How To Develop a Multi-Year Capital Plan
Planning Saves Time and Money

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Public officials in small communities have more than enough work to do. Why should they consider taking on the extra work involved in multi-year financial and capital planning? Capital maintenance and improvement planning is sound community management for a number of reasons, including:

• Good infrastructure management and investment are needed to ensure basic health and safety for citizens.
• Carefully planned infrastructure investment can maximize the economic potential and visual attractiveness of the community.
• Prudent management of facilities and investments today can reduce future operating costs and help avoid higher replacement costs and unexpected crises in the future.
• A more systematic approach to multi-year financial and capital planning can also benefit the community by improving the basis for intergovernmental cooperation decisions and by enhancing opportunities for lower-cost financing and access to state and federal aid programs.

In addition to these community benefits, developing a multi-year financial and capital plan has clear benefits to the governing board as it faces its future work load: allowing for better project ranking and affordability measures, clearing up uncertainty about current levels of investment, resolving the problem of dealing with the same issues repeatedly, and improving the annual budget and budget process.

Developing a Plan and Process
A multi-year capital plan has a variety of parts. A community can begin to develop a plan and progress gradually. As we discuss the various parts we will note what is essential and must be done, and what things may be developed or added over time. In addition, we will note how and where the Capital Plus software accomplishes key tasks and documentation.

1. Establish Goals and Ground Rules
Community Goals. Small communities are looking for ways to survive and make a better future, and there are many ways to do so. If such an effort is underway or already complete, put the results to use in prioritizing capital projects. Continued on next page

Essential Terms and Definitions

Capital Plan (Capital Improvements Program): A capital plan is a multi-year financial plan that:
• Lists and describes capital projects a local government plans to undertake,
• Indicates how projects will be funded, and
• Projects the effects of the plan on key financial variables, such as the real property tax rate.
Assessing the effects of a group of capital projects on the general financial picture is sometimes referred to as fiscal capacity analysis. The length of the capital plan period is a local decision but five or six years are often recommended.

Capital Project: A capital project results in the acquisition or increased value of a capital asset (e.g., land, land improvements, infrastructure and equipment). It involves expenditures over a certain amount for something—equipment, a building, a new water line, etc.—that will provide benefits for more than a certain “specified period of time,” typically one year. The “certain amount” must be decided by the local government developing the plan. Usually, the larger the local government budget, the larger the amount.

Capital Budget (or Annual Capital Budget): The capital budget is the authorization of needed spending, etc. for the current or first year in the capital plan as a part of the municipality’s annual budget. This is the critical link that brings capital planning into reality. It is preferable to have a separate portion of the annual budget for the capital budget, listing the capital projects to be funded in the current year and the funding source(s). For smaller municipalities this may be a simple one-page attachment.
of questions that identify important areas for establishing ground rules. It is important to answer them early on and then review the answers each year for needed changes.

- **Who will constitute the capital planning group?** Having a small group make important decisions concerning the capital planning process is likely to give it more legitimacy and broader government and public support than if a single person makes these decisions. A variety of individuals can be members of this group, but it is probably best to keep the group to three to six persons.

- **How long will the capital planning period be?** The capital planning should decide how many years to use for the capital planning period. The capital planning texts usually recommend a period of five or six years.

- **How will capital projects be defined?** The capital planning group should agree on a definition of a capital project to provide guidance to those who will be asked to develop capital project proposals. A local government capital project is typically viewed as involving expenditures over a certain dollar amount for an improvement (such as building a water line extension) or equipment that will provide benefits for more than a certain specified period of time. Capital planning literature usually recommends a one year period, but longer time spans are possible.

- **Who will make the projections and gather the data?** A good candidate for projecting expenditures and revenues is a local

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If such an effort is not complete yet, plan to use the results in future years.

Capital projects can be instrumental in developing one type of community rather than another. For example, water and wastewater facilities needed by an area that envisions a future as a dairy farming area will be much different than water and wastewater facilities needed for a jurisdiction that sees its future as a suburban area. Thus, agreement on future objectives can be a useful guide to those approving capital projects for future investment. Forging such an agreement is not an easy task, however. While the capital planning process may be greatly enhanced if this can be successfully done, the process may usefully proceed without it.

**Financial Policy and Goals.** Multi-year capital plans that will “see the light of day” must fit within the overall financial picture the municipality faces. Plans that do not meet this hard test of financial reality usually bring more frustration and disappointment than progress. Setting a multi-year financial plan creates an important baseline or target that helps shape and discipline governing board decisions.

A useful financial picture combines the real financial capacity and condition of the local government with desired financial policies. Key financial policies state goals or guidelines for important financial items, including: percent of the annual budget to be committed to capital improvements, limits on the size of annual debt service, and limits on total debt outstanding. Existing basic financial policy or goals will make it much easier to develop a multi-year financial and capital plan.

