



County Technical Assistance Service

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What is a Capital Improvements Plan?

Dear Reader:

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We hope this information will be useful to you; reference to it will assist you with many of the questions that will arise in your tenure with county government. However, the *Tennessee Code Annotated* and other relevant laws or regulations should always be consulted before any action is taken based upon the contents of this document.

Please feel free to contact us if you have questions or comments regarding this information or any other e-Li material.

Sincerely,

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What is a Capital Improvements Plan?

Reference Number: CTAS-1697

What is a capital improvements plan (CIP)? Why implement a capital improvements plan? Initially, local governments are required by the state or federal government or pressured by citizens to provide a service which entails purchasing or constructing what is known as a capital asset or improvement. These capital improvements are generally buildings, equipment, and land which have high costs and long lives. Capital improvements are often used to provide new services or as a replacement for existing services. Due to the large expenses and long expected asset life, the local government should develop a plan for additions and replacement of the capital assets. Investments in capital improvements are generally expensive and in most cases the local government will issue debt to pay for capital improvements. The related debt will be paid for over a number of years in a debt service operating budget. Capital improvements generally are accounted for in a capital improvements budget as opposed to the annual operating budgets.

Operating Budget

The operating budget is an annual budget developed and approved by local government for receipt and expenditures of funds that generally have a life expectancy timeframe of less than one year. These funds are revenues, received from federal, state, and local sources and expenditures for the various services provided by the government. The expenditures would include salaries, supplies and materials, interest and principal on outstanding debt, and other current period (fiscal year) operating expenses. This budget would account for revenues and expenditures for a 12 month period referred to as a fiscal year.

Capital Improvements Budget

The capital improvements budget is a finance plan and program to purchase or contract for capital improvements—land, buildings, and other capital improvements that are considered large expenses and have a long life expectancy. Generally the funding for these capital improvements comes from the issuance of debt by bonds or notes and in some cases other revenues such as property tax and operating transfers. Generally a capital improvement budget exceeds 12 months and always extends to the completion of a specific project.

Definitions for Capital Budgets

Reference Number: CTAS-1698

- Capital Improvements—Facilities and equipment that are either required by law or necessary for public interest. Generally expensive and have long useful lives. Includes land, buildings, and equipment.
- Capital Improvements Plan (CIP)—A multi-year document used to identify needed additions and replacement improvements to your capital assets.
- Capital Improvements Financing—The mechanism that is used to provide funds to purchase improvements to your facilities. Generally funds are provided by long term bonds/notes or additional funding from recurring or excessive revenues in operating budgets.
- General Obligation (G.O.) Bonds—Debt created by local governments in the form of bonds not exceeding 40 years. Bonds are backed by the full faith and credit of the local government. Most G.O. bonds do not exceed 30 years.
- Capital Outlay Notes—Debt created by local governments not exceeding 12 years.
- Bond Anticipation Notes—Debt that does not exceed two years. Used for the purpose of delaying the issue of long term bonds in anticipation of better market conditions.
- Local Government Pools—Funds borrowed by a local government organization which is then loaned to local governments.
- Fixed Asset Accounting—An organized process of maintaining the inventory and historical costs of the capital assets of the government.
- Financial Advisor—A consultant used to assist the local government in understanding their financial plan and financial needs.
- Construction Manager—A person or firm used to assist the local government in overseeing a capital project. The manager can be an outside firm or an employee of the local government.

- Owner's Representative—Similar to a construction manager; however, generally is engaged earlier in the project's development and assists in the project's initial planning and scheduling and with the procurement of construction contracts.
- Capital Project Fund—An accounting system used to account for the revenues and expenses of the capital projects.

Advantages of a Capital Improvements Plan (CIP)

Reference Number: CTAS-1699

Some of the major advantages of a CIP are—

1. A CIP creates orderly and systematic planning for the acquisition, financing, and use of capital improvements.
2. An organized CIP provides for a more effective evaluation of alternatives and solutions than the crisis-decision process.
3. A CIP allows for a more in-depth consideration of hidden costs which affect the operating budgets.
4. A CIP provides for funding of projects on a priority basis and keeps a governmental unit within its financial bounds.
5. A CIP can provide for stable payments and tax rates over a period of time.
6. Since a CIP requires different kinds of information and involves multiple-fiscal years for project completion, a CIP developed at a different time than the operating budgets will provide for a better understanding of needs and alternatives.
7. A good CIP will promote better planning and installation or construction since the acquisition will be before the crisis time.

