Proposed changes to the Budgeting and Management of the Capital Improvement Plan

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A. Background on the City's Capital Improvement Program (CIP)

Per the City's fiscal policies, all City construction projects and equipment purchases costing **$25,000 or more** are included in the City's adopted CIP. The five-year CIP is refreshed and adopted as part of the budget with every Financial Plan and accomplishes several goals.

CIP Goals

Maintains and replaces existing City infrastructure in accordance with the City's asset management plans, infrastructure replacement schedules, and other documents.
Meets community needs and desires as established during the Community Forum, Major City Goals and Council priorities.
Plans, schedules, and finances projects to ensure cost-effectiveness and conformance with established policies.

Comprehensive policies relative to the development of the City's CIP are specified in the Fiscal Policies section of the 2021-23 Financial Plan[1] including detailed information relative to both the two-year Financial Plan and the five-year CIP forecast.

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[1] 2021-23 Financial Plan, Pages 537-569. https://www.slocity.org/government/department-directory/finance/city-budget

The 2021-23 Financial Plan includes funding for 115 construction projects (inclusive of new assets, asset replacements and asset maintenance) that are managed primarily by CIP Engineering, Transportation, Maintenance or Utilities project managers.

City construction projects are carried out through seven distinct phases, shown to the right. While the construction phase is the most visible to the community, it is also the culmination of months to sometimes years' worth of planning, scoping, design, engineering, and permitting; all leading up to the construction phase.

The 2021-23 Financial Plan represents significant growth to the City's CIP due to the passage of the Local Revenue Measure (Measure G-20) which increased the local sales tax rate from 0.5 percent to 1.5 percent which, at the time of adoption, was projected to generate approximately $22 million annually. General Fund capital expenditures for FY2022-23 have increased by 65% compared to pre-Measure G-20 levels.

Project Identification & Budgeting
- City Council & community input
- Project planning & development
- Funding identified & approved by Council

Project Design
- Preliminary work
- Project layout and mapping
- Retain consultant design services

Plans & Specifications
- Development of detailed information
- Coordination with third party utilities
- 50% design review
- 90% plan review/design review
- Project communications
- Environmental review

Permits
- City building permit
- Outside agency permits

Project Ready to Construct
- Design completion
- Advertisement of project for public bid
- Award of construction contract