As with community vision and goals, detailed financial policies are not required to begin multi-year financial and capital planning. Working through the capital planning process using Capital Plus can give local officials experience with setting financial targets and help them identify areas where they need financial policies and guidelines in planning future investment. To build a financial picture with Capital Plus, local officials will need to make assumptions about the growth of key financial items in the future.

**Establish Ground Rules.** Capital planning is an annual process. Setting ground rules for the process and deciding who will take on various roles and responsibilities is an important early step, which will help avoid confusion and improve the potential for success. Below is a list
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official—typically the budget officer—who routinely works with the budget and has a good sense of how costs are likely to increase, what the governing board is likely to approve for expenditures, and what amounts of state aid are likely to be received.

• Who will work with **Capital Plus** to develop reports? There are at least three possible candidates: a technical assistance person who is helping develop the jurisdiction’s capital plan; the local budgeting expert who, by inputting the data, will probably catch errors and learn more about how the software capabilities; or an assistant who inputs the data under the supervision of the technical assistance person or the local budgeting expert.

• Who will review the reports and approve the final capital plan? The local governing board should, of course, approve the final capital plan because the board will later have to make significant decisions to implement the plan. The governing board may want input from others, such as the budget officer, the municipal attorney, the capital planning group, the planning board, board committees, and individual citizens and citizens’ groups.

• What will be the annual schedule for developing the capital plan? Just as there is a schedule of tasks to be completed by certain dates in order to generate a local government’s annual budget, there should also be an annual schedule for developing its capital plan. The specifics of this schedule should be decided by the local jurisdiction; the answers to the above questions will help develop these specifics.

2. Estimate Fiscal Capacity

An important preliminary step is to help local officials use existing records and local knowledge to help construct a multi-year financial picture to aid in establishing a realistic capital plan. In this step, local officials project operating expenditures and revenues and taxable assessed value for real property for each budgetary fund for the multi-year planning period that they have chosen. They also consult records to gather data on existing debt service commitments and the status of reserves. Projecting revenues, operating expenditures, and transfers to reserves helps build an essential financial picture for capital planning purposes. A danger, however, is that the projection process may become so detailed and time-consuming that other aspects of the process are cut short. Ample time should be saved for developing a full list of carefully considered capital projects.

**Projection Rules of Thumb.** Recent patterns of change and knowledge of unique factors and circumstances are important guides for projecting future revenue and expenditure growth. The projection process is not meant to provide an exact financial forecast. Some expenditure items, such as the salaries of appointed officials, remain relatively constant with lump-sum increases every so often. Items, such as gas and electric bills, experience stable annual percent increases. As with annual budgeting, a conservative approach is to estimate revenue growth slightly on the low side and expenditure growth slightly on the high side of real expectations.

**Methods For Reducing The Number of Items To Project.** The easiest method for reducing the projection workload is to project total expenditures (less transfers to reserves) and total revenues for each fund. Examine these two items over as many recent fiscal years as possible. **Capital Plus** allows you to enter a “summary” account code for this total in making projections. A second approach is to project the “major” revenue and operating expenditure accounts and lump the smaller accounts into an “All Other” category for projection purposes. If, for example, metered water sales are 95 percent of total revenues in the water fund, and 10 other items make up the remaining five percent, then only two projections need to be made.

3. Prepare Information about Proposed Capital Projects

Local officials need to identify potential projects and develop and record that information. **Capital Plus** provides for the collection of a broad array of information and has space for entering information in the following areas: project start date, project description, project notes, total cost, sources of debt and non-debt financing for the project, and changes in operating expenditures and revenues due to the project.

**Strategies for Getting Started.** The ideal method for developing a capital plan is to begin with a full inventory of capital assets, which notes the condition of assets and provides a firm basis for developing a prioritized list of needed capital and equipment items. Combining the

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results of a capital assets inventory with plans for new capital items linked to new building and development needs would constitute a relatively comprehensive approach. The following suggestions are offered as ways to begin developing a list of capital projects:

- **Start With a Single Fund:** One way to pare down the work and get started is to identify all capital projects in a single fund, and add projects from additional funds each year until all municipal operations have been incorporated into the capital plan.
- **Start With Previously Identified or In-Process Projects:** The mayor, supervisor, or governing board can usually identify a short list of projects that have been discussed or initiated in recent years. In some cases this may mean formalizing an informal capital plan as the first year’s action and separating capital spending out of the operating budget activity in the current year’s budget.
- **Do Not Wait for Complete Information:** Avoid the temptation to postpone proposing and writing up projects until you have complete information or final-cost estimates. *Capital Plus* provides the flexibility of recording projects in the concept stage and scheduling them beyond the timeframe of the plan. By getting such partial works in the file, the need they represent is registered in the system while the project is shaped, information is gathered, or funding is secured.

### What are the basic elements of a capital plan?

There are five components to a capital plan and its process:

- **Establish Goals and Ground Rules:** Document or develop community and financial goals and set a basic policy framework for annual capital planning activities. In subsequent years, goals and ground rules should be reviewed and adjusted.

