces costs by identifying and consolidating duplicative expenditures across municipal departments
- Encourages careful project planning and design to avoid costly mistakes and to help a community reach desired goals

The Technical Assistance Bureau also created a *Capital Improvement Planning Manual* with forms and instructions that municipalities can use to put an annual CIP program into practice. This manual and the associated worksheets referenced within this report are available through the following [link](#).

IMPLEMENTING A CAPITAL IMPROVEMENT PROGRAM

Step One Adopt a CIP Bylaw, Appoint a CIP Committee, and Set a Timetable

Towns that lack a town administrator, in particular, should consider establishing a CIP committee to provide a dedicated, advisory resource for overseeing its capital program. To create and empower a CIP committee requires the town to adopt a bylaw at annual town meeting ([M.G.L. c. 41, §106B](#)). The board of selectmen may also want to consider adopting formal policies to guide the town's capital planning process and debt management.

Each year, the CIP committee should create a timetable to give to all local officials involved in the CIP process, including all department heads and board chairs. Working backwards from the annual town meeting date, the calendar should specify deadlines for completing each step of the CIP process, allowing sufficient time to complete reviews and to present the committee's recommendations to the board of selectmen. The appendix includes a sample CIP committee bylaw, policies, and calendar.

Step Two Prepare an Inventory of Existing Capital Assets

Critical to implementing an effective CIP is the assembly of a complete inventory of all town and school properties, assets, and fleet. In creating this inventory, the CIP committee should include, at minimum, all buildings, fleet, and equipment, but it is desirable to include utilities, roads, and sewers as well. For each asset, the inventory should detail (as applicable): the dates built, acquired or last improved, original cost, current condition, expected useful life, depreciated value, extent of use, and any scheduled replacement or expansion dates.

As a starting point, the CIP committee can refer to the schedule of fixed assets that the town accountant is required to maintain per Statement 34 of the Governmental Accounting Standards Board.¹ A list of insured assets from the town's insurance carrier may also provide useful data. Finally, the CIP committee should solicit asset information from each department head and board chair. In the Capital Improvement Planning Manual are sample forms for collecting this data.

Step Three Determine the Status of Previously Approved Projects

The next step is to review projects already underway, determine if additional funds are needed, and ascertain the amount of unspent funds available from completed or discontinued projects. This

¹ www.gasb.org/st/summary/gstsm34.html

verification process is a prerequisite to conducting a full analysis of fiscal capacity, and the summary reporting of it helps keep officials involved in the budget process informed of the progress of projects approved in prior years.

Step Four Assess the Town's Financial Capacity

With the assistance of the accountant and treasurer, the town administrator should analyze the town's ability to afford major expenditures by examining recent and anticipated trends in revenues and expenditures, including debt and other liabilities. This analysis helps the CIP committee to propose a funding source schedule designed to:

- Keep the tax rate stable
- Balance debt service and operating expenditures
- Determine available debt capacity and acceptable debt service levels
- Maximize intergovernmental aid for capital expenditures

Step Five Solicit, Compile, and Evaluate Project Requests

The CIP committee next solicits departmental requests for capital projects. Using forms like those in the Capital Improvement Planning Manual, each department submits requests, which should include clear details of each project's justification, cost, net effect on the operating budget, and implementation schedule.

Once the project proposals are compiled, the CIP committee evaluates each based on criteria related to policy objectives, including:

- Preserve or enhance town assets – Will the project maintain or improve an existing facility? What is its anticipated useful life? Does it replace a piece of equipment needed to provide public services? Is the current asset beyond its reasonable life? Is the acquisition part of a scheduled replacement plan to keep vehicles or equipment operational and preclude major repair costs?
- Increase government efficiency and effectiveness – Does the project reduce operating costs (e.g., eliminate costly repairs) or increase effectiveness? Does it reduce potential legal liability (e.g., repair a broken sidewalk) or threats to service continuity (e.g., replace an old street sweeper before it breaks down completely)? Does it improve customer service or provide a new, needed service?

- Be a good steward of public resources – Does the project increase revenues? Are grant funds available to cover a portion or all of the cost?
- Consider impacts on the operating budget – What types of ongoing savings might be realized from the project? Does it increase operating costs?