Disadvantages of a Capital Improvements Plan (CIP)

Reference Number: CTAS-1700

The main disadvantage of a CIP is that it requires time and effort of local government officials and staff. However, a large number of local governments in the United States feel that the effort and time is necessary to properly and efficiently manage the local government and its services.

Legal Authority for a Capital Improvements Plan (CIP)

Reference Number: CTAS-1701

Under general law each operating department is required to prepare and submit an annual operating budget to the county mayor on or before April 1 of each year or on another date specified by the county legislative body (T.C.A § 5-9-402). There is no statutory requirement for a capital improvements budget. However under the County Powers Relief Act of 2006 public chapter 953 (T.C.A § 67-4-2901) a county could be required to adopt a Capital Improvement Plan. This law is activated if a county desires to levy a tax on the privilege of residential development known as a county schools facilities tax (T.C.A § 67-4-2904). In summary, the law states a county is required to adopt a capital improvement program before passing the school facilities tax. Further the Tennessee General Assembly has recognized the needs for county governments to understand and begin documenting their infrastructure needs and has put into law public acts 1996 public chapter 817 codified as T.C.A. § 4-10-109—Inventory of Public Infrastructure Needs.

Recommended Practice: Complete and annually review the [TACIR's Public Infrastructure Needs Inventory Form](#).

Reasons for a Capital Improvements Plan (CIP)

Reference Number: CTAS-1702

One of the primary reasons for a CIP is that the stakes are high because the projects are usually very large and very expensive. A second reason is that decisions made will impact the county financially for years. A third reason is that spending will vary from year to year because needs vary from year to year.

A fourth reason is that the asset service life is long and should meet the citizens' needs for the life expectancy of the asset. A secondary reason for a CIP is that the implementation of the projects will take time because of potential financing and purchasing or construction time.

In summary, reasons for a CIP include:

1. Projects are large and expensive
2. Debt financing is often used and extends for years
3. Spending varies from year to year
4. Decisions have impact for years
5. Implementation takes time and happens in stages

As of 2008, 91 of the 95 counties in Tennessee were in debt. This indebtedness is the result of capital improvements made within those counties. As of 2008, at least sixteen counties have a specific revenue source that annually funds a capital improvement fund(s). This is an increase of seven additional counties since 2006. Both of these statistics confirm that capital projects will continue to be a part of the annual operations of counties and should be considered in the overall planning process of a county's finances.

It is highly recommended that a county develop a Capital Improvement Plan.

Factors Creating the Need for a Capital Improvements Plan (CIP)

Reference Number: CTAS-1703

Initially, the local government is required by the state or federal government or pressured by citizens to provide a service. To provide these mandated services, buildings, equipment, and land must be purchased by the local government. Since these capital improvements do not last forever, local government should develop a plan to replace them or make necessary additions on a timely basis when they are needed. What factors create the need for capital improvements?

Physical Obsolescence—The physical quality of a capital improvement will deteriorate over a period of time. Buildings usually last from 30 to 50 years while equipment will last from 5 to 10 years. Land should last forever. Since this physical obsolescence can be projected, the local government should have a plan to replace or restore the item when it reaches the time and condition for replacement or restoration.

Functional Obsolescence—In many cases, buildings and equipment become functionally obsolete before they become physically obsolete. For example, a three story school building may be a sound physical structure, but it does not meet the requirements of handicapped children and fire safety. To correct these deficiencies may not be cost-effective since the building will have to be replaced before the debt created to fund the improvements is paid. Another example would be that a building may be 35 years old and require \$2 million to renovate with the new debt retirement over a 20 year period. At the end of 10 years, less than half the debt will be paid, but the local government will have a 45 year old building with a state or federal mandate requiring the replacement.

Sometimes the population shifts from one area to another in the same local government jurisdiction resulting in the land location and improvements being functionally obsolete to best serve the people. Some equipment may have a life of more than 10 years; however, the maintenance cost may be too expensive compared to a new replacement or new equipment may result in greater productivity. Whenever an item is basically sound physically but not economically, a governmental service would be functionally obsolete.

Population Growth—Because of population growth in many counties and cities, capital improvements must be added to adequately provide services. Working closely with local planning departments, local governments can analyze and project population growth which can be used to project future capital improvement needs. Also, data in the county property assessor's office, local electric departments, and school attendance records will provide information relative to population growth and its location. A state or federal mandate has often created issues related to functional obsolescence or population type issues such as reduction in pupil teacher ratios.

State and Federal Mandated Services—When the state or federal government mandates new services or the expansion of current services, the local government must plan for required capital improvements. Examples of such mandates are kindergarten education, elementary guidance counselors, ambulance service, sanitation landfills, and jail standards including additional courts, accessibility for the handicapped, bus safety standards, reduction in teacher pupil ratios, and many others.

Citizens' Pressure for Optional Services— In many cases local citizens demand optional services such as libraries, parks, civic centers, ambulance services and fire protection.

Changes in the Economic Base—The change from an agriculture and industrial economic base to a high technology base will require local governments to expand capital improvements to attract businesses. These improvements will include facilities for re-training citizens and providing facilities for management by high tech businesses. The results of a recent survey by the University of Tennessee as published in the Business Location Determinants in Tennessee indicate that local governments must prepare the community to compete for new businesses. Of the fifteen major determinants, five would be the responsibility of the local government:

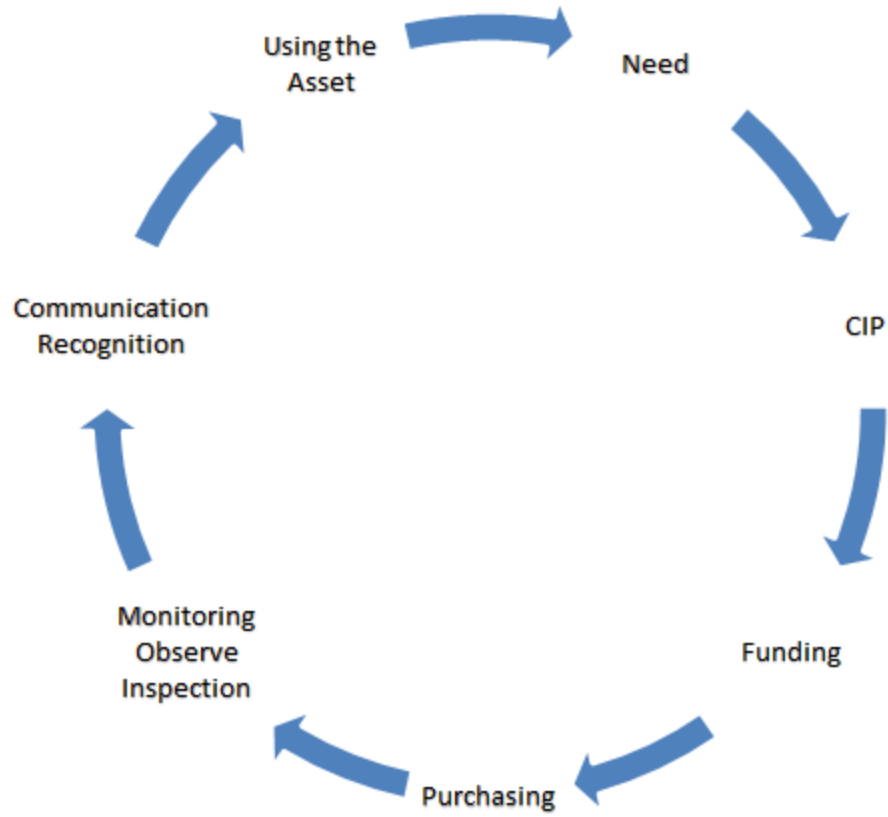
<u>Factors Essential in Choice of Location</u>	<u>Responsibility</u>
1. Existing production facilities	Business
2. Less union influence	State
3. Right to work laws	State
4. Pro-business of state government	State
5. Worker productivity (training, experience, & ability)	Local*
6. Access to current markets	Location
7. Skilled work force (training, experience, & ability)	Local*
8. Availability of credit	Business
9. Low taxes	State & Local
10. Open new markets	Business
11. Cheap and available energy	Location
12. Government support for building construction	Local*
13. Quality of life	Local*
14. Water supply	Location
15. Cheap and available land	Local*

*All of the Local responsibilities either directly or indirectly are affected by capital improvements.

The CIP Cycle

Reference Number: CTAS-1704

The following graph depicts the CIP Cycle. The steps are identifying a need, structuring a plan, securing funding for a project, purchasing or constructing a project, monitoring the construction, giving public recognition, and finally using the asset.



Source URL: <https://eli.ctas.tennessee.edu/reference/what-capital-improvements-plan>

