

Capital Financing Strategies

AWC Budgeting Workshop – August 2, 2024

Tracey Dunlap, Consultant/Retired Kirkland Deputy City Manager
George Dugdale, Kirkland Financial Planning Manager

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Agenda

Characterizing the Issue

Capital Financing Sources and Strategy Considerations

The Process

Practical Application

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Characterizing the Issue

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What are Capital Facilities?

The Growth Management Act requires jurisdictions planning under GMA to have a capital facilities plan element

For this purpose, capital facilities have a dollar value above a certain threshold (example, \$25,000 or \$50,000), with a useful life that exceeds five years

Examples of capital facilities for municipalities include roads, bridges, sidewalks, utilities (water, sewer, stormwater), buildings (city hall, fire stations, maintenance facilities), parks, etc.

Unlike operating costs, capital funding needs are large, discrete, and accumulate if deferred

Impacts can be abrupt and financial integrity threatened without a long-term plan for funding capital needs

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What is the Issue?



Public Works and Utilities are capital intensive businesses

Assets are often 8-10 times annual revenues



Municipal financial management often focuses on cash needs

Budgets may be cash flow driven

Capital may be funded on an "as available" basis

Borrowing may be considered a last resort, when delay is no longer an option

Accumulating cash may be viewed as indicating that current revenues are too high

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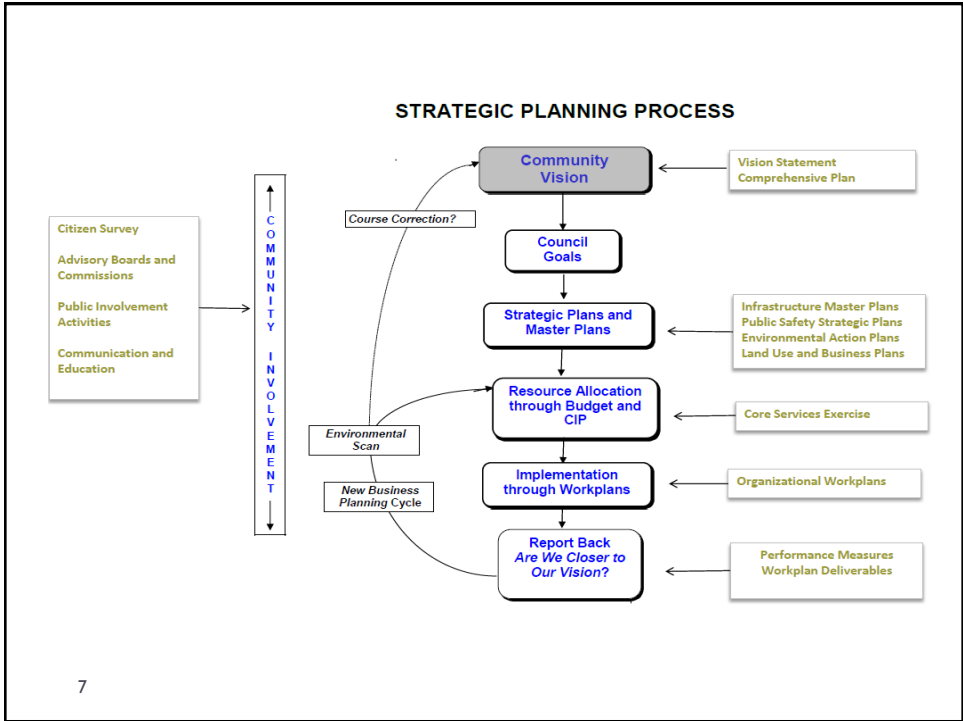
What is the Purpose of a Strategy?

- ▶ Capital needs increase over time
 - ▶ Original system may not have been constructed with municipal revenues (developer built, grants)
 - ▶ Cost escalation
 - ▶ Increasing complexity due to density and regulation
 - ▶ Replacement needs accumulate if deferred
 - ▶ The easy stuff has already been done!