In addition, the team evaluates each project for its influence on the following policy areas:

- Public health and safety
- Education
- Economic growth
- Aesthetics / historic preservation
- Cultural and recreational opportunities
- Environmental sustainability

Step Six Establish Project Priority

In this step, the CIP committee ranks capital proposals as objectively as possible. This is perhaps the committee's most difficult task, although the select board's adoption of capital improvement and debt policies can provide helpful guidance. In addition to formal policies, use of a rating sheet can facilitate objectivity. Committee members should review project proposals using consistent criteria and evaluating each in relation to the others to determine their relative importance. This will enable the committee to prioritize projects based on objective analysis in context with community goals.

Established criteria help differentiate between the merits of each project proposal, but they need not be used rigidly in developing a CIP plan. For example, projects receiving modest scores because they do not contribute to policy areas but are critically needed (such as replacing very aged equipment) can be elevated for consideration in the plan based on need and resource availability.

Step Seven Develop a CIP Financing Plan

Based on adopted policies and an assessment of the town's financial capacity, the CIP committee must recommend a method to finance each project. There are various ways to finance capital improvement projects. The broad range of options include bonding for municipal debt, strategically managing local financial resources, and taking advantage of state and federal grant programs.

MUNICIPAL DEBT

For very costly capital projects, general obligation bonds represent the most common funding method. Typically, these are issued for time periods ranging from five to 30 years, over the course of which the community pays off the debt principal and interest. Paying the debt over time has the advantage of allowing capital expenditures to be amortized over the life of the project. We advise communities to consult with their financial advisor when contemplating issuing debt.

Funding sources to pay back the debt can include:

- Bonds funded within Proposition 2½ tax limits: In choosing this option, a community must carefully plan the funds used to pay the debt service to avoid impacting the annual operating budget and remain within the tax levy limitations of Proposition 2½ ([Levy Limits: A Primer on Proposition 2½](#)).
- Bonds funded outside Proposition 2½ tax limits: This option is known as a debt exclusion, or exempt debt, because it involves a temporary exemption from the tax limit imposed by Proposition 2½. To pay this debt service, a community increases the annual property tax rate for a range of fiscal years until the bond is paid off. This funding requires a two-thirds approval vote of town meeting and a subsequent majority approval of voters participating in a ballot vote. Prior to the voting, local officials must determine and present the debt exclusion's impact on the tax rate so that voters can understand the financial implications ([Proposition 2½ Ballot Questions - Requirements and Procedures](#)).
- Bonds funded with enterprise funds: When a capital project relates to an enterprise fund ([M.G.L. c. 44, §53F½](#)) operation, such as a sewer department, user fees are used to pay the debt service. The state often subsidizes interest costs, and grant funds may also be available at times. A community must analyze the cost of an enterprise capital project for its impact on user rates. Enterprise fund debt service does not affect the general operating budget unless the community needs to use general funds to subsidize user fee revenues.

LOCAL FUNDING STRATEGIES

For some smaller purchases or projects, communities can choose to use funds available in a given year. To help ensure consistent capital funding levels year to year, there are also a variety of long-range fiscal planning strategies.

- Free Cash: Free cash is defined as the remaining, unrestricted funds from operations of the previous fiscal year, as certified by DLS. After certification, a community may appropriate free cash for any municipal purpose.
- Enterprise Retained Earnings: Enterprise fund operations, like water and sewer, may accumulate an operating surplus to fund future capital expenses. This surplus, known as retained earnings, is similar to free cash and must be certified by DLS before it can be used, but the use of the retained earnings of an enterprise is restricted to enterprise-related expenditures.
- Capital Outlay / Pay-As-You-Go: A pay-as-you-go capital project is one that can be funded with current revenues and paid off within one year. If the community has the financial capacity to pay for the project in a year, the taxpayers' cost is lower than bonding because no interest is involved. This method takes careful planning to avoid impacting the annual operating budget.
- Capital Outlay Expenditure Exclusion: This funding mechanism allows the community to raise the total dollar cost of a capital purchase or project through a one-year increase in the tax levy. This also avoids the long-term interest costs associated with borrowing funds. As with a debt exclusion, it requires a two-thirds vote of town meeting and a majority vote in a community-wide referendum ([Proposition 2½ Ballot Questions - Requirements and Procedures](#)). Note that a capital exclusion can only be used to fund municipal purposes for which the town is authorized to borrow money as defined in state statutes.
- Capital Stabilization Funds: Local officials can create and set aside money in multiple stabilization funds ([M.G.L. c. 40, §5B](#) and [Informational Guideline Release \(IGR\) 04-201](#)), outside of the general fund, for different purposes, including paying for all or portions of future capital projects. A two-thirds vote of town meeting is required to create a special stabilization fund as well as to appropriate money into and out of the fund. This type of fund can also be set up in conjunction with an enterprise fund.

