Municipal Technical Advisory Service
INSTITUTE FOR PUBLIC SERVICE

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Capital Budgets and Multi-Year Budgets

The University of Tennessee
Municipal Technical Advisory Service
1610 University Avenue
Knoxville, TN 37921-6741
865-974-0411 phone
865-974-0423 fax
www.mtas.tennessee.edu

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Capital Budgets and Multi-Year Budgets

Reference Number: MTAS-1829

We estimate the wisdom of nations by seeing what they did with their surplus capital.

Ralph Waldo Emerson,
"Wealth," English Traits (1856)

Overview

The International City/County Management Association publication *Budgeting: A Guide for Local Governments* defines a capital budget as "a spending plan for improvements to or acquisition of land, facilities, and infrastructure." The definition continues by describing its elements: "The capital budget (1) balances revenues and expenditures, (2) specifies the sources of revenues, (3) lists each project or acquisition, and (4) must ordinarily be approved by the legislative body."

Capital Budget vs. Operating Budget

Reference Number: MTAS-1830

How is a capital budget different from the adopted operating budget? The capital budget is a subset of the adopted budget. A municipality can have a regular budget without a capital budget, but it can't have a capital budget without a regular budget. Furthermore, state laws do not require capital budgets.

Capital budgets typically operate on a project length schedule rather than a fiscal year schedule. Capital budgets also mark the first year of a Capital Improvement Program (CIP) or multi-year budget, which typically spans five years. The CIP should be updated every year to review expected revenues, inflation, project length, project necessity, and prioritization.

So why go to the trouble? For large projects that will take more than one year to complete or finance, and for projects that are not financed by proprietary or trust funds, having a separate place to track the project and its expenses is much easier. In addition, these are very expensive (typically more than $25,000) undertakings and deserve closer attention and scrutiny. Furthermore, this type of long-term planning helps set priorities, forces consideration of life expectancies of facilities and equipment, allows multi-year financing for projects that could otherwise not be attempted without debt issuance, improves cash management by simplifying debt retirement, and rating agencies look favorably upon cities with CIPs.

Developing a Capital Budget

Reference Number: MTAS-1831

The first step in developing a capital budget is to plan. This includes setting a calendar (much like the one for the annual budget); creating an inventory of equipment, buildings, and facilities; assessing the status of current large projects, including funding and targeted completion dates; identifying future needs; and finally prioritizing the items. All departments need to be involved in this process.

The next step is to look at finances. Assess and establish your financing options (Can we pay for this in cash if we set aside $10,000 each year for five years? Is lease/purchase a better option? What about issuing a bond for the new public works garage?); determine financial limits (How much will we have to work within two years?); and determine your current debt obligations (We owe $20,000 on this loan and will have it paid off in the middle of next year).

The last stage of the capital budgeting process is implementation. The CIP is normally approved by resolution, with the first year of the program (the capital budget) adopted as a separate section in the annual budget. As mentioned earlier, once the program has been adopted and firms are hired, land is purchased, and construction begins, close scrutiny of these large and expensive projects will save you a lot of headaches and, potentially, bad publicity in the future.

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