

Request for Decision

Capital Budget Policy

Presented To:	City Council
Presented:	Tuesday, Jan 15, 2019
Report Date	Wednesday, Jan 02, 2019
Type:	Presentations

Resolution

THAT the City of Greater Sudbury repeal By-law 2012-119;
AND THAT the City of Greater Sudbury adopt the Capital Budget Policy, as outlined in the report entitled "Capital Budget Policy" from the General Manager of Corporate Services, presented to City Council on January 15, 2019.

Relationship to the Strategic Plan / Health Impact Assessment

This report supports Council's strategic pillar of Responsive, Fiscally Prudent, Open Governance.

Report Summary

This report provides Council with an update to the Capital Budget Policy. This revised policy builds on prior direction from City Council about the City's asset management strategy and the City's Long Term Financial Plan. It aligns capital project selection with the corporation's evolving enterprise risk management practices. It provides City Council with more, and more direct, control over capital project selection and increases transparency and accountability for results.

Financial Implications

There are no financial implications associated with this report.

Signed By

Report Prepared By

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Digitally Signed Jan 2, 19

Division Review

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Financial Implications

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Recommended by the Department

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Capital Budget Policy

Background

Governments at all levels own, lease or control an array of assets in order to deliver services to citizens. The amounts and timing of capital investments are among the most important decisions a governing body will make. A policy for informing decisions about capital spending decisions increase the assurance they reflect transparent, consistent steps that reflect community priorities, financial plans and reliable performance data.

It is typical for a local government's capital renewal or replacement needs to exceed its available funds. This makes choices about capital spending particularly sensitive since tradeoffs are often necessary that can lead to unmet service expectations, unplanned emergency repair or maintenance costs, or higher overall costs.

A policy to guide capital spending decisions helps minimize the impact of such tradeoffs. It incorporates data about the serviceability of assets and their state of repair, expected service levels and potential financing sources to carry out planned investments in a fiscally sustainable manner. As investments are being made, information about the progress of capital projects is also desirable so that adjustments or changes to planned activities can be made in a timely fashion.

The Capital Budget Policy guides the preparation of the City's short and long term capital plans. This revised policy builds on prior direction from City Council about the City's asset management strategy and the City's Long Term Financial Plan.

ANALYSIS

The Long Term Financial Plan, approved in April 2017, identified a variety of financing strategies for supporting the City's programs and services for the next ten years. When it was approved, staff were also directed to review and amend, where appropriate, various financial policies to support the plan's implementation. Some of the changes related to capital planning included:

1. Amending financial policies
 - o Change the city's debt limit by increasing it to 10% of net revenues. This was approved by Council in 2017.
 - o Expand reporting on capital projects to include reporting on projects in progress (as opposed to the current requirement to report only on completed projects). This is addressed by the policy recommended in this report.
2. Considering the introduction of a capital levy
 - o The imposition of a capital levy that would be used exclusively for capital purposes (including debt or reserve contributions) is intended to accelerate progress on capital projects that address known service deficiencies or asset renewal needs.

3. Strengthening asset management practices
 - o An Asset Management Policy was approved in April 2018. It anticipated capital budgeting would prioritize spending decisions based on an enterprise-wide understanding of the highest identified capital needs.
 - o The Asset Management Policy anticipated capital budgeting practices would reflect the following principles:
 1. An enterprise-wide risk assessment would inform capital budgeting recommendations.
 2. Asset renewal spending choices would reflect service level expectations.
 3. Multi-year capital projects would have their full funding plan approved when the project is approved, reducing the risk that multiple approvals would be needed to complete a project, or that funds would become unavailable to fulfill the project's service promise.
 4. Capital project management would follow consistent, enterprise-wide standards.

The policy recommended in this report updates the current Capital Budget Policy which was last updated in 2012. Recommended changes fully address the outstanding items from previous recent policy changes, creating strong alignment between strategy, financing and capital project management practices.

Capital Budget Funding

The recommended changes strengthen financial control. Currently, when a capital project is approved, 100% of the funds are provided in the year the project is approved. For multi-year projects, allocating all funds in the first year requires other projects to be deferred to future periods, since available funding is allocated to cover the multi-year project's full cost. This is an inefficient use of funds.

Similarly, the current policy led to the proliferation of numerous service-specific reserves that further reduced the efficient allocation of funds and created unnecessary complexity in discussions about financing plans for specific projects. The recommended policy simplifies financing plans by consolidating several service-specific capital reserves to create a single reserve for capital projects. This aligns with changes designed to emphasize enterprise-wide service priorities.

