PRESENTING AND FUNDING MAJOR CAPITAL PROJECTS
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When cities and towns consider capital improvements and projects, there are options on how the request is presented and how it is funded. Capital expenditure requests can be put forward as budget line items or as separate articles, while funding can involve direct dollar outlays or borrowing. First, however, the community should establish policy thresholds or guidelines to determine what qualifies as a capital expenditure.

Defining a Capital Expenditure

Typically, a capital expenditure is defined in terms of useful life and cost. For instance, a policy might state that to qualify as a capital expenditure, a proposed purchase or project must have a useful life of three or more years and must exceed $10,000 in cost, or whatever policymakers decide works best for the community. Both thresholds must be satisfied; otherwise, the purchase or project is not a capital item and would be funded as an expense in the departmental operating budget.

Capital requests should be reviewed by a capital improvement committee or pass through another formal evaluation process ultimately ending with recommendations to a legislative body. The most effective capital programs prioritize all departmental requests in a ranking system that measures each project against set criteria and gives it a cumulative score. In this way, all proposals are subject to the same objective review standards and analyzed in the context of community-wide needs. Subject to available funds, higher scoring projects are given priority and recommended in the upcoming fiscal year, while lower scoring (i.e., lower priority) projects are scheduled over a five-year capital plan.

Presenting a Capital Expenditure Request

A capital expenditure request can be presented for approval of town meeting, town council, or city council in the following ways:

- <u>Multiple Request Capital Improvement Budget Article</u> - All capital requests involving purchases or small projects from all departments can be listed in a single budget article. The article is frequently in a table format that lists for each item the amount requested, amount recommended, and proposed funding source. Although a single vote approves or rejects all items in the article, each expenditure can be discussed, amended or removed. Other capital purposes can be added as long as a corresponding funding source is identified to maintain a balanced budget prior to submitting a Tax Recap Sheet to DLS.

- Single Request Budget Article - Although any capital request may be presented in its own article, this manner of presentation is most often reserved for significant purchases, building construction, and other major infrastructure projects. The article must at least specify the purpose, proposed cost, and funding source. In some instances when bonding is involved, evidence of the project approval and bond authorization is required in a separate article. A municipality should consult its bond counsel in this regard.

- Capital Outlay Line Item - A direct dollar outlay for a capital purpose can be included as a line item in a departmental budget. As a general rule, a capital outlay is used for purchases or projects at the lower end of the capital cost range.

Funding a Capital Expenditure

When a project is small-to-moderate in size, a direct appropriation or dollar outlay would cover the complete cost for the capital expenditure. These outlays can be funded by any nonrestricted revenue source, which must be specified when the expenditure is approved. For larger outlays, a municipality can seek voter approval of a capital expenditure exclusion (M.G.L. c. 59, §21C(i½)), which raises in tax revenue the money needed to cover the total cost of a capital project or acquisition. A capital exclusion does not involve borrowing over time but instead authorizes a one-year increase in the levy limit to raise needed dollars.

Alternatively, if a major project or purchase is financed through the issuance of municipal bonds, a city or town must identify the source of the funds necessary to pay debt service on the borrowing. If excess revenues already exist, the annual debt service amount can be split and added to the long-term principle and to the long-term interest line items in the operating budget. However, if additional revenue is needed, municipal leaders can seek community-wide voter approval of a debt exclusion or override referendum.

A debt exclusion (M.G.L. c. 59, §21C(j)) raises tax revenue beyond Proposition 2½ limits to pay debt service costs on borrowing to finance a capital project, (e.g., new school construction). The additional tax from a debt exclusion remains a part of the tax levy only for as long as the term on the underlying bond.

An override (M.G.L. c. 59, §21C(g)) is primarily a means of funding recurring expenses and is used specifically when additional revenue is needed to balance the annual budget. Unlike a debt exclusion, the tax increase from an override remains a permanent part of the tax levy. Although some or all of the override money may be a direct dollar outlay or dedicated to debt service payments, financing capital improvements in this way is not a sound financial management practice.

Making Good Decisions

Understanding the available options for funding capital improvements is essential to good decision making. Equally important is the completion of five-year revenue and expenditure projections, the adoption of debt and reserve policies, and the implementation of a thoughtful capital request evaluation process. With this type of information in hand, municipal leaders are better equipped to act in ways that effectively protect public assets and realistically plan for the future.