Two things should be noted regarding an enterprise fund stabilization fund. First, any special stabilization fund is maintained within the community's trust funds and not in the enterprise fund. Second, while the purpose of a special stabilization fund may be changed by town meeting, it is our legal opinion that when money is transferred from an enterprise fund it is restricted to the enterprise fund purpose. This restriction would not apply to general fund revenues appropriated to a special stabilization fund.

- Special Purpose Funds: State statutes permit communities to establish various special purpose accounts, which set aside money for a restricted, specific purpose, some of which may be investment in departmental facilities and equipment. Individual statutes govern the establishment and use of these accounts. Examples include the sale of cemetery lots and off-street parking fee accounts.
- Revolving Funds: With a revolving fund, a community can set aside revenues received through fees and charges for a specific service. These must be annual authorized by town meeting with the max amount to be spent, receipts credited, and the purpose for which funds may be spent, including capital costs ([M.G.L. c. 44, §53E½](#)).
- Overlay Surplus: Overlay reserve is an annual account to cover anticipated property tax abatements and exemptions for that fiscal year. Any balance in the overlay accounts in excess of the remaining amounts to be collected, abated, or to satisfy an Appellate Tax Board case in that year may be transferred by the assessors' initiative or within ten days of request by the chief executive ([IGR 11-101](#)). These (overlay surplus) funds may be appropriated by town meeting for any purpose for which a town may expend funds or close to fund balance at year end.
- Surplus Bond Proceeds: After completion or abandonment of a project, the legislative body may appropriate any balance of remaining bond proceeds to a purpose which debt may be authorized for an equal or longer period of time than the original issue ([M.G.L. c. 44, §20](#)).
- Sale of Surplus Real Property: Pursuant to state statute, when real estate is sold, the proceeds must first be used to pay any debt incurred in purchasing the property. If no debt is outstanding, the funds "may be used for any purpose or purposes for which the city, town or district is authorized to incur debt for a period of five years or more...except that the proceeds of a sale in excess of five hundred dollars of any park land by a city, town, or district shall be used only by said city, town, or district for acquisition of land for park purposes or for capital improvements to park land" ([M.G.L. c. 44, § 63](#)).
- Community Preservation Act (CPA): Through this program, a community raises funds for a range of projects designed to acquire or preserve historic, conservation, recreational, and affordable housing assets defined under [M.G.L. c. 44B](#). Revenues are raised through a surcharge of up to three percent on real property tax bills and matching dollars from the state. Acceptance requires a town meeting approval or a citizen petition, together with a referendum approval by majority vote.

Pursuant to the acceptance of [M.G.L. c. 44B](#), the town also creates a community preservation fund to receive all the monies collected to support a CPA program, including but not limited to, tax surcharge receipts, proceeds from borrowings, funds received from the state, and proceeds from the sale of certain real estate. A town's community preservation committee, established in accordance with the statute, analyzes the potential for full or partial CPA funding and makes its own town meeting recommendations. It is good practice to coordinate the work of the CIP committee and the community preservation committee to present a cohesive package rather than following a piecemeal approach.

STATE AND FEDERAL FUNDING SOURCES

Communities can seek capital funding from any of several funds and grants offered by the state and federal governments. Examples include:

- Chapter 90 Roadway Funds: These are funds that the state's Department of Transportation allocates to municipalities each year for road maintenance, construction, and equipment.
- Massachusetts Department of Environmental Protection's State Revolving Loan Funds: These include the Clean Water State Revolving Loan Fund and the Drinking Water State Revolving Loan Fund. Both typically offer a mix of grant funds and low interest loans. Repayment does not begin until two years after the monies have been borrowed.
- Massachusetts School Building Authority (MSBA): MSBA provides funding for school design and construction projects. For an eligible community, MSBA determines a reimbursement amount based on community need, with a minimum base rate of 31% that may be increased depending on the community's income, property wealth, and poverty rate.
- Massachusetts Water Resources Authority (MWRA) Loan and Grant Programs: Predominant among these are the Inflow and Infiltration Program and Local Pipeline Assistance Program.
- Community Development Block Grant: This federal program administered by the Department of Housing and Urban Development offers grant money for local development projects.
- The Parkland Acquisitions and Renovations for Communities (PARC), Green Communities, and MassWorks Infrastructure Program are some other examples of state funding sources.

