

# QUICKNOTES

*Planning fundamentals  
for public officials and  
engaged citizens*

*This PAS QuickNotes was prepared by Terry Holzheimer, FAICP, director of Arlington Economic Development and adjunct faculty member at Virginia Tech's graduate program in Urban Affairs and Planning.*

## Capital Improvements Programming

### WHAT IS A CAPITAL IMPROVEMENTS PROGRAM?

A capital improvements program (CIP) is a road map for planning and funding public facilities and infrastructure. It typically incorporates both the construction of new facilities and the rehabilitation or replacement of existing capital. It is often required by law and usually involves a relatively formal process of public hearings and adoption by the local governing body. Many states provide a handbook for preparing a CIP in the context of specific state statutes. Typically, a CIP covers a period of three to six years and serves as a declaration of intent by a locality to make capital expenditures on the schedule indicated. A CIP may or may not consider multiple forms of funding; at a minimum it includes those expenditures to be funded through bonded indebtedness.

Planning, finance, and engineering professionals should be part of the team preparing the CIP. Despite an interdisciplinary approach, though, CIPs too seldom incorporate an analysis of future operating costs associated with the capital investments or the broad fiscal impacts of such investments.

### PROJECTING CAPITAL NEEDS

Growth and development call for new or expanded infrastructure or facilities. Best practices include an economic analysis of the fiscal impact of new investments, including the life cycle costs of maintaining and operating facilities or infrastructure. A community should have a set of adopted facilities standards and a comprehensive public facilities plan to guide the more short-term CIP. There is an essential linkage between growth and the timing, phasing, or concurrency of capital investments.

### FUNDING FACILITY NEEDS

A funding plan should start with projections of annual aggregate costs for facilities and infrastructure as a cash-flow model. This should be developed with consideration for population and employment growth and the need to replace obsolete or inefficient existing facilities. Once there is a model of funding needs, the source of funds for each project can be considered; a wide variety of options are available.

Most local officials think of the CIP as a plan for general obligation (GO) bond financing. GO bonds carry the lowest interest rates because they are full faith obligations of the issuer over a long term, typically 15 years or longer. They generally require a referendum; they are rated securities issued as tax exempt bonds. As general obligations, the rating agencies consider the overall fiscal position and management of the locality in deriving ratings. Measures such as a community's debt as a percentage of the taxable base, debt service as a percentage of general fund expenditures, reserves as a percentage of revenues, and other fiscal factors affect the ratings and place practical limits on indebtedness.

"Paygo" financing of facilities and infrastructure is usually an annual appropriation from general fund expenditures, carryover, or reserves. Since paygo funding does not involve the issuance of debt or payment of debt service, but relies on annual expenditure decisions, it is typically used for more modest capital projects such as facility expansions, renovations, or infrastructure replacement.

Revenue bonds are tax-exempt bonds that are underwritten based on an identified external source of revenue, e.g. toll roads, recreational facilities, etc. Because revenue bonds are not general obligation financing, they generally do not count against the locality's debt ceiling and should not affect the metrics used by the rating agencies.

Some communities enter into lease-purchase agreements or public-private partnerships for the development of facilities. Such agreements can lower facilities costs through the use of tax deduc-

*The Lukmire Partnership, Inc. Eric Taylor, Photographer*



*General obligation bonds were used to fund a public library, community theater, and parking deck as the focal point of a redevelopment project.*



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tions by a private developer and the deferral of some public costs into future years. They have the added benefit of not counting against the debt ceiling.

Special tax districts can be used to layer capital expenditures on top of those carried by the general fund. Because it is a special purpose tax, the revenues and expenditures must be accounted for discretely and not comingled with general revenues. A subset of special districts is the special district authority, which can receive and spend the added tax revenues for a specified purpose. Special districts may or may not require a referendum.

Transfer payments from higher level governments in the form of formula returns or special grants may be dedicated to capital or infrastructure needs. States fund projects such as school construction or roadway improvements based on a funding formula tied to population, income, or other factors. Funding is often related to specific state revenue collections, such as the sales tax, gas tax, or lottery revenues. The federal government also funds infrastructure and facility projects through categorical grants based on qualifying factors such as regional personal income or unemployment.

A CIP can be quite complex, with multiple sources of funds available and often with single projects funded by multiple sources. While a single CIP document typically presents a relatively short-term funding plan, it behooves a community to consider factors such as facility life cycle costs, aggregate new spending required related to growth, and operating costs in devising a fiscal plan for funding facilities and infrastructure that goes beyond the typical short-term CIP budget.

## EXPORTING COSTS

Local debt service to finance capital improvements has grown over recent decades as a percentage of general fund revenues, increasing faster than population, households, and real per capital personal income. Communities look for ways to pass some of these costs on to others, effectively exporting such costs to developers and ultimately the buyers of new homes and commercial tenants. Exactions, proffers, conditional zoning, impact fees, linkage programs, and fiscal zoning have all been used to move these costs to developer pro formas. A significant portion of a community's capital improvements can be exported, reducing the need for direct public funding of facilities and infrastructure.

## GUIDELINES FOR PREPARING A CIP

There are practices beyond those required by law that will yield far better results in guiding facilities and infrastructure investment:

1. Long-term projections of demographics and growth patterns should inform both facilities and service standards.
2. Fiscal impact analysis is an essential tool for projecting facility and infrastructure expenditures and annual net costs.
3. Funding plans should match facilities costs with sources of funding, as many facilities may have multiple or alternative sources of funding, requiring a CIP to include more than the traditional bond funding.
4. Funding plans must also consider the timing of growth and provide for concurrency between the need for improvements and other construction.
5. Facility needs will most likely exceed the funding available through traditional forms of public finance, requiring creativity and innovation and the exportation of costs.
6. There are limits to the extent to which costs can be exported; they must meet strict tests of nexus and reasonableness. However, the use of these tools may be essential to funding the volume of facilities and infrastructure needed.
7. The capital improvements program should be fully integrated and linked with the local comprehensive plan, using all of the tools available to fund capital projects.

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*W. Paul Farmer, FAICP, Executive Director and CEO; William R. Klein, AICP, Director of Research and Advisory Services; Tre Jerdon, QuickNotes Editor; Tim Mennel, Senior Editor; Julie Von Bergen, Assistant Editor; Susan Deegan, Senior Graphic Designer.*

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