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Capital Financing Sources and
Strategy Considerations

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Threshold Questions

- ▶ How do you come up with an order of magnitude for the need and how does that relate to actual experience?
- ▶ Does your balance sheet reflect all the assets you have in the ground, especially developer donated plant?
- ▶ Do you have a current funding strategy?
 - ▶ Does available funding define needs?
 - or
 - ▶ Are needs defined and a funding strategy developed to meet those needs?






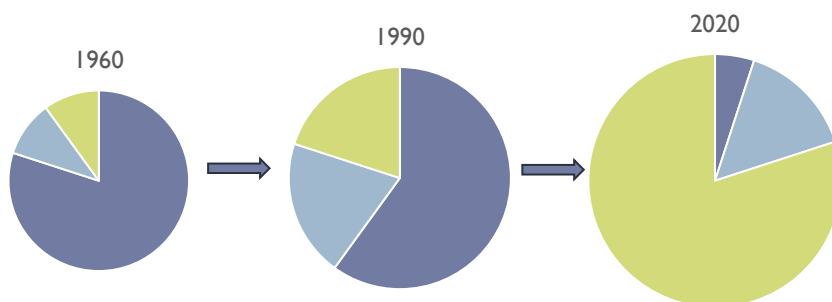
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Example of Lifecycle of Capital Needs

▶ Sizing needs

- ▶ Repair and replacement 
- ▶ Upgrades 
- ▶ Expansion 

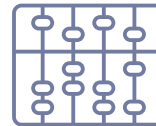


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Where Do We Start?

- ▶ Ideally, you have master plans that address these needs for a long planning period – 20 years or more
- ▶ If that information is not available, or only focuses on system expansion, there are a few ways to get a rough estimate of the minimum that needs to be invested in repair and replacement:
 - ▶ Depreciation
 - ▶ Survivor curves



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Depreciation

- ▶ Depreciation is an accounting measure of the “consumption” of assets based on useful life
- ▶ It is a simple financial measure based on useful life, not a technical assessment
- ▶ Depreciation assumes consumption based on the original cost of the asset. Replacement costs will be higher due to:
 - ▶ Inflation
 - ▶ Built environment
 - ▶ Regulations



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Survivor Curves

Infrastructure does not age uniformly

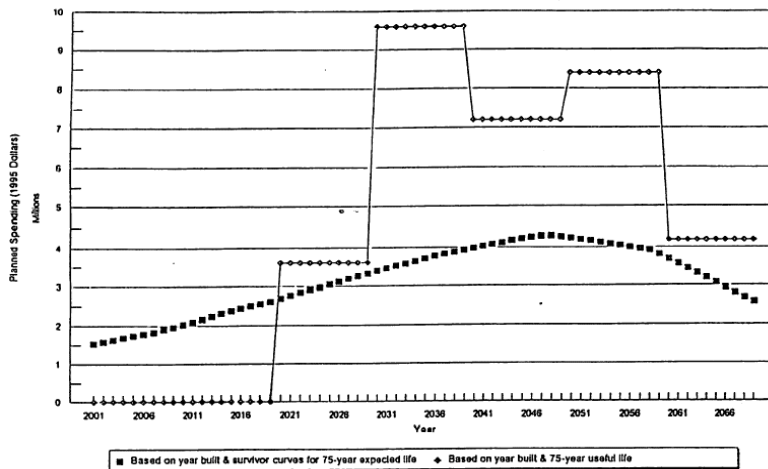
Survivor curve approach is adopted from the insurance industry

Balancing accounting measure against failure rates

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Water Main Replacement Spending Example



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What does this tell you?



How does your current capital funding compare to annual “consumption” of assets? Remember costs go up just due to inflation and many assets were originally built on/under undeveloped land



If your funding is well below depreciation and you have not been regularly replacing assets or reserving funds, actual costs will likely be even higher due to past unfunded liabilities



The best way to determine replacement needs is a technical evaluation as part of the engineering planning process

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Capital Financing Strategy Considerations



Evaluate all funding options



Consider the use of a combination of cash and debt



Restrict funding for future use

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Direct Cash Funding



Equity issues of how much past, current, and future customers should bear



Available and stability of recurring revenues



Obligation to replace assets – “going concern”



If all funds are not expended immediately, accumulate and reserve funds for future needs

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What Revenue Sources Can We Work With?

