

THE CITY OF GREATER SUDBURY POLICIES AND PROCEDURES

Appendix One

DEPARTMENT:

Finance

SECTION:

All Sections

TITLE:

Capital Budget Policy

APPROVED BY:

Senior Management

DATE:

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1.0 CONTEXT AND NEED FOR A POLICY

The purpose of this policy is to provide fiscal control and accountability related to the preparation and monitoring of the capital budget.

The Municipal Act requires municipalities to prepare and adopt budgets for each year. The capital budget includes estimated capital project revenue and expenses required to build, replace and maintain capital assets owned by the City of Greater Sudbury.

This policy deals with the preparation of the capital budget, monitoring of the capital budget, variance reporting, adjustments and budget reallocations.

This policy does not deal with the preparation or monitoring of the operating budget as these procedures are outlined in the Operating Budget Policies.

This policy does not deal with the accounting for Tangible Capital Assets as these procedures are outlined in the Tangible Capital Assets Policy.

1.1 Definitions

- i. "Capital Assets or Expenditures" are non-financial assets having physical substance that:
 - a) Are held for use in the production or supply of goods or services, for rental to others, for administrative purposes or for the development, construction, maintenance or repair of other tangible capital assets.
 - b) Have useful economic lives extending beyond one year.
 - c) Are to be used on a continuing basis.
 - d) Are not held for sale in the ordinary course of operations (ie. inventory).

- ii. “Capital Budget” means the annual Council approved plan of the City of Greater Sudbury for expenditures and revenues to acquire, construct or rehabilitate capital assets. The capital budget is distinguished from the annual operating budget which normally provides for the day to day expenditures of the municipality for items such as salaries, heat, hydro, maintenance etc.
- iii. “Capital Forecast” means the projection of expenditures and revenues for years beyond the capital budget approval year in which the forecast is made. Generally the forecast will project capital projects for the next four years.
- iv. “Capital Project” means an undertaking for which capital expenditures are made or are to be made including expenditures to acquire, improve, repair, replace, construct or extend life of land, buildings, structures, machinery and equipment, computers, software, infrastructure, linear assets, and studies.
- v. “Deficit” means the shortfall of funding between a capital project budget and the total capital project costs.
- vi. “Division” means part of a department headed by a Director.
- vii. “Department” means an organizational unit of the City of Greater Sudbury headed by a Senior Management Team member.
- viii. “Project Manager” means the person who is responsible for the planning, execution and closing of any capital project.
- ix. “Repairs and Maintenance” expenses are costs undertaken to maintain existing assets in working condition and do not extend the useful life of the asset.
- x. “Surplus” means the excess of funding between a capital project budget and the total capital project costs.

2.0 CAPITAL BUDGET PREPARATION

2.1 Identification of Capital Projects

Each year, operating departments are required to identify capital projects required for a five year period and documented in the Capital Budget and Capital Forecast. These capital projects are prioritized by the department, based on individual ranking methodologies and criteria.

The annual Capital Budget and four year Capital Forecast is presented to Council on an annual basis, preferably in the fall of each year.

The Capital Budget and Capital Forecast must be reviewed and approved by the SMT member, CFO and CAO, prior to submission to Council.

2.1.1 Capital Budget Estimates

The Project Manager is responsible to establish the scope and provide the best estimate of the total costs for each Capital Project. The budget estimate should include all costs of the individual components of the work that comprise the capital project, such as, but not limited to, contract costs, land acquisition costs,

contingency, and outside professional services such as contract administration, engineering, demolition, architect, anticipated legal costs, utility relocates, equipment and furnishings. The estimate must include the non-refundable portion of sales taxes (ie. HST).

The City uses the following categories to describe capital projects:

Rehabilitation/Replacement ("R"): These projects are required for on-going capital renewal and replacement of existing assets.

Expansion ("E"): These projects are required to expand existing capital assets in order to maintain or improve existing service levels for the City's increased population, traffic, or employment.

New ("N"): These projects are required to add new capital assets in order to increase the level or quality of service

An operating department may identify a single line in the capital budget as a "contingency". This contingency is available to support priority projects for which there is no existing budget, including repairs, "rehabilitation/replacement" or "expansion" of existing capital assets. It can also be used to support projects already identified in the capital budget, but which require additional funding in accordance with Section 3.3.2 of this policy. A contingency budget cannot be used to fund a project that is categorized as a "New" capital project or a scope change to a "New" capital project if the amount is greater than \$50,000 without Council Approval.