Under the recommended policy, funds are allocated in the year they are required. A multi-year project is still fully funded, but only the funds required for its first year are provided when the project is approved. The balance of the project's funding is "committed" in future years according to the project schedule. This is a more efficient use of funds as it allows for more projects to be considered in the current period yet still remain within the budget directions established by City Council.

Capital Project Selection

The recommended changes increase the assurance that the corporation's highest priority projects are included in the budget. Currently, the capital budget policy anticipates Council will direct spending limits for various "funding envelopes". The effect of this approach has been to assign specified capital amounts to various divisions within the corporation. The divisions then identify capital spending priorities up to the assigned funding limit. This increased the likelihood that projects that had no clear "owner" or that crossed divisional boundaries would not be funded and, ultimately, that significant corporate capital priorities would remain unaddressed.

Under the recommended policy, an enterprise-wide process for determining priorities exists and is used by a cross-functional team of staff from across the corporation. Council's strengthens its control over projects, as criteria for project selection can be defined when it issues budget directions. Similarly, the recommended policy anticipates that Council can review planned projects in more detail when considering budget recommendations. This increases the likelihood that Council's priority projects will be appropriately considered in the capital budget.

Managing Capital Project Spending

The recommended changes strengthen cash management practices. By emphasizing enterprise-wide priorities and changing the structure of reserves, projects with excess funds or that are running deficits can be more readily addressed. The recommended policy does not support traditional capital project management practices that encourage Directors to retain project surpluses or delay reporting project deficits.

Through the creation of "holding accounts" and increased project reporting requirements, the recommended policy establishes contemporary capital project management practices and a "best in class" approach for capital budgeting. It ensures cash will be efficiently deployed throughout the year.

Holding accounts would:

1. Be available to fund project costs that exceed the Council approved project budget, within specified limits and subject to explicit disclosure requirements.
2. Be the funding source for emergency capital projects subject to the provisions of the Purchasing By-Law.
3. Be the funding source to leverage in-year investment opportunities, subject to specific controls.

The recommended policy encourages timely project completion. Currently, it is possible for a project to remain inactive for several periods after Council approval. This typically occurs when staff resources are not available to support the project, new priorities are introduced that require resources to be redirected, or conditions affecting the specific project changed and require plans to be reassessed. The recommended policy calls for approved projects that experience 24 months of inactivity to be closed

and funds returned to the Holding Account. If the project is still required, it would re-enter the prioritization process and be considered along with other capital project priorities.

Reporting

The recommended policy maintains quarterly reporting requirements and enhances information about project spending. There will also be an annual update report produced in the spring that provides information on all outstanding projects. In addition an annual presentation will be done in early fall that details major projects status and commentary on major projects completed.

Conclusion

The recommended Capital Budget Policy aligns capital budgeting practices with the principles described in the Asset Management Strategy and the long-term perspective anticipated by the Long Term Financial Plan. It aligns capital project selection with the corporation's evolving enterprise risk management practices. It provides City Council with more, and more direct, control over capital project selection and increases transparency and accountability for results.

Relevant Links for Further Information:

1. Finance and Administration Committee meeting of May 22, 2012

Staff report: Capital Budget Policy

<http://agendasonline.greatersudbury.ca/index.cfm?pg=agenda&action=navigator&id=487&itemid=5599&lang=en>

2. Finance and Administration Committee Meeting December 13, 2016

Staff report: KPMG Asset Management Plan

<http://agendasonline.greatersudbury.ca/index.cfm?pg=agenda&action=navigator&id=1034&itemid=11966&lang=en>

3. Finance and Administration Committee Meeting April 25, 2017

Staff report: Long Term Financial Plan

<http://agendasonline.greatersudbury.ca/index.cfm?pg=agenda&action=navigator&id=1126&itemid=13119&lang=en>

4. Finance and Administration Committee Meeting of October 24, 2017

Staff report: Asset Management Strategy

<http://agendasonline.greatersudbury.ca/index.cfm?pg=agenda&action=navigator&id=1175&itemid=13959&lang=en>

5. Finance and Administration Committee Meeting of April 17, 2018

Staff report: Asset Management Program

<http://agendasonline.greatersudbury.ca/index.cfm?pg=agenda&action=navigator&id=1271&itemid=14692&lang=en>

6. City Council Meeting of September 11, 2018

Staff report: Enterprise Risk Management Policy

<http://agendasonline.greatersudbury.ca/index.cfm?pg=agenda&action=navigator&id=1246&itemid=15640&lang=en>

THE CITY OF GREATER SUDBURY POLICIES AND PROCEDURES

DEPARTMENT:

Finance

SECTION:

All Sections

TITLE:

Capital Budget Policy

APPROVED BY:

Executive Leadership Team

DATE:

April 4, 2001; Revised May 11,2012;
Revised December 6, 2018

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 investment plan which includes the Capital Budget and the Capital Outlook. 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 permit, design, build, replace and maintain Capital Assets owned by the City of Greater Sudbury. The Capital Budget includes projects that have been recommended based on an enterprise risk approach to prioritization. Capital Projects may extend over multiple years. The approval of a Capital Project in the Capital Budget approves all expenditures and funding sources for the Capital Project for the current year and all future years by year on an expected cash required basis. In the following year Council will have the ability to reaffirm the cash flow and funding sources previously approved or approve changes required to accomplish the remainder of the Capital Project previously approved.