Construction

Project Completion
- Ribbon cutting
- Notice of completion project closeout

The growth of the CIP has exceeded the City's existing organizational capacity to effectively deliver capital projects. To address this, the 2021-23 Financial Plan included budget augmentations of $500,0000 in FY 2021-22 and $1 million in FY 2022-23 and beyond to "right-size" the organization to address the increased project workload. In 2021, the City contracted with Management Partners, a local government consulting firm, to perform an assessment of the delivery of the CIP and provide both structural and process improvements to deliver projects. The Management Partners assessment resulted in 53 recommendations covering all aspects of the City's CIP to improve project delivery.
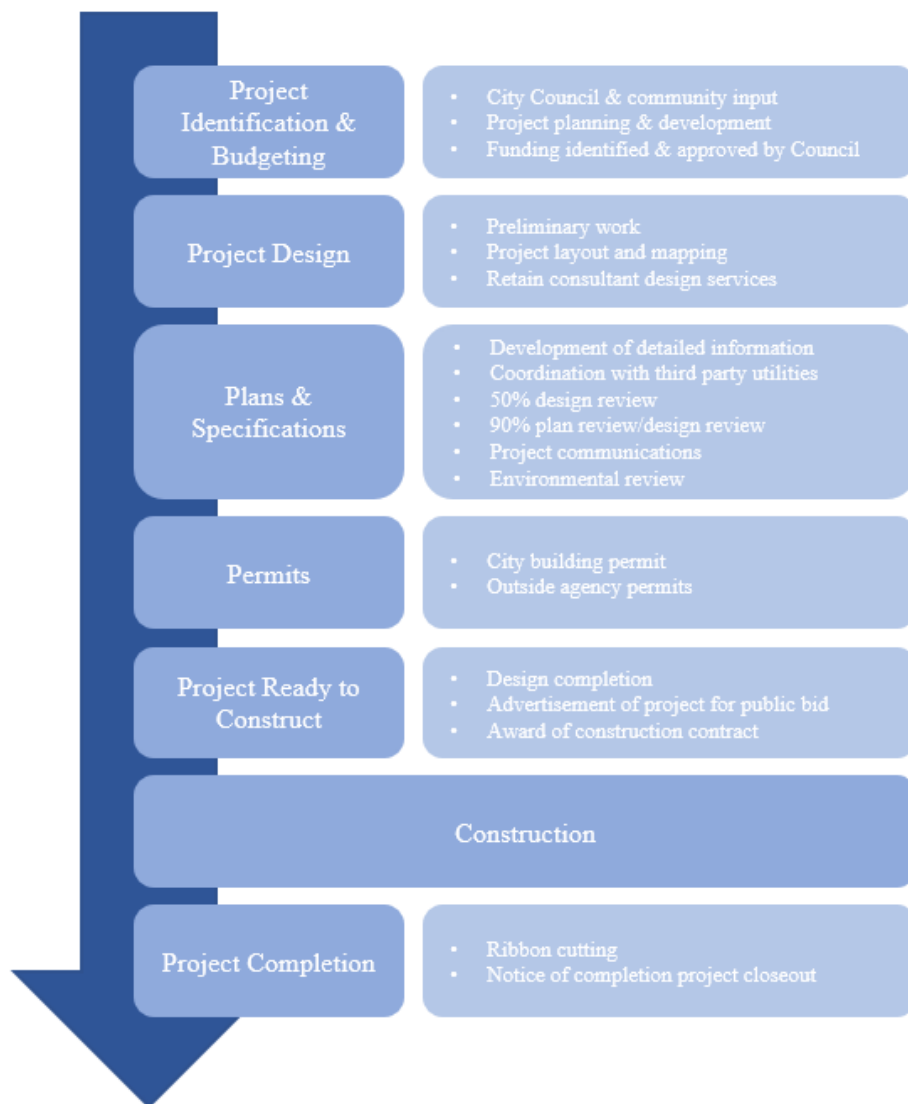
In addition to the expansion of the CIP due to the passage of Measure G-20, CIP delivery is currently also constrained by a number of different factors, including staffing constraints, supply chain issues, and construction cost escalation.

B. CIP Process Improvements Made in Response to the Management Partners Study
A CIP Process Improvement Manager was hired in November 2021 to lead the implementation of the Management Partners recommendations, as well as other identified areas for improvement. Process improvement work to date has been approved by Council as required and included:

1. Creation of two new classifications of staff in the CIP Division:

    a. **Capital Improvement Plan Administrative Manager** to manage the non-technical and financial aspects of the City's CIP, and

    b. **Capital Projects Manager** to provide project management for capital projects that do not require a high degree of engineering expertise and to partner with Engineers to manage larger and more complex capital projects.

2. **Addition of 4.00 FTE net new positions** to build capacity to address the growth of the annual CIP. These positions include the new 1.00 FTE Capital Improvement Plan Administrative Manager and 1.00 FTE Capital Projects Manager positions noted above, 1.00 FTE Supervising Engineer and 1.00 FTE Engineering Inspector. In addition to these net new additions, 1.00 FTE Engineer was reclassified to a Capital Projects Manager (the Public Works Department now has 2.00 FTE Capital Projects Manager positions).

3. **Development of a reporting database** to centralize information about project status (including scope, timeline and budget) in a single document for streamlined reporting.

4. **Collaboration with Finance and IT staff to improve financial system** (Oracle) functionality to better track and control capital project budgets and expenditures.

5. Development of a **recommended new budget structure** for the Capital budget (discussed in more detail below).

6. **Clarification of CIP processes** through enhancement of CIP governance, including:

    a. Updates to CIP policies to clarify CIP processes, and support the recommended new budget structure discussed in more detail below

    b. Development of a Charter to clarify the role of the CIP Review Committee and meeting procedures

    c. Development of project evaluation criteria to be used on an ongoing basis, regardless of economic outlook and external impacts

    d. Development of a Project Request Form that departments will be required to complete in order to request funding for a new capital project. This form is intended to:

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assist departments in developing the scope of the requested project,
provide the CIP Review Committee with the information needed in order to evaluate and prioritize projects for funding, and
provide a good starting point for project managers to develop project plans.