▶ Restricted Capital-Focused Sources:

- ▶ Real Estate Excise Tax (REET)
- ▶ Impact Fees
- ▶ Utility Capital Facilities Charges
- ▶ Local Improvement Districts
- ▶ Grants (State and Federal)



Caveat: Many capital funding sources come with significant rules and restrictions

▶ Current Revenues

- ▶ General Fund Taxes
- ▶ Utility Rates



Caveat: Most utilities are enterprise funds - revenues are restricted to utility purposes

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What Revenue Sources Can We Work With?

▶ Voted Options

- ▶ MPD/TBD
- ▶ Levy Lid Lifts
- ▶ Excess Levy (Voted Bonds)



▶ Voted Options Considerations:

- ▶ Choice of the capital projects funded by the levy
- ▶ Involvement of the community
- ▶ Strong communications
- ▶ Affordability
- ▶ Important role of bond counsel/financial advisors

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Debt Funding (not a revenue source!)

Mechanism for better matching outlays to assets useful lives

Helps manage the total burden on current customers

Promotes long-term perspective on long-lived assets

Relatively low cost of capital for governments vs. the private sector or consumers

Spreads costs more evenly over time

Long-term commitment - requires reliable revenue source to repay and that security requirements are met

Make sure you can deliver before you borrow!

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Grants (Free money?)



Depending on the funding source, grant administration can impose a significant burden (and risk)

Federal grants have specific requirements that are subject to audit

Sometimes it is hard to tell if it is Federal money, as it may pass through other agencies



Understand the long-term commitments you may be making

Requirements after grants expire

Construction bidding and timeline requirements

Reporting requirements

Read all the documents carefully and have a plan to comply with provisions



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The Process

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The Process



Step 1: Laying the Foundation

Initial public review of the need to plan and the approach

Define Goals:

- Fund current and future infrastructure needs
- Safeguard assets and financial strength
- Protect the interest of current and future constituents

Establish financial policies

Restrict replacement reserves

Identify and gather source documents

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Step 2: Project Long-Term Capital Needs

Review master/system plans or asset management information

In the absence of engineering assessments, estimate future replacement needs based on the age of the system

Incorporate replacement needs in planning documents

Include replacements and capital improvements/enhancements to obtain a picture of long-term capital funding needs

Establish prioritization criteria

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The Process



Step 3: Forecast Funding Sources

Project primary revenue sources

Identify needs that are candidates for debt financing

Project reserve accumulations and uses

Develop a tool to generate scenarios

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Step 4: Establish Check Points

Compare annual investment levels with projected needs

Develop a process for updating needs as planning information is available

Update revenue source calculations regularly (connection charges, impact fees, rates, etc.)

Monitor debt obligations

Review priorities and set criteria for trade-offs

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The Process



Step 5: Develop Financing Strategy Scenarios

Establish needs and priorities
Evaluate funding sources
Review against check points



Step 6: Educate Staff, Elected Officials, and the Public

Magnitude of the issue
Role of debt in capital financing
Need to maintain and generally increase revenue sources
Possible need to accumulate reserves on future needs
Report on Progress

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Implementation



Getting Policy-Makers and the Public On Board

Define the importance of the issue
“Legacy”
Equity
Rate/revenue stability
Maintaining/improving service levels



Policy and Accounting

Memorialize policy commitments in adopted actions/bond documents
Restricted funds and accounts
Standards for budget and financial plan development



Practical Considerations

Needs will be clarified/change over time – flexibility is key
Policies may change with new management/elected officials
Requires involvement of engineering, maintenance, and financial expertise

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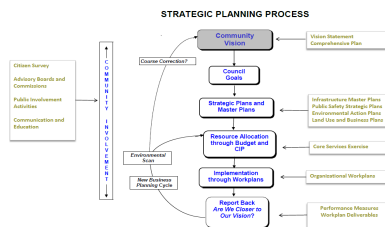
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Practical Application