- **Estimate Fiscal Capacity:** Create a multi-year financial picture with assumptions about future changes in operating expenditures, revenues, assessed value, reserves, and known debt service commitments.

- **Prepare Information on Proposed Capital Projects:** Identify potential capital projects and then develop and record needed information on the projects. Choose the projects to be included in the plan and schedule their investment over the planning period.

- **Examine Capital Plan Fiscal Impacts and Revise:** Review the plan and its impacts on fiscal capacity and make any needed adjustments to the basic financial picture or to the schedule of capital projects.

- **Implement the Annual Capital Budget:** Include authorization for the capital budget in the annual budget and initiate needed actions to acquire or prepare for the acquisition of the current year’s capital plan items. In addition, prepare for other capital projects scheduled for upcoming years (e.g., get engineering estimates, complete site preparation).

### 4. Examine and Revise the Capital Plan

After choosing an initial set of projects to include in the capital plan, local officials need to evaluate the initial financial picture. They may want to seek input from the public and professionals, such as a financial consultant, municipal attorney, or a civil engineer.

Once the capital project data have been entered, *Capital Plus* generates a report that shows figures by fund on how the local government’s financial situation will change if the capital projects are undertaken as scheduled. This report shows the following:

- Additions to previously projected expenditures and revenues necessary to complete proposed projects;
- Additions to debt and debt service payments that local officials project for completing the proposed projects;
- Withdrawals from reserve funds that local officials project for completing the proposed projects;
- Additions to, or subtractions from, previous projections of regular operating expenditures and revenues that local officials assume will occur once the projects are completed; and
- Annual projected real property tax rates or additional amounts that need to be raised if the capital plan is implemented the way that local officials propose.

After evaluating this information, local officials may want to change projections and capital... Continued on page 10
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projects data previously entered into Capital Plus to generate the first capital plan reports. If so, entries need to be modified, and a second set of reports generated for evaluation. This evaluation and revision process is done as many times as necessary to produce a capital plan acceptable to the local governing board.

5. Implement the Annual Capital Budget

Once it has been updated for the year, the capital plan serves as a basis for the annual capital budget, which is part of the next annual operating budget. This is the critical link needed to assure that the capital plan will become a reality. In addition to the capital budget each year, preliminary work needs to be done so that the current year’s capital projects can move forward and projects scheduled in upcoming years can also progress. This preliminary work includes: engineering, site preparation, securing financing, or seeking public comment and participation. A rough schedule of activities should be developed and responsibilities assigned.

Each year the capital plan process is repeated and must be completed in time to prepare the annual budget. Goals and ground rules should be reviewed and updated, the previous inputs into Capital Plus (projections and capital projects) should be reviewed, modified, and extended for an additional year, and new sets of reports should be generated until an acceptable capital plan is again produced.

Changing Local Budgeting

The annual budget process is an important legislative priority for local councils and governing boards. In most communities the process is well established and difficult to change. Implementing a capital plan and planning process requires change. It is important to anticipate some of the problems that may emerge.

The capital budget must precede the annual budget process. The capital planning process of updating the multi-year plan must precede the annual budget process. The capital plan portion of budget deliberations will extend the length of the formal budget process. As you begin to implement a capital planning process, it appears to both extend and complicate the annual budgeting activities. Initially, this is true because changing budget practices will take longer as everybody makes needed adjustments and the “kinks” get worked out. As you continue over several years, the benefits of the capital planning framework will begin to “kick in,” easing other board decisions and reducing the work of drafting the annual budget.

Capital planning opens up a range of policy and prioritization issues. As you begin the capital plan development process, a range of prioritization issues arises and can seem overwhelming. For example, scheduling water system improvement projects for the next five years will likely reveal that there is not a prioritized list of projects from which to select. Further it may expose on-going conflict or confusion about water and wastewater improvement policies. It is important to remember that capital planning does not create these issues, it merely brings them to the surface. Pick the most important ones to address first and do as much as time and resources permit.

Be aware of changes in control over capital decisions. The changes involved in initiating a capital plan may bring new people into the decision-making process and threaten others who have exercised control over decisions in the existing annual budget process. There is not enough space to discuss this issue in depth, but it is important to consider how the process should be structured and how this will affect decision makers.

Expect challenges to those who staff the budget process. Change can be disruptive and upsetting for those responsible for budget preparation. Give adequate lead time to assess potential changes in work and work load for staffing the annual budget process. Discuss with budget preparation staff why a capital plan is being initiated and request their input on how to proceed and what problems they foresee. Look for areas where capital planning will stretch the time or skills of staff and elected officials. Be open to the need for training or outside assistance, particularly during the first few years. Developing a capital plan may show problems in the way the current annual budget is structured or stretch the capability of the current bookkeeping/accounting system. Be prepared to assess these areas and shore them up if necessary before proceeding with the plan.

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