Operating departments may group similar renewal and replacement projects that are minor and routine, under one project in the budget binder. For example, "playground upgrades", "watermain replacements/rehabilitation", "various surface treatments", "lift station upgrades".

For multi-year capital projects that have distinct pre-construction and construction phases, departments have the option to set up two separate projects in the capital budget and capital forecast – one for pre-construction and the other for tender and construction costs. When possible, departments are encouraged to obtain detailed estimates or complete detailed design one or two years in advance of the budget approval. This will give departments the ability to more accurately budget construction costs to be approved by Council.

Each complex capital project should contain a contingency which must be managed. There will always be uncertainties (e.g. soil conditions) inherent in the implementation of any capital project. The role of contingency is to address that uncertainty, and the contingency will be used as the project progresses through its various phases: conceptual design, detailed design, development and

implementation. Project Managers are accountable to establish a contingency where considered necessary and monitor its usage.

Operating departments must complete a Capital Justification Form for all capital projects in excess of \$100,000. Where beneficial, Project Managers are encouraged to complete a Capital Justification Form for capital projects less than \$100,000.

If there is an operating budget impact as a result of the new infrastructure or expansion to the City's capital assets, it must be disclosed to Council in the Capital Budget. The base operating budget will be increased (decreased) when the asset is brought into service.

2.2 Capital Funding

The following sources of revenues are available to fund capital expenditures:

- Annual contributions from operating budget (Capital Envelopes)
- Federal and provincial grants
- Contributions from Reserves, Reserve Funds, Obligatory Reserve Funds
- Development charges revenues or contributions from the Development Charges Obligatory Reserve Funds
- Contributions from others, donations, cost recoveries
- Debt financing

2.2.1 Annual Contributions from the Operating Budget

The City establishes capital allocations by function, which are funded from the municipal tax levy and the water/wastewater user fees. These allocations are called "capital envelopes".

The following are the Council approved capital envelopes:

Capital Envelope Name	Description
Citizen and Leisure	Any capital needs of the libraries, parks and recreation facilities except for the actual buildings, such as shell, roof, mechanical, structural etc.
Administration Infrastructure	Corporate needs such as telephone systems, copiers, communication systems, meeting rooms and related furniture, Council Chambers

Capital Envelope Name	Description
Information Technology	Capital needs for information technology supported by CGS. This may include licensing and maintenance costs when included in the acquisition price
Furniture	For capital furniture replacement available to all operating departments of CGS
Fire Services	All capital needs of Fire, except buildings
Health and Social Services	All capital needs of Health and Social Services, including buildings for Pioneer Manor, Children's Services and Ontario Works
Police Services	All capital needs of Police Services, including buildings
Buildings (two envelopes) - CD Buildings - IS/ES/Fire/LEL,GD	All City Buildings except Health and Social Services, Police, Transit Facilities capital envelope funds projects relating to building renewal such as building shell, windows, energy retrofits, accessibility retrofits, structural, exterior structure, mechanical, roofing.
Roads	All capital needs of roads, drainage, stormwater management systems and bridges and related traffic equipment system improvements, streetlights
Environmental Services	Waste disposal and diversion
Waste Water	All capital needs of waste water plants, linear systems and related equipment
Water	All capital needs of water plants, linear systems, and related equipment
PeopleSoft ERP	All PeopleSoft/ERP corporate initiatives and upgrades
Healthy Community Initiative (HCI) Fund	At the discretion of each Councillor for their respective wards and in accordance with the Council Expense and HCI Policy (Note: This policy is in progress and will be presented to Council in June 2012)
Planning	All capital initiatives related to Planning (ie. GIS, related equipment, mapping, etc)
Transit	All transit bus replacements, miscellaneous transit equipment, and improvements to transit facilities and bus shelters

Capital Envelope Name	Description
Communications Infrastructure	Capital needs and improvements relating to communication systems and towers. This infrastructure is used by Police, Fire, and Transit
Lionel E. Lalonde Centre Equipment	All equipment needs of the facility that are not covered by the Facilities Capital Envelope.
Emergency Management	All capital needs of the Emergency Operation Centre

Each year, the capital envelopes are increased by the greater of 2% or the first quarter Non-Residential Building Construction Index as reported by Statistics Canada.

Over time, the needs of the City may change, requiring allocations between these envelopes. The CFO and CAO, in consultation with the SMT, would set the allocations on an annual basis, in advance of the capital budget preparations.

The Capital envelope funding should be first allocated to any urgent, one-time, costly capital demands or legislated capital projects and any remaining capital funds shall be prorated to the remaining capital envelopes.