The Capital Outlook includes a projection of timing of expenditures and amounts by individual project that are not included in the approved Capital Budget.

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

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 (i.e. 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 Outlook” means the projection of expenditures for years beyond the capital budget approval year in which the outlook is made. Generally the outlook will project Capital Projects for the next four years.
 - iv. “Capital Prioritization Tool” means a standardized tool which is used by many Departments to score each Capital Project on criteria including strategic priority, financial considerations, risk management and asset renewal. This tool is used to select which Capital Projects are selected to be funded and presented to Council for approval.
 - v. “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.
 - vi. “Capital Program” is a group of similar Capital Projects that are minor or routine that can be grouped together.
 - vii. “Deficit” means the shortfall of funding between a Capital Project budget and the total actual Capital Project costs.
 - viii. “Department” means an organizational unit of the City of Greater Sudbury headed by an Executive Leadership Team (ELT) member.
 - ix. “Holding Account” means an account set up in the Reserves that will be used for project savings that can be used to fund over-expenditures from other Capital Projects based on established materiality thresholds.
 - x. “Repairs and Maintenance Expenses” are costs undertaken to maintain existing assets in working condition and do not extend the useful life of the asset.
 - xi. “Surplus” means the excess of funding between a Capital Project budget and the total actual Capital Project costs.

2.0 CAPITAL BUDGET PREPARATION

2.1 Identification of Capital Projects

Each year, Directors are required to identify capital projects required for the next five year period and documented in the Capital Budget and Capital Outlook. A capital project must be supported by a business case and associated

documentation, in accordance with the process established by ELT.

The Capital Budget and Capital Outlook must be reviewed and approved by ELT, prior to submission to Council.

2.1.1 Annual Contributions from the Operating Budget

The City establishes capital contributions, which are funded from the municipal tax levy (available for all City capital projects excluding water/wastewater funded from user fees and Fleet, Parking, Parks Equipment, Paramedic Services and Police funded from their respective reserve funds), and water/wastewater user fees.

The following are the Council approved capital contributions:

Capital Contribution Name	Description
General	All capital needs of City assets excluding Water, Wastewater, Police, Communication Infrastructure, City Fleet Equipment, Parks Equipment, Paramedic Services (EMS), and Parking
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
Healthy Community Initiative (HCI) Fund	To support the promotion of Greater Sudbury as a healthy community where funds are issued to projects that promote community growth and contribute to the quality of life in Greater Sudbury. Funds of \$600,000 (\$50,000 per ward) for all twelve wards have been set aside from the overall capital contribution to be used for the HCI Fund in accordance with By-Law 2018-129.

Each year, the capital contributions are increased by the greater of 2% or the first quarter (or most recent quarter, if the first quarter is not available at the time of preparation of the annual budget direction report to Finance and Administration Committee) Non-Residential Building Construction Price Index (for Ottawa) as reported by Statistics Canada.

Council will approve the capital contributions during the budget deliberations.

Capital Financing Plan

Finance will review all available funding sources and propose to ELT a comprehensive financing plan to support the annual capital budget.

Council will approve the capital financing plan as part of budget deliberations.

3.0 CAPITAL BUDGET MONITORING AND VARIANCES

3.1 Monitoring of Capital Budget

If budget variances are anticipated, Directors responsible for managing the Capital Project must notify Finance as soon as possible, so that funds can be reallocated in accordance with Section 3.3.1 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, requiring an unplanned funding expenditure, 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 funding source for the emergency will be the relevant Holding Account or capital financing reserve fund.

If a Capital Project has not had any activity for 24 months the project will be closed and the remaining project funds will be transferred to the Holding Account or relevant capital financing reserve fund where applicable. The ELT member can request that the CAO approve an extension in exceptional circumstances.

3.2 Capital Budget Reporting

3.2.1 Completed Capital Projects Report

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

The capital variance report will identify capital projects in excess of \$200,000 which have been completed during the quarter.