It is expected that further work efforts implementing more of the Management Partners study will be reflected in the 2023-25 Financial Plan. On September 22, 2022, staff presented recommended process improvements related to the structure of the CIP budget to the Revenue Enhancement Oversight Commission (REOC). Below is a summary of budget recommendations presented to the REOC.

C. Process Improvements for Budget Structure: CIP 'Funding Buckets'
As discussed in the FY 2021-22 Mid-Year Budget Update and FY 2022-23 Budget Supplement, supply chain issues and cost escalation have significantly impacted the delivery of the City's capital projects; an example is the Summer 2022 Roadway Sealing project, which came in significantly over bid and required a budget adjustment of almost $1.6 million. To provide staff with flexibility to adjust the budgets of individual capital projects, staff is recommending that the City Council appropriate funding for Asset Maintenance and Asset Replacement costs in the CIP budget at a 'funding bucket' level, rather than at the individual project level.

This approach would allocate a total budget to each category (see below) and in doing so, Council would provide staff with the flexibility to move money between projects within a funding bucket administratively, without seeking approval from the Council. This approach will put emphasis on delivering projects and shift priorities to ensure projects are being constructed. Asset Maintenance projects are ones that address recurring and annual needs to maintain existing assets. Asset Replacement projects are ones that address periodically recurring and/or annual needs that replace existing assets with a similar new asset. Use of funding buckets is not recommended for New Asset projects which expand the City's infrastructure that serves the community—budget adjustments for those projects are recommended to remain under the purview of the City Council due to their scope, fiscal impacts including debt issuance, and generally higher level of community interest.

The funding buckets are intended to group like projects within the **Asset Maintenance and Asset Replacement project type** and include:

1. Fleet
2. Facilities
3. Open Space and Natural Areas Preservation
4. Parking and Transit
5. Parks, Urban Forestry, and Public Art
6. Streets, Bridges and Multimodal Transportation
7. Creek and Flood Protection
8. Information Technology
9. Water Resources, Treatment and Distribution
10. Wastewater Collection and Treatment

1. *The use of funding buckets has several benefits, including:*

    a. Appropriation at the bucket level and staff discretion to move money within a bucket allows the City to be nimbler in responding to cost overruns, as well as changes to project prioritization to deliver projects instead of lengthy processes to re-allocate budget. Under current processes, staff must seek Council approval to make a budget adjustment for a project. Drafting and routing these reports takes time and is limited to review at one of two monthly meetings; a process that can take up to two months.

    b. Projects are priced closer to when they are initiated, rather than during budget development, which can be two years before a project begins. Developing project cost closer to when they are initiated allows for more accurate cost estimates, based on known scopes and the impact of external conditions (e.g. cost escalation).

    c. Staff has additional time to develop project scopes. Rather than scoping projects during budget development to identify a budget to seek Council appropriation, staff will have the ability to focus on scoping projects as they are assigned, which will result in more accurate and complete project scopes (more time to scope projects directly aligns with a Management Partners recommendation).

2. Controls, Checks, and Balances to Support Funding Buckets
Feedback from the REOC was that they understood why staff was recommending use of funding buckets and that it would provide much-needed flexibility to move money between projects when higher cost estimates would otherwise halt forward momentum. However, the REOC also expressed some concern about their and the City Council's opportunity to be informed and provide guidance or direction to staff in the event that any capital project(s) exceed estimated budget to the extent that they might impact delivery of other projects in the same bucket. Staff is planning to return to the REOC in December to continue this discussion and provide additional information as requested by the members.

3. Policy Language
Recognizing that the funding bucket approach changes how the REOC makes recommendation to the City Council for appropriating funding for capital projects, staff has been working on updates to policies and procedures to assure that appropriate controls and checks and balances are in place.