Step Eight Annually Present the Capital Program and Capital Budget

The CIP committee should present an annual capital report to the board of selectmen for review and adoption. The report should provide the committee's analysis of the town's fiscal capacity and summarize its recommendations for the upcoming year's capital budget and for the multiyear CIP program as well.

The board of selectmen may hold a public hearing to present the CIP and solicit citizen comment. If the board typically holds a hearing on the annual operating budget, it can incorporate the CIP hearing into it also. The board of selectmen considers (and may amend) the proposed capital budget and program and subsequently forwards these to the finance committee.

The finance committee reviews and recommends action on the capital budget in context with the overall capital program. A finance committee recommendation to amend the capital budget would suggest disagreement with portions of the capital program, and these differences should be resolved with the selectmen prior to town meeting.

In preparing the town meeting warrant, it is good practice to set capital budget items apart in their own warrant article(s), separate from the main, operating budget article. However, the town could also incorporate capital items as part of the omnibus budget but list them separately as specific appropriations. A CIP bylaw might also dictate that no capital expenditure appropriation may be voted that has not been considered in the CIP committee's report to the selectmen (unless the CIP committee explains the omission in writing). The sample CIP bylaw in the appendix contains a version of this language.

A presentation by the town administrator or selectmen of the entire capital improvement program at annual town meeting demonstrates to the community that the capital budget is part of a long-range plan to maintain and upgrade the town's infrastructure. This practice thereby informs those present of the ongoing need for large capital expenditures and provides them with the opportunity to look into the future and consider the quality of services that will be provided. Town meeting's adoption of the capital budget informs the rest of the community of the commitment to plan for and fund the acquisition and/or development of capital facilities.

Step Nine Monitor Approved Projects

Once town meeting adopts the capital budget and the fiscal year begins, departments are authorized to begin implementing projects. Before purchasing authorized items departments should communicate with the treasurer to make sure the timing is right given the community's cash

flow. The board of selectmen, through the town administrator and/or CIP committee, should monitor department progress. Periodic reports by the CIP committee to the selectmen should indicate changes in the targeted completion dates, identify serious problems, and document the financial status of each project. Those reports may be based on project updates provided by the responsible departments on a quarterly or other regular basis.

Step Ten Update the Capital Program

Annual updating of the capital program involves repeating Steps Two through Nine to reflect new information, policies, and proposed projects. The CIP committee should review and revise the entire program as necessary to reflect its most recent determinations of the need for new equipment, the maintenance of existing equipment, the town's social and environmental conditions, the development or revision of financial policies, and the community's financial resources. After the first year has been budgeted, the CIP committee adds one year to the capital program and updates the remainder of the plan.

APPENDICES

Appendix I Sample Capital Improvement Program Bylaw

Appendix II Sample Capital Improvement Budget Policy

Appendix III Sample Capital Improvement Debt

Appendix IV Sample Capital Budget Calendar

APPENDIX I SAMPLE CAPITAL IMPROVEMENT PROGRAM BYLAW

Section 1. The board of selectmen shall establish and appoint a committee to be known as the Capital Improvement Planning committee, composed of one member of the board of selectmen, one member of the finance committee, one member of the planning board, the school superintendent or his designee, and three residents of the town appointed by the moderator. The town accountant (or executive secretary or other administrative officer) shall be an ex officio committee member without the right to vote. The committee shall choose its own officers.

Section 2. The committee shall study proposed capital projects and improvements involving major, nonrecurring, tangible projects and assets which: 1) are purchased or undertaken at intervals of not less than five years; 2) have a useful life of at least five years; and 3) cost over \$25,000. All officers, boards, and committees, including the select board and school committee, shall, by _____ of each year, give to the committee, on forms prepared by it, information concerning all anticipated projects requiring town meeting action during the ensuing five years. The committee shall consider the relative need, impact, timing, and cost of these expenditures and the effect that each will have on the town's financial position. No appropriation shall be voted for a capital improvement requested by a department, board, or commission unless the proposed capital improvement is considered in the committee's report or the committee shall first have submitted a report to the board of selectmen explaining the omission.