If changes in project circumstances provoke discussions about continued funding of a capital project (due to changes in priorities and potential reprioritization in a future year), these changes will be disclosed in the variance report and funds will be either transferred to the relevant Holding Account in accordance with Section 3.3 below, or transferred to the respective capital financing reserve fund.

3.2.2 Capital Status Update Report

The CFO will provide the Finance and Administration Committee or Council with a Capital Status Updates Report annually. This report is projected to be completed prior to the end of March and provided to the Committee in April. This report will include the following:

1. Detail all outstanding capital projects and a brief comment on status (when completion is anticipated, expected final surplus/deficit, etc.).
2. For larger projects (over \$3.0 Million for Roads, Water and Wastewater and over \$1.0 Million for all other Departments), a complete commentary is required that will detail project highlights, accomplishments, expected timeline to completion, funding sources, etc.
3. Provide a summary of all projects completed from the prior Capital Status Update Report, including information on surpluses and deficits.
4. Update the balances remaining in the Holding Account and the transactions since the last report.

3.2.3 Mid-Year Capital Status Presentation

Staff will provide the Finance and Administration Committee or Council with a mid-year capital status presentation. This presentation is projected to be done prior to the end of September. This presentation will include the following:

1. Detail all major capital projects and a brief comment on status (when completion is anticipated, project highlights, accomplishments, expected timeline to completion, funding sources, etc.).
2. Provide a commentary on all major projects completed.

3.3 Capital Project Variances

Capital Project budgets will be based on guidelines approved by ELT for quality and completeness, and reflect all available information at the time the project is submitted for consideration. Project variances compiled and reported throughout the project will be based on best available estimates.

3.3.1 Holding Accounts

Holding Accounts will be created as reserves and will be funded by surpluses on Capital Projects and will be used to fund over-expenditures on other Capital Projects, subject to limits.

Finance will be responsible for administering the Holding Accounts.

Holding accounts will have target balances as follows:

- Capital General Holding Account \$4,000,000
- Water Rate Holding Account \$1,500,000
- Wastewater Rate Holding Account \$1,500,000

3.3.2 Capital Project Surplus – Transfer to Holding Accounts

If a surplus arises or is anticipated from an existing Capital Project, staff will contact Finance who will record and transfer the surplus to the appropriate holding account or capital financing reserve fund.

3.3.3 Capital Project Deficit – Use of Holding Account Funds

A Capital Project deficit can be funded by the relevant Holding Account or capital financing reserve fund to a limit of the greater of 10% of the original Council approved project budget or \$100,000. If the additional funding requirement is greater than noted above, a report providing the funding source is required for Council approval. If the parameters of the Capital Project change significantly (due to an increase in complexity or unanticipated timing related issues) and immediate approval for the sound investment of capital is required, the CAO has the discretion to use the relevant Holding Account or capital financing reserve fund to fund a project deficit of up to 20% of original Council approved project budget.

Previous use of the Holding Account or capital financing reserve fund to fund a project's overrun must be added to the new use of the Holding Account or capital financing reserve fund to calculate the limit of excess over budget in aggregate.

Any Capital Project deficits funded by the Holding Account will be reported to Council in the next quarterly Completed Capital Projects Report.

3.3.4 In Year Investment Opportunities – Use of Holding Account Funds

If an investment opportunity arises to leverage external funding the Holding Account will be the funding source. This is to decrease the impact on other

previously approved priority projects. ELT member approval is required for projects that require up to \$100,000 in funding. The CAO may approve a request for up to \$250,000 in funding. Any amounts above \$250,000 will require Council approval.

There will be other investment needs during the year that are not an emergency situation but are sound investments of Capital. The CAO has the approval to fund required studies or projects from the Holding Account up to a maximum of \$100,000 per project. Any projects invested in will be reported to Council in the next quarterly Completed Capital Projects Report.

3.4 Scope Change - Capital Project Surplus

Where opportunities exist to improve project outcomes, reduce anticipated future costs or achieve a related but previously unanticipated outcome, unexpended project funds that would otherwise be deemed to be surplus may be redirected to capture such opportunities. Such changes cannot increase the overall Capital Project budget beyond the Council approved amount. Investments up to a limit of the greater of 10% of the original Council approved project budget or \$100,000 can be approved by the ELT member, the CAO may approve a request for up to \$250,000 in funding and if the scope change is greater than above, the approval of Council is required. Any remaining surplus after any scope changes will be transferred to the Holding Account or reserve fund.

For unit price contracts for roads, water and wastewater linear projects, the quantities are estimated when the specifications are drafted, and payments for increased or decreased quantities may be required due to actual field conditions. Any total project over-expenditure on these projects would fall under the provisions of Section 3.3.3. above.