

# 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>