Section 3. The committee shall prepare an annual report recommending a capital improvement budget for the next fiscal year and a capital improvement program with recommended capital improvements for the following four fiscal years. The report shall be submitted to the board of selectmen for its consideration and approval. The board shall submit its approved capital budget to the annual town meeting for adoption by the town.

Section 4. Such capital improvement program, after its adoption, shall permit the expenditure on projects included therein of sums from departmental budgets for surveys, architectural or engineering advice, options, or appraisals. No such expenditure shall be incurred on projects that have not been so approved by the town through the appropriation of sums in the current year or in prior years or for preliminary planning for projects to be undertaken more than five years in the future.

Section 5. The committee's report and the selectmen's recommended capital budget shall be published and made available in a manner consistent with the distribution of the finance committee report. The committee shall deposit its original report with the town clerk.

APPENDIX II SAMPLE CAPITAL IMPROVEMENT BUDGET POLICY

- The town will make all capital improvements in accordance with an adopted capital improvement program.
- The town will develop a multiyear plan for capital improvements and update it annually.
- The town will maintain all its assets at a level adequate to protect the town's capital investment and to minimize future maintenance and replacement costs.
- The town will enact an annual capital budget based on the multiyear capital improvement plan. Future capital expenditures necessitated by changes in population, real estate development, or economic base will be calculated and included in capital budget projections.
- The town, as part of its capital planning process, will project its equipment replacement and maintenance needs for the next several years and will update this projection each year. From this projection, a maintenance and replacement schedule will be developed and followed.
- The town will coordinate development of the capital improvement budget with development of the operating budget. Future operating costs associated with new capital improvements will be projected and included in operating budget forecasts.
- The town will determine the least costly financing method for all new projects.
- The town will identify the estimated costs and potential funding sources for each capital project proposal before it is submitted to town meeting for approval.
- The town will use intergovernmental assistance to finance only those capital improvements that are consistent with the capital improvement plan and priorities and whose operating and maintenance costs have been included in operating budget forecasts.

APPENDIX III SAMPLE CAPITAL IMPROVEMENT DEBT POLICY

- The town will confine long-term borrowing to capital improvements or projects that cannot be financed from current revenues.
- When the town finances capital projects by issuing bonds, it will pay back the bonds within a period not to exceed the expected useful life of the project.
- On all debt-financed projects, the town will make a down payment of at least _____ percent of the total project cost from current revenues.
- Total debt service for general obligation debt will not exceed _____ percent of total annual locally generated operating revenue.
- Total general obligation debt will not exceed that provided in the state statutes.
- Where possible, the town will use special assessment, revenues, or other self-supporting bonds, instead of general obligation bonds.
- The town will not use long-term debt for current operations.
- The town will retire bond anticipation debt within six months after completion of the project.
- The town will maintain good communications with bond rating agencies about its financial condition. The town will follow a policy of full disclosure on every financial report and bond prospectus.

APPENDIX IV SAMPLE CAPITAL IMPROVEMENT BUDGET CALENDAR

August

Town administrator distributes capital manual and capital budgeting guidelines.

Departments begin considering their capital needs for the upcoming fiscal year.

Complete the annual update of capital asset inventory (buildings and equipment).

November - January

Departments submit capital projects to town administrator, who compiles them into a comprehensive capital package.

Capital package given to Capital Improvement Planning (CIP) committee for review.

CIP committee meets with department heads, provides feedback, and requests clarification. Department heads revise submissions as necessary.

Hold joint town/school budget meeting. Present revenue and expenditure projections, free cash estimate, and overview of prospective capital needs.

Feburary

CIP committee submits capital budget and multiyear plan to selectmen via town administrator.

Town administrator updates revenue and expenditure projections with latest data and revises financing plan based on updated revenue projections.

March

Town administrator finalizes proposed capital budget and presents it to the selectmen for approval.

April

Board of selectmen forwards capital and operating budgets to finance committee for review.

Finance committee reviews capital and operating budgets and meets with department heads as necessary.

Finance committee finalizes its budget recommendations.

Selectmen post town meeting warrant.

May

Town meeting