At the September 22nd REOC meeting, staff presented policy updates that are being developed for consideration by the City Council on January 10, 2023, as a part of the *Budget Foundation*. As of the writing of this report, the language is under development and a summary of the changes to be recommended is included below:

Recommended Changes to Existing Policies	
Policy Title	**Description and Rationale for Change**
Project Manager	Reflects current role for project managers to manage project scope, budget allocation, timeline and communications with project stakeholders. Revisions clarify that project management is primarily performed by staff from CIP Engineering but can also be done by staff in other departments, as appropriate.
CIP Review Committee	Expands description of the CIP Review Committee's role and reflects current membership of the Committee. Revisions clarify that the Committee is responsible for: 1. Assessing the City's fiscal condition and staff capacity to deliver projects so that the recommended CIP represents what can realistically be accomplished; and 2. Recommending to the City Manager the projects that should be included in the biennial financial plan, as well as appropriate funding levels for the CIP funding buckets; and 3. Considering new projects that may be requested mid-year to address emergent needs; and 4. Evaluating the re-prioritization of projects as needs and conditions change to ensure consistency with project evaluation criteria, ability to deliver projects, and City priorities.
CIP Appropriation	Clarifies recommended new approach of City Council appropriation of CIP budget to 'funding buckets' for Asset Maintenance and Asset Replacement projects and provides staff discretion to administratively move funding within the buckets. Identifies the 'buckets' as: 1. Fleet 2. Facilities 3. Open Space and Natural Areas Preservation 4. Parking 5. Parks, Urban Forestry, and Public Art 6. Streets, Bridges and Multimodal Transportation 7. Creek and Flood Protection 8. Information Technology 9. Water Resources, Treatment and Distribution 10. Wastewater Collections and Treatment Clarifies that appropriation of budget for New Asset projects is made to individual projects and that budget adjustments for these projects require City Council authorization.

Recommended New Policies	
Policy Title	**Description and Rationale for Change**
Project Type	Identifies and defines project types, including Asset Maintenance, Asset Replacement, and New Asset projects, and clarifies existing process of considering Asset Maintenance needs before recommending funding for projects to replace existing assets or construct new assets.
Project Request Forms	Requires that departments submit a Project Request Form (PRF) to formally document and describe requested capital projects. Use of this new form is intended to ensure that the Committee has the information it needs to evaluate and prioritize projects for funding. This new practice is also intended to address a Management Partners recommendation that staff allocate additional time for project scoping. The information provided on the PRF is intended to help address this recommendation by requiring requesting departments to articulate the scope of a project early on.

Project Evaluation Criteria	Identifies the criteria that will be used to evaluate and prioritize requested capital projects for funding. Evaluation criteria is as follows (equally weighted at 1 point each):
	
	1. Does the project support economic sustainability of the community and organization?
	
	2. Does project address a critical community health or safety need?
	
	3. Does project make good on ongoing commitments? Consider:
	   a. Previously budgeted (or existing external funding source)
	   b. Approved planning documents
	   c. Address mandates or legal requirements
	
	4. Does the project address core infrastructure needs?
	
	5. Does the project provide a visible and measurable community benefit?
	
	6. Does the project align with Major City Goals?
	
	7. Does the project address Measure G priorities?
	   a. Economic development and business retention
	   b. Safe and clean public areas
	   c. Youth/senior services and recreation facilities
	   d. Open space/natural areas preservation and maintenance
	   e. Street maintenance and transportation
	   f. Community safety and emergency preparedness
	   g. Protect financial stability
	   h. Creek and flood protection
	   i. Address homelessness

	8. Does the project have a positive impact on ongoing operations?
	
	   a. Reduction to operating costs
	
	   b. Improved service delivery

Creation of Projects	Establishes that projects will only be created outside of budget development process only if they address an emergency need or are directed by the City Council.
Project Appropriations	Clarifies the recommended new approach of appropriating CIP funding to 'buckets' by identifying that appropriation to individual projects does not occur with adoption of the budget. Identifies five options that staff can pursue if a project is expected to be considerably over estimated budget: 1. Eliminate the project 2. Defer the project for consideration to the next Financial Plan period 3. Rescope or change the phasing of the project to meet the budget 4. Re-prioritize projects and appropriate additional budget from the appropriate bucket to the project to meet the need 5. Appropriate additional resources as necessary from the Capital Projects Reserve if the re-prioritization of projects is not possible or advantageous or insufficient funding remains in the overall budget allocation withing the funding bucket.
Administrative Budget Adjustments	Establishes the process staff must follow to process a budget adjustment administratively within a bucket. The process requires consultation between the project manager, City Engineer, CIP Administrative Manager, and Public Works Analyst to consider the request for additional funding for a project within the context of other projects intended to be funded within the bucket. To assure appropriate checks and balances, the policy also identifies the required routing for budget adjustments which must be signed off by staff from the proponent department, Public Works staff, and Finance staff.
CIP Reporting	Requires staff to publish reports on the CIP on a quarterly basis, as part of Quarterly Budget Reports provided to the REOC and City Council; and specifies that the reports should include a summary of administrative budget adjustments made within appropriated funding buckets, associated tradeoffs, as well as a status update on projects in progress.

