

Funding Capital Expenditures

A discussion of key terms and considerations for
funding capital projects

Discuss Key Funding Tools

- I. