

To: The Board of Selectmen

From: Capital Budget Committee

Subject: Capital Planning and Funding

We would like to review a proposal to establish a Capital Maintenance Fund at the meeting scheduled for Monday, September 10th in your offices.

Background

Since the creation of the Capital Budget Committee, we have worked towards establishing an organized and transparent process for identifying, approving and financing capital expenditures across all departments in the Town. With the help of Mike, Buckley, we are in the process of completing a list of Town assets, their condition, a depreciation schedule and a calendar for replacement and repair. This is the first step in codifying policies and procedures for managing the assets of the Town.

Unfortunately, the majority of the committee's activities have been largely tactical. We have been confined to considering requests for acquisition or repair of depreciating assets. More often than not the "squeaky wheel" gets the attention of the committee and the voters. We believe these types of decisions will not benefit the Town in the long run because capital expenditure decisions are not being made in the context of all of the Town's long term capital needs.

We are at a point in the process where we need to establish a mechanism for constructing a long term plan for the Town's capital priorities with a special emphasis on capital spending and its potential impact upon the town's capital structure.

Discussion

A major reason for our past, tactical activity has been a lack of consistent funding for any capital need. In fact, capital expenditures have rarely been broken out and identified in the budget process. As a result, some capital expenditures are incorrectly identified as operating expenditures in department budgets. Over time these expenditures may overstate department operating budgets and make it difficult to analyze the financial effectiveness of the Town's financial management policies. In addition, capital maintenance expenditures and new capital project expenditures are often misunderstood by the departments and the voters. As current headlines will support, our circumstances are not unique. States, agencies and municipalities rarely consider maintenance of assets in their budget analysis.

For profit companies explicitly identify moneys that are to be used to fund operating expenses, capital repairs and replacement and new capital expenditures because the criteria for funding each type of expenditure is different. The accountants use depreciation as a measure of the needed funding for maintaining assets. Annual depreciation is a simplified method for understanding the estimated cost of maintaining (or replacing) the asset, as it ages. If we were to use this methodology with the Town's

accounting, we would quickly see that the Town's capital assets and their depreciation schedules are significant. Cohasset's assets include public buildings, land, athletic fields, parks, roadways, bridges, piers, docks, waterfront age, water supply and distribution, sewer distribution and treatment, fire trucks, an ambulance, construction equipment, police cars and motorcycles, at least four boats, computers, office equipment, and . . . well, you get the idea. If one were to total the replacement value, and divide by the useful life of each item, one could estimate the annual depreciation of assets the town incurs.

As we mentioned, with Mike Buckley's assistance, we have tallied town assets (ex. Water and Sewer, roads and bridges). This incomplete asset inventory totals \$.

Our rough estimate of depreciation of this inventory is \$.00 annually. Our funding for this depreciation is \$ 0.

In short, before considering any requests for new capital items, we can estimate our annual capital maintenance costs at \$.00.

Proposal

In order to more clearly define the mechanism for funding of existing capital repairs and replacement, we propose that Cohasset create a stabilization fund for capital maintenance. The fund would be financed through an annual \$500,000 appropriation at Town Meeting and the return of any money from the sale of depreciated assets.

We propose that the Town maintain a balance in the fund of \$2 - 3MM. The fund's expenditures would be restricted to capital maintenance, and new, non-bonded purchases.

Rationale

Unfunded capital needs compete for scarce resources with new projects. As a result, existing assets often go without maintenance, raising the cost of their eventual repair, or lowering their value at disposal.

Competition for resources distracts attention from developing a comprehensive capital plan. The primary benefit for such a plan will be to anticipate town capital needs before they are upon us, allowing for their acquisition in a more thoughtful, cost effective manner.

Dedicating funds annually to capital will be viewed positively by bond rating agencies. Any upgrade in outlook or rating can lower the towns borrowing costs.

A capital stabilization fund would be the funding mechanism for many of the projects brought before the town. It is not intended to replace bonding activity for large projects (buildings, etc.); instead, it is intended to segregate funds from the tax levy specifically for capital maintenance. As a result, such items would no longer compete for resources from the general revenue stream.

We look forward to your thoughts and comments.