Policies Recommended to be Deleted	
Policy Title	Description and Rationale for Change
Program Objectives	Eliminating policy that does not reflect current practice. The existing policy states that "Project phases will be listed as objectives in the program narratives of the programs, which manage projects."

D. Existing Purchasing Policy Requirements

In addition to the policy updates summarized above, it is worth noting that the City's Purchasing Policy, which was approved by Council in May 2022, requires that staff must seek City Council approval to award construction contracts over $200,000. Most of the projects included in the City's CIP have a construction cost that exceeds this threshold, which means that staff will continue to regularly be before the City Council to seek approval to proceed with projects. With each Council Agenda Report, the City Council will have the opportunity to ask questions about projects and provide direction to staff, as necessary.

E. Regular CIP Project and Budget Reporting

Finally, as noted in the summary policy language above, staff will provide quarterly reporting to both the REOC and City Council about project status and use of funding within each bucket for transparency and increased communications. In addition to providing information on the project status, the reports will also include a detailed accounting of project funding, including:

- Initial budget estimates for each project (the total of all projects in a funding bucket will equate to the appropriated funding amount),

- Current budget appropriated to each project,

- Current expenditures charged to each project, and

- At completion, the total actual cost of each project.

Presentation of these reports on a quarterly basis (approximately every three months) will provide additional opportunity for both REOC and the City Council to ask questions and provide direction to staff, as necessary.

Draft templates of the reports are below. These reports will be provided for each funding bucket and included in the Financial Plan and Budget Supplement for budget recommendations and adoption:

Bucket: Streets, Bridges & Multimodal Transportation			
Priority	Project	Estimated Cost	Estimated Completion
	Total		

Quarterly Reports to City Council and REOC:

Bucket: Streets, Bridges & Multimodal Transportation		
FY 20XX-XX Adopted Bucket Amount	$x,xxx,xxx	
Appropriated to Projects	$x, xxx,xxx	See below for a listing of funded projects.
Council-Approved Changes to Bucket	$xxx,xxx	
Current Bucket Balance	$x,xxx,xxx	

Priority	Project	Initial Estimate	Current Appropriated Budget	Current Expended	Actual	Status	Notes
	Total						

Priority – Priority assigned by CIP Review Committee during Financial Plan development. This is static.
Project – Project number and name, as included in Financial Plan document. This is static.
Initial Estimate – Estimated project cost, as presented in Financial Plan to support requested budget appropriation. This amount is static.
Current Appropriated Budget – Amount appropriated to a project ("Task" in Oracle) at the time the report is created. This amount changes.
Current Expended – Amount of
Actual – Total amount expended on the project ("Task" in Oracle) upon project completion/closeout. This amount is not included until a project is complete.
Notes – Notes specific to individual projects. Use to explain significant budget changes compared to estimate and why projects aren't funded in priority order (if applicable).

F. Inclusion of CIP Engineering program staff time and certain other positions involved in project delivery in the capital, rather than the operating budget.

In addition to the funding bucket approach, staff also plans to recommend the inclusion of the CIP Engineering program supporting project delivery in the capital budget. The intent of doing this is to accurately reflect the cost of delivering the City's CIP. Many other organizations achieve this by charging staff time to individual projects, based on timecoding. Staff is building a list of employees predominately in Public Works who play a significant role in capital project oversight and delivery and the percentage of time they spend doing this work. As a part of the 2023-25 Financial Plan, staff will recommend inclusion of this staff time in the capital budget, rather than the operating budget.