Council will approve the capital envelopes during the capital budget deliberations.

2.2.2 Federal and Provincial Grants

The long term financial plan states that the City should:

- Recognize that funding from senior governments is a crucial element of financial sustainability.
- Seek additional sustainable revenues from the provincial and federal governments.
- Seek senior government funding sufficient to bridge the funding gap between net required costs and affordable tax and user charge rates/revenues
- Participate in grant/subsidy programs only if programs/projects to be supported are required or can be justified independent of the provision of the grant/subsidy.

Operating departments and Finance will endeavour to secure capital grants from federal and provincial governments, for any capital project identified in the capital forecast listings, or for a specific project approved by Council.

The Finance Department will review all capital grant applications and agreements greater than \$100,000, and prepare and/or review grant subsidy claims and submit all claims to external funding agencies.

Finance will be the co-ordinator and contact for external funding agencies relating to submitted subsidy claims for capital projects.

2.2.3 Contributions from Reserves, Reserve Funds and Obligatory Deferred Reserve Funds

The annual capital budget will include an annual contribution from the following reserve funds:

- Fleet
- Land Ambulance
- Parks Equipment
- 199 Larch Street
- Parking
- Cemetery Services
- Agricultural Drains

Other contributions from Reserves and Reserve Funds may be required to fund capital needs, in accordance with the Reserves and Reserve Funds By-law.

2.2.4 Development Charges Revenues

Development charges are collected by municipalities to recover a portion of the growth-related costs associated with the capital infrastructure needed to service new development. Development charges in the City are established through by-law and are payable on the date the building permit is issued and is based on the Development Charges Schedule in force on that date.

Each year, Finance, in consultation with Project Managers will review the Capital Budget to determine if there are any growth related projects that are eligible for recovery from development charges.

Generally, the City finances the growth related portion of capital projects. At the end of each year, the capital projects are reviewed, and the growth related portion of the capital costs are identified. The actual development charges revenues collected during the year are then applied to fund any growth related portion of the project as identified in the current Development Charges

Background Study. This unbudgeted funding results in unallocated dollars in the capital cost centres which is transferred to the respective capital financing reserve fund.

For certain projects, development charge revenues are identified as a source of the funding for the capital project. In these cases, the annual budget includes an estimate of the development charges to be collected and at the fiscal year end, actual amounts are reconciled. If a shortfall arises, it will be identified and funded in a future capital budget or future development charge revenues will be applied until the balance is funded.

2.2.5 Contributions from Others, Donations, Cost Recoveries

Operating departments may enter into cost sharing agreements in accordance with the Delegations By-law or when approved by Council. If contributions, donations or cost-recoveries are anticipated, they should be included in the capital project budget.

Where a project involves cost sharing, up-front funding from participants is mandatory, unless authorized otherwise by Council. In addition, a formal agreement should be prepared and it should include, but not limited to, legal name, purpose of agreement, terms and conditions, cost sharing allocation for project estimate and any variances, interest rate (if applicable) and authorized by original or electronic signature.

2.2.6 Debt Financing

In accordance with the Long Term Financial Plan (LTFP), more specifically, Principle #7 “use debt financing where appropriate”, any internal or external debt financing must be approved by Council, and should only be considered for:

- new, non-recurring infrastructure requirements
- programs and facilities which are self-supporting, and
- projects where the cost of deferring expenditures exceeds debt servicing costs

The LTFP also stated that Council should:

- Consider undertaking a short-term, managed program of debt financing to address the City's current infrastructure deficiency and to reduce further deterioration of the City's infrastructure
- Issue debt for terms no longer than the anticipated life of the funded assets

Reductions in External Debt Repayments

The LTFP also recommends: “As debt charges decline due to retirement of debt, apply savings to accelerate achievement of full life cycle costing for City infrastructure.”

When preparing the annual budget, any decrease in annual debt repayments, shall be offset by a corresponding increase in the contribution to the respective Capital Envelope. This allows the envelopes to increase while having no impact on the operating budget.

Finance Approval for Debt Financing

If a capital project is identified that meets the above noted criteria for debt financing, an application should be made by the SMT member to the Chief Financial Officer.

The Financial Planning and Policy Section will determine if it is in the City’s best interest to finance the project internally or externally.

Council approval is required for either internal or external debt financing.

Internal Debt Financing

From time to time, a capital project may require internal debt financing, with repayments to come from future capital envelopes or other sources over time. If the term of the repayment exceeds two years, then interest will be charged.

