



Capital Budgeting in the States

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Current Economic and Fiscal Situation

State Fiscal Overview

- Fiscal 2016 marks the 6th consecutive annual increase in general fund spending and revenues
- Budget environment for most states indicates continued stability and modest growth
- Some states are facing difficult fiscal challenges due to various issues
- Fiscal improvements over the last several years have not returned states to historical patterns of growth

Measurable Improvements to the State Fiscal Environment

- States enacting spending increases in many areas
- Budget gaps and mid-year budget cuts have significantly decreased
- Tax revenues grew more strongly in fiscal 2015 after declines at the end of fiscal 2014
- Revenues on target or above projections in most states
- Total balance reached an all-time high if fiscal 2015 in actual dollars
- State Medicaid spending growing more slowly
- State and local hiring has begun to increase somewhat

Major Challenges to State Budgets: 2016+

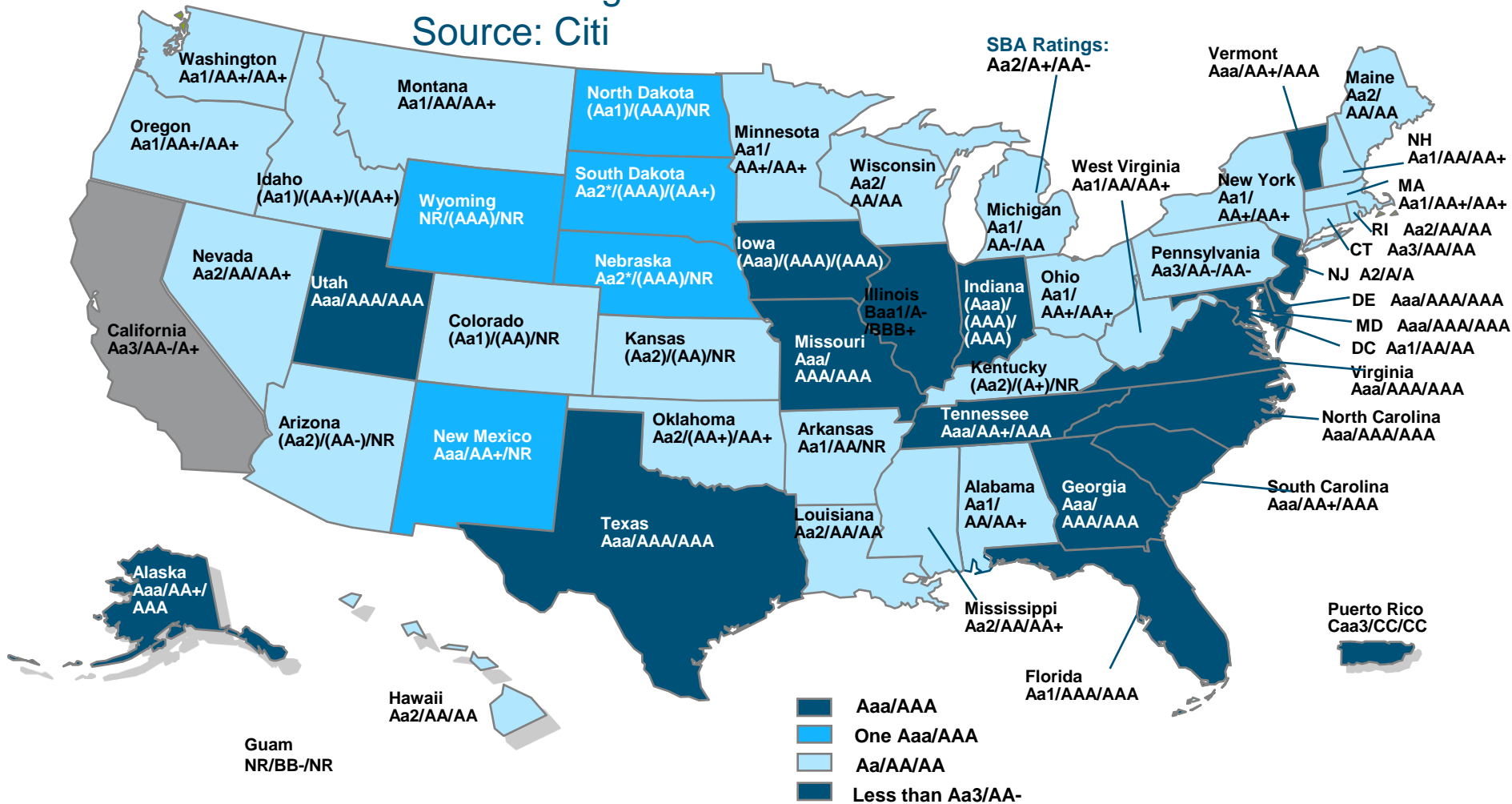
- Revenues and spending have yet to surpass pre-recession highs after accounting for inflation
 - Revenue growth projected to be modest in fiscal 2016
- Future economic growth levels?
- Rising health care costs and questions around ACA
 - Long-term Medicaid concerns remain
- Pensions and retiree health care
- Pent-up demand for infrastructure
- Certain states impacted by oil price declines, federal cuts, tax related issues, long-term liabilities, slow economic growth, etc.
- Federal uncertainty surrounding future funding levels, tax code, etc.
- States will continue to make painful choices

Condition of America's Infrastructure

- America's overall grade is D+ according to report from American Society of Civil Engineers
- Estimated Investment Needed by 2020 is \$3.6 trillion
- Program area grades include: roads (D), transit (D), ports (C), schools (D), drinking water (D)

Bond Ratings as of Jan. 2016

Source: Citi



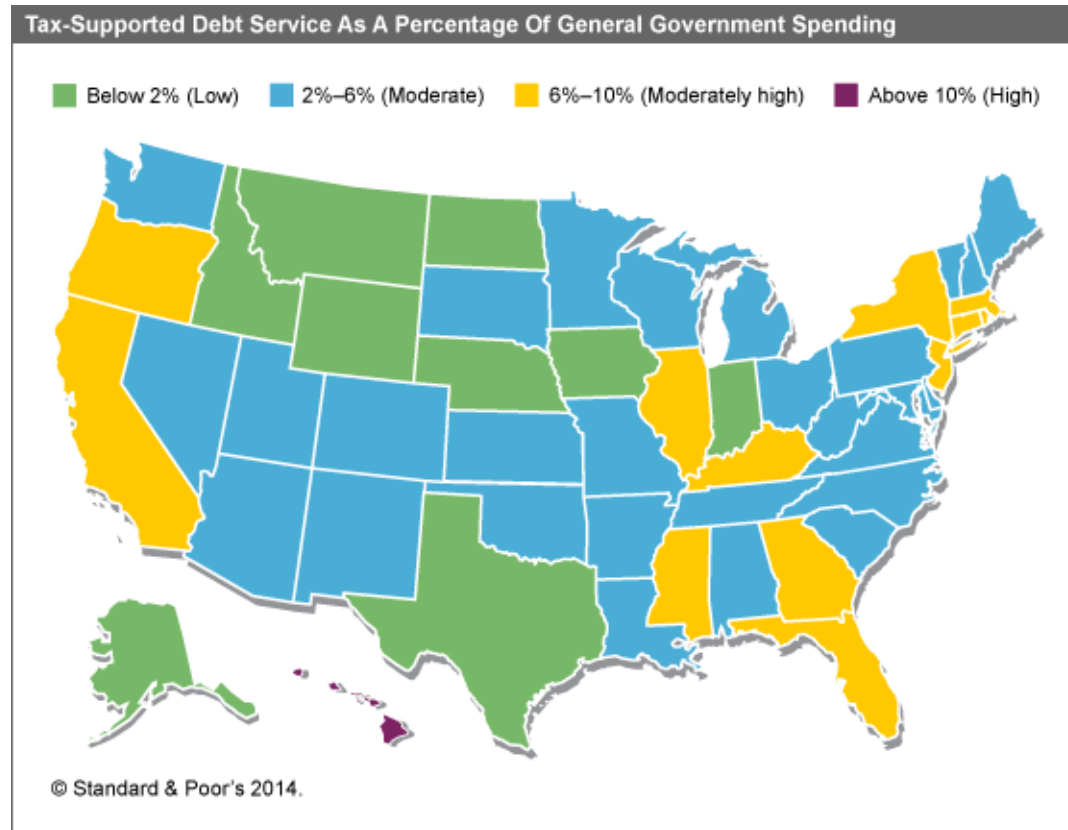
Order of Ratings: Moody's/S&P/Fitch as of January 5, 2015

*Lease revenue and/or Certificate of Participation ("COP") rating

NR: General Obligation Debt is Not Rated

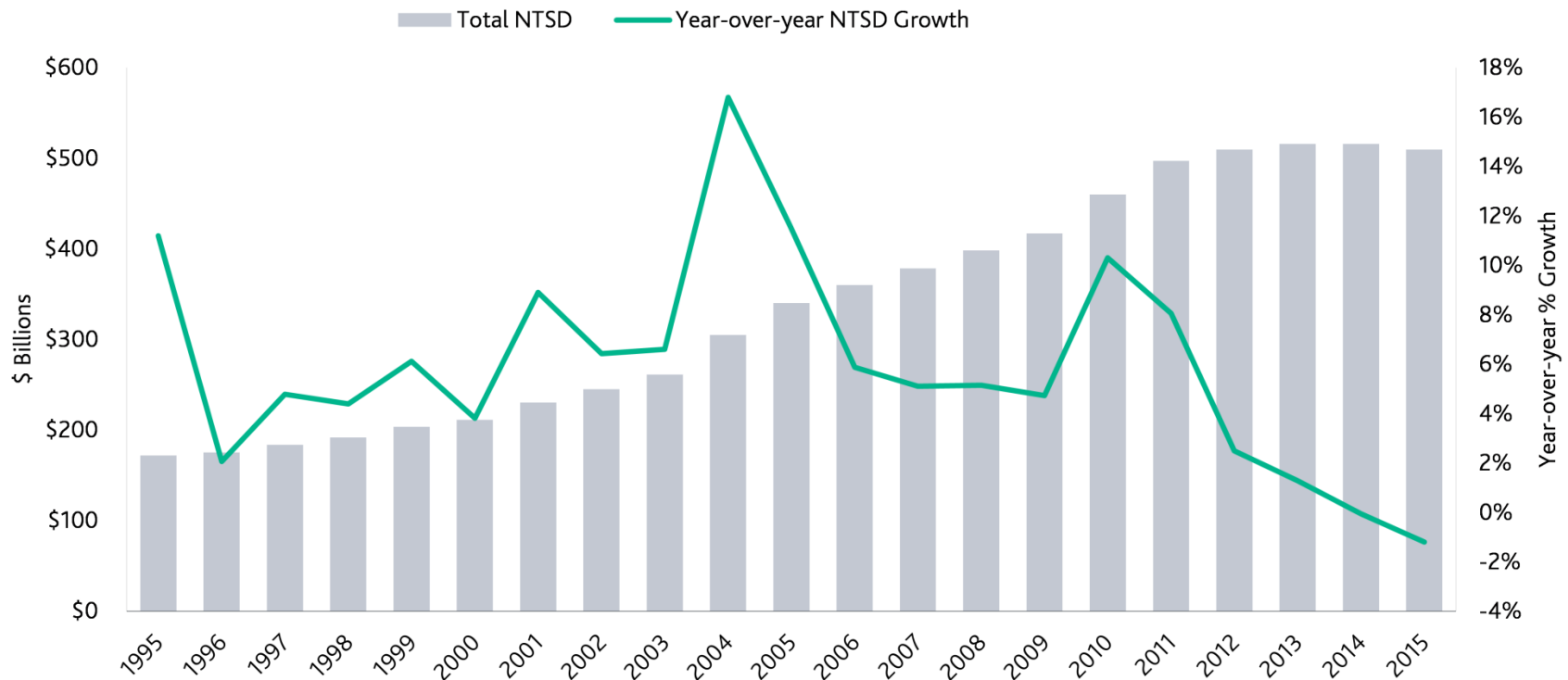
(" ") Indicates issuer credit rating which is equivalent to a General Obligation rating

S&P Debt Service Levels



Total Debt Falls for 1st Time in Nearly 30 Years

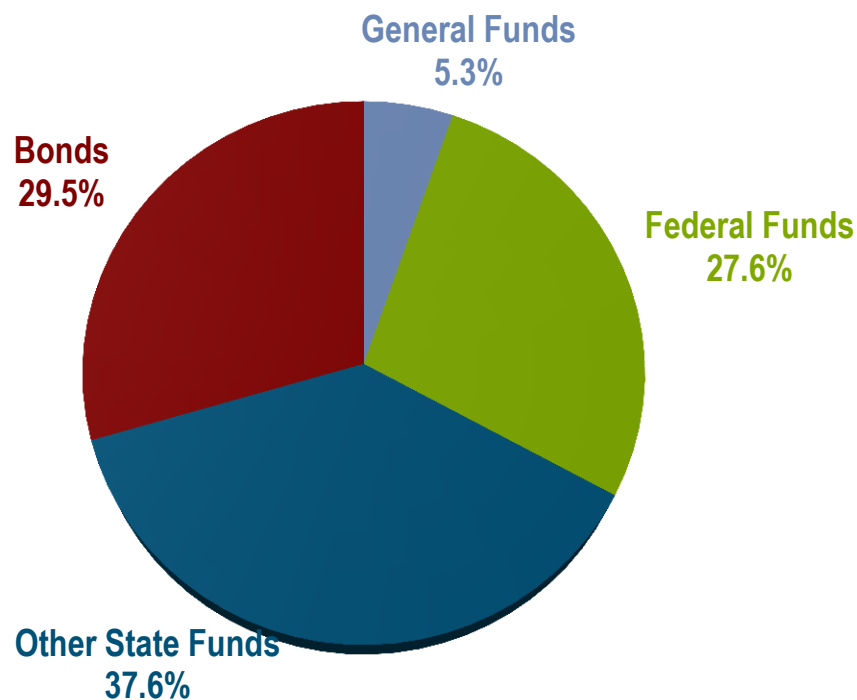
Source: Moody's Investors Service



Capital Budgeting in the States

Capital Spending by Funding Source (Percentage)

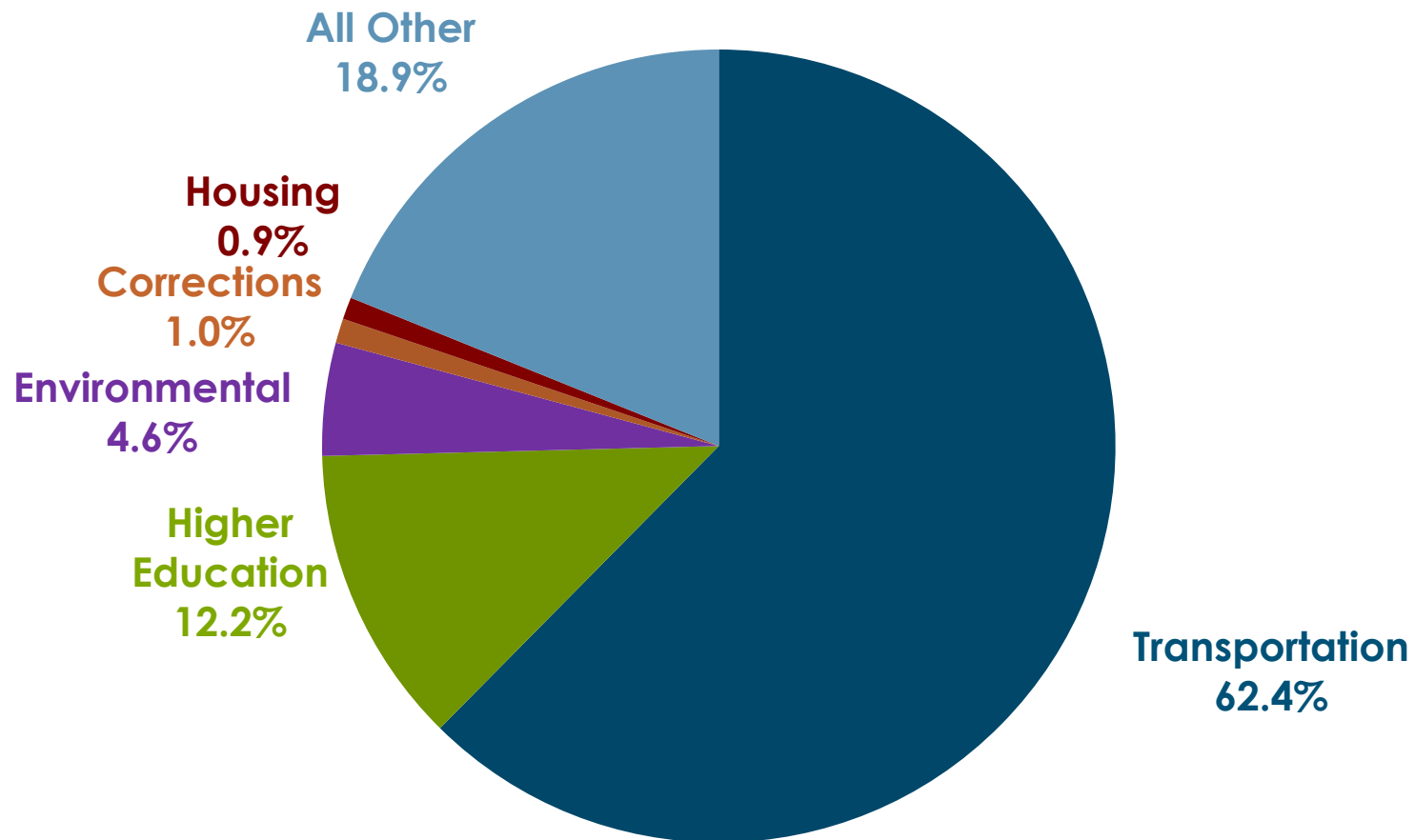
Total State Capital Expenditures by Funding Source, Fiscal 2015



Source: NASBO State Expenditure Report

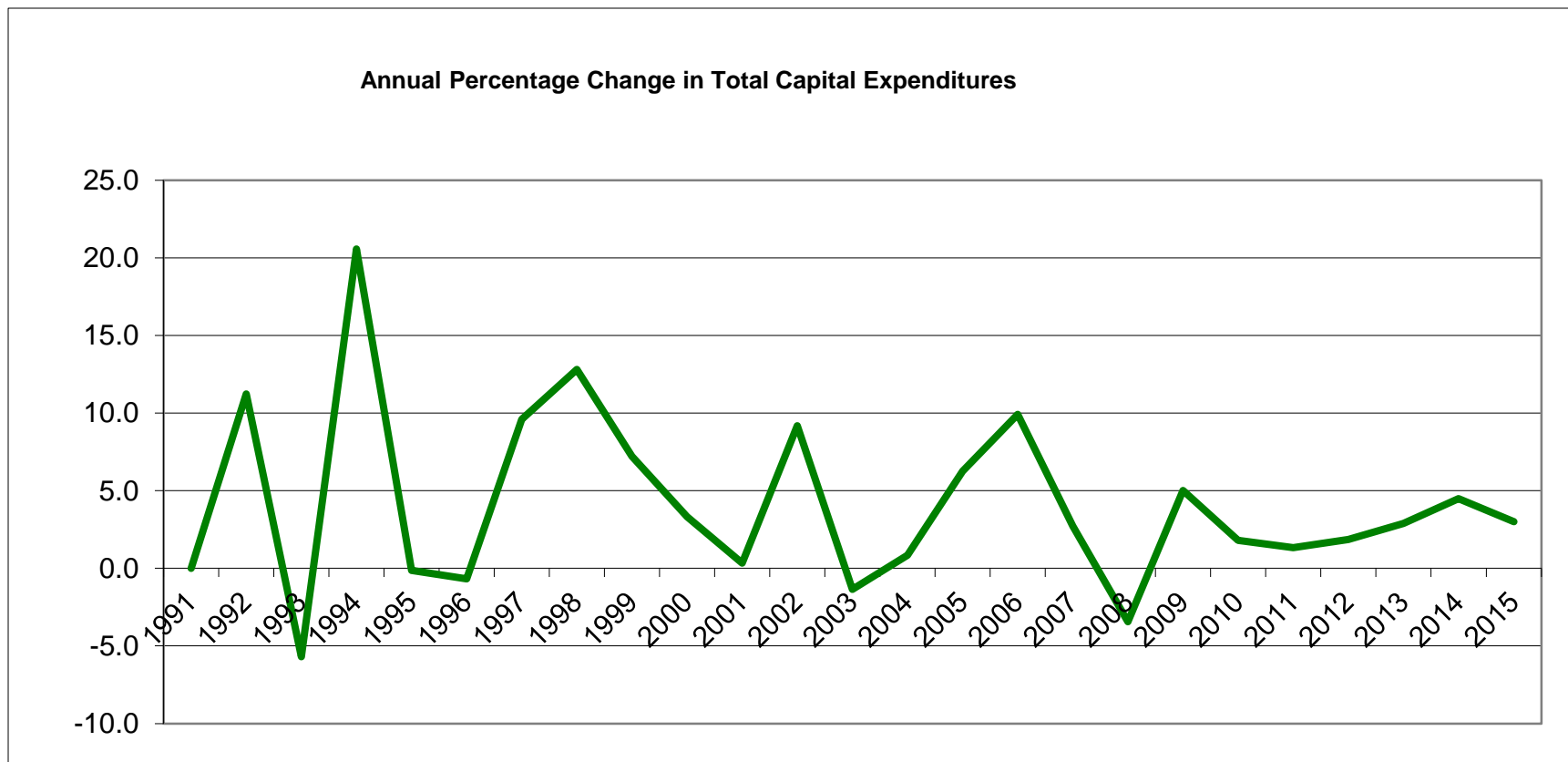
State Capital Expenditures by Function

Estimated Fiscal 2015



Source: NASBO State Expenditure Report

Recent Slow Growth in Capital Spending



Source: NASBO State Expenditure Report



SPRING 2014

CAPITAL BUDGETING IN THE STATES

NATIONAL
ASSOCIATION
OF STATE
BUDGET OFFICERS



Capital Budgeting in the States 2014

50 State Survey of the Capital Budgeting Process

5 Chapters with 43 Tables and Notes

Data is Mostly Narrative not Fiscal

Highlights State Specific Examples

Recommended Practices



Report Contents

Introduction: Overview Including Federal Efforts to Address Infrastructure

Ch. 1: Defining Capital and Maintenance Expenditures

Ch. 2: Organization of the Capital Budget and Planning Process

Ch. 3: Capital Budget Development and Execution: Project Selection, Cost Estimation and Tracking

Ch. 4: Capital Financing and Debt Management

Ch. 5: Capital Asset Management

Definitions of Capital and Maintenance Expenditures

Source of Definition of Capital Expenditure

- Statute – 34 states
- Regulations – 14 states
- State Code – 14 states
- Constitution – 6 states
- Other – 19 states

Expenditure Items Included in the Capital Budget

- Capital construction – 50 states
- Land/site acquisition – 47 states
- Equipment – 41 states
- Information technology – 29 states
- Asset must be physical – 26 states
- Expenditure must be non-recurring – 24 states

Programs not Included in the Capital Budget

- Transportation – 19 states
- Hospitals – 9 states
- Environmental protection – 6 states
- Higher Education – 3 states
- Corrections – 0 states

Treatment of Maintenance

- 29 states have a specific mechanism for setting aside funds for maintenance projects in the capital budget
- 22 states have a specific mechanism for funding maintenance projects not included in the capital budget

Good Practices for Identifying Capital and Maintenance Expenditures

- Definitions of capital expenditures should be specific and clear
- Distinguish capital projects that are included in the capital budget from those that are not
- Define maintenance expenditures and develop maintenance funding mechanisms by formula or statute
- Develop a formal system to rate and track maintenance projects

Organization of the Capital Budget and Planning Process

Capital Planning Overview

- Organization of the capital budgeting and planning process is intended to provide continuity between the annual or biennial budget process and long-term capital strategies
 - States need to integrate the long-term impact of capital projects with shorter-term operating plans
- Most states begin capital planning with a multi-year, detailed capital improvement plan, or CIP
- The capital budget in a majority of states is developed primarily by using the first year of the CIP

Capital Planning Process

- 43 states maintain a multi-year capital improvement plan (CIP)
- The number of years of capital expenditures contained in the CIP varies from 2-10 years
- Agencies primarily responsible for maintaining the CIP include departments of administration, departments of finance, offices of management and budget, offices of capital planning, division of facilities development, etc.
- In 39 states, the capital budget is developed primarily by using the CIP

Capital Project Management

- 33 states have a central agency responsible for maintaining capital projects
- In those states, the central agency...
 - Schedules projects – 29 states
 - Develops a project cost-estimate – 33 states
 - Offers financing recommendations – 15 states
 - Does technical review – 32 states
 - Builds budget request – 21 states
 - Monitors and tracks project progress – 33 states

Capital Budget Document

- 26 states enact an annual capital budget, 21 states enact a biennial capital budget, and 3 do both
- In 32 states the capital budget is distinct from the operating budget, while in 18 states it is part of the operating budget
- 25 states have a joint legislative/executive review board for capital project approval prior to budget enactment

Entities eligible to make request for capital expenditures

- State agencies – 50 states
- Elected officials – 26 states
- Public authorities – 19 states
- Private organization – 8 states
- Higher education institutions – 47 states
- Hospitals – 14 states
- Boards – 18 states

Additional Capital Planning Information

- In 43 states, the state requires that capital budget requests contain information estimating the fiscal impact on future operating budgets
- 15 states have made significant changes to the capital planning or capital budgeting process in the last 5 years
 - Arkansas, Colorado, Georgia, Indiana, Massachusetts, Michigan, Nevada, New Mexico, New York, Oklahoma, Oregon, Pennsylvania, South Carolina, Vermont, and Virginia

Good Practices in Capital Planning and Budgeting

- Identify institutional responsibilities and develop capital budgeting systems that target informational needs accordingly
- Maintain centralized oversight of capital projects or institute mechanisms to maintain consistency
- Ensure effective legislative involvement occurs throughout the capital budgeting process
- Identify the budgetary impacts of capital projects on the operating budget over a multi-year period

***Capital Budget Development and
Execution: Project Selection, Cost
Estimation and Tracking***

Prioritization of Capital Projects on a Statewide Basis

- Functional or program area – 22 states
- Health and safety needs – 40 states
- Problem severity/urgency – 45 states
- Service demands – 28 states
- Cost-benefit analysis – 23 states
- Formal scoring system – 16 states
- Governor's priority – 45 states
- Legislative priority – 39 states

Analyzing Capital Budget Requests in Aggregate

- Potential cost-savings – 30 states
- Waste or duplication – 21 states
- Scheduling problems – 17 states
- Potential to delay projects – 20 states
- Potential revenue producing project – 19 states
- Emergency requests – 28 states

Good Practices in Capital Budget Development and Execution

- As part of analysis of capital project requests, states should verify that programmatic objectives are achieved through the capital project
- Capital spending requests should be compiled and analyzed on a statewide basis
- Establish a reliable tracking system to keep projects on schedule and within budget
- Assess the likelihood of cost overruns and know how they will be handled

Debt Management and Capital Financing

Debt Issuance

- 43 states have a centralized agency or financing authority primarily responsible for debt issuance
- 19 states require voter approval through a statewide referendum for general obligation debt issuance

Debt Policies

- 38 states have a constitutional, statutory, and/or policy limit regarding total general obligation debt
- 25 states have a constitutional, statutory, and/or policy limit regarding general obligation debt service
- 20 states have a debt affordability criteria

Good Practices in Capital Financing and Debt Management

- The characteristics of capital projects should be analyzed to determine a suitable financing method
- The number and types of state entities that can issue debt should be limited to increase fiscal control and decrease transaction costs
- Develop clear debt policies that limit debt burdens to a percentage of revenue collections or the taxable base
- When utilized appropriately, alternative capital financing options can provide effective solutions for capital needs
- Long-term leases represent future liabilities

Capital Asset Management and Valuation

Capital Assets

- 44 states maintain a database containing an inventory of capital assets
- Data included in the capital asset inventory can include:
 - Age of facility, condition of facility, degree of use, maintenance costs, replacement costs, etc.

Good Practices in Capital Asset Management and Valuation

- Maintain an inventory of capital assets that is updated regularly and audited periodically for accuracy, deficiencies, and consistency
- A centralized database for state capital assets can streamline the record keeping process
- Capital asset valuation provides capital managers and state officials with better decision-making tools

www.nasbo.org

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