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Developing Kirkland's CIP



- Work starts with strategic planning processes (Transportation, Water/Sewer)
- Some topic related action plans (Safe Walk Routes to School)
- CIP developed with available funding estimates, departmental requests and City Manager direction
- Council feedback
- Annual reports on progress against plans

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CIP Development Process



Step 1: Priorities memo to Council establishes framework for development and includes some key deliverables



Step 2: Using long range plans, available funding, and prior CIP departments prioritize projects for next 6-year window



Step 3: City Manager provides review and proposal for Council



Step 4: Council deliberations before adoption of CIP via resolution, and 2-year projects in biennial budget via ordinance

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Some Specific Examples

Master
Plan/Dedicated
Funding Sources

Aging
Infrastructure/Long-
Term Funding

Opportunistic
Funding

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Transportation Benefit District (TBD)



2020 Release of Safer Routes to School Action Plan



2021-2022 Development of Capital Program from plan



2022 Passage of \$20 vehicle license fee (VLF)



2023-2028 Capital Improvement Program Spending Timeline



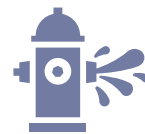
2024 Debt Issuance to support capital projects - debt service paid using VLF revenues

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Aging and Failing Utility Infrastructure

- ▶ Major long-term replacements are contemplated in rate models
- ▶ Inflation and other cost pressures can cause short term impacts
- ▶ Mitigate new system needs via connection charges
- ▶ Prioritization through General Plans that happen every 5-years
- ▶ Emergency repairs use existing repairs



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Maintenance Center Remodel

- ▶ Full remodel of maintenance center beyond realistic funding sources
- ▶ Used property acquisition set asides to secure new site for Parks maintenance
- ▶ After visioning process for Public Works, City has identified priority items and key land acquisitions
- ▶ Not all needs will be funded, but site will be modernized and expanded as funding allows



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Key Questions to Evaluate

Does it maintain existing level of service or is it a new LOS?

Regulatory (required) or discretionary (policy-based)?

Consistent with:

- Master Plan?
- Council Goals?
- Workplan?

What options did you consider?

What would you trade-off?

One-time vs. ongoing?

Have all costs been included?

Expenditure reductions/offsets?

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A Few More Specific Examples

New
Program

Project Cost
Increases

Regional
Facility

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New Program



- ▶ Scenario: The Parks department wants to add a new sports program (think pickleball) that requires additional facilities and staffing for maintenance. What questions would you ask?
 - ▶ Is the program identified in the PROS Plan?
 - ▶ Are there any underutilized facilities that could be adapted?
 - ▶ Are there outside organizations that could run the program?
 - ▶ Has the community or Council identified an interest or need?
 - ▶ Can revenues support the program?

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Project Cost Increases



- ▶ **Scenario:** A \$10 million capital project was added in the last CIP update and staff is now estimating that the cost is \$15 million. What questions would you ask?
 - ▶ What are the drivers of the increase?
 - ▶ If the scope has changed, why?
 - ▶ Are there alternative approaches to keep the project within budget?
 - ▶ Can the project be phased or deferred, so that future revenues can be used for the difference?
 - ▶ What lower-priority projects that can be deferred to provide a funding source?

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Regional Facility



- ▶ **Scenario:** Surface Water is recommending that the City construct a Regional Decant Facility on a piece of commercial property that was recently put on the market. What questions would you ask?
 - ▶ What do we currently do and why is a new facility needed?
 - ▶ Who are the potential regional partners and what are they willing to commit to the effort?
 - ▶ If there are grants available for construction, what obligations do they require of the City?
 - ▶ What are the zoning, neighborhood, and transportation implications?
 - ▶ What might be the revenue loss if the property is removed from the tax rolls?

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Wrap Up



Capital financial planning is not a sprint, it is a marathon



It is important to start and recognize that your strategy will need to evolve over time



Developing a strategy is a blend of policy, financial, and technical (engineering) decisions – establish a team



Discipline and flexibility are both key to long-term success!

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Questions?



Thanks for your attention!



Some helpful resources:

MRSC Capital Facilities Planning page
including useful links to other resources
and examples

MRSC Revenue Guide for Washington
Cities and Towns

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