Any internal financing recommended to Council will be in accordance with the City’s Investment Policy, which states that interest will be charged at one percent above the average investment rate locked in at the time the internal financing is approved. Finance will provide interest rates and amortization schedules for each project with internal debt financing.

3.0 CAPITAL BUDGET TIMING, MONITORING AND VARIANCES

3.1 Timing of Capital Envelope Funding

After the Capital Budget is approved by Council, the Finance Department will record the contributions to capital from the operating budget.

If at time of budget preparation, the operating department is aware that the project will not be completed in the current year, then the funding will be transferred to committed reserves. This will be disclosed in the capital budget document.

If the estimated timeline of the capital project is in excess of two years, a separate cost centre will be created for the capital project. Also, if the project has several funding sources and cost components, a separate cost centre can be created to assist in managing the project.

The capital fund does not earn interest. Therefore, capital projects identified and funded through the envelope system should have sufficient funding so as not to require interest revenue.

3.2 Monitoring of Capital Budget

The SMT member and Director must clearly assign roles and responsibilities and a Project Manager for each capital project. The Project Manager must be disclosed on the capital justification form.

Capital expenditures and revenues must be monitored on a regular basis by SMT members, Directors, Managers, and Project Managers. They are responsible to ensure that the project actual expenditures are within the approved budget.

The Tender Award Form must be completed for each project in excess of \$50,000 and must contain approvals in accordance with the Purchasing Authority Policy.

If capital project budget variances are anticipated, operating departments should notify the Coordinator of Capital as soon as possible, so that funds can be reallocated in accordance with Section 3.3 below. In addition, if a variance cannot be funded, the CFO and CAO shall be made aware of the anticipated over expenditure.

If an emergency situation should arise, the operating department should use their best judgment in assessing the situation, however, the authority to make the appropriate expenditure is granted through the Purchasing By-law, and a report to Council must follow.

The CFO will provide the Finance and Administration Committee or Council with a Capital Variance Report after each quarter end as follows:

- a) March month end
- b) June month end
- c) September month end
- d) December year end

Additional variance reports will be provided at the request of Council, or as determined necessary by the CFO and/or CAO/SMT member.

The capital variance report will identify capital projects in excess of \$200,000 which have been completed during the quarter. This variance report will disclose all budget reallocations made in accordance with Section 3.3 below.

If a capital project is cancelled, it will be disclosed in the variance report and funds will be either transferred to another project in accordance with Section 3.3 below, or transferred to the respective capital financing reserve fund.

3.3 Capital Project Variances

Capital project budgets within the capital envelopes will be based on best estimates at the time the capital envelope funding is approved. It is inevitable that actual expenditures will vary upwards and downwards from the original estimates.

3.3.1 Capital Project Surplus

If a surplus arises or is anticipated from a capital project, the Project Manager has the authority to use the unspent funds as follows:

- a) Reallocate within the same envelope to fund an over expenditure incurred from another approved capital project; or
- b) Contribute to the respective capital financing reserve fund; or
- c) Use to expand scope or limits of a project categorized as “rehabilitation/replacement” project for an existing capital asset, if available funds are verified by Finance, and approved by SMT member. If scope changes are greater than 20% of project budget and \$500,000, then Council approval is required; or
- d) Use to add a project categorized as “new” or “expansion” which was not identified in the capital budget if less than \$50,000. Available funds must be verified by Finance, and project approved by SMT member. If it is greater than \$50,000 then Council approval is required.
- e) Use for a scope change to a project categorized as “new” or “expansion”, if less than \$50,000. Available funds must be verified by Finance, and project approved by SMT member. If it is greater than \$50,000 then Council approval is required.

3.3.2 Capital Project Deficit

If a deficit arises or is anticipated in a capital project, the Project Manager can fund the shortfall by either:

- a) Reallocating from the same envelope any surpluses incurred from another approved capital project identified within the department approved capital budget; or
- b) Reallocation from the contingency line identified in the Capital Budget
- c) Reduction of the scope of existing project or an alternate project, if approved by SMT and if less than 20% of Council approved project budget and \$100,000. If variance greater than 20% of project budget and \$100,000, then Council approval is required

When a deficit is anticipated or occurred within an envelope, and it cannot be funded using either option (a) or (b) or (c) above, a report must be presented to Council for approval, advising of the reasons for the over expenditure and recommending a funding source.

3.3.3 Budget Reallocations

Any budget reallocation must be initiated by the Project Manager and should be documented and approved in the Budget Reallocation Form. In addition, any reallocations in accordance with Section 3.3 above will be disclosed to Council in the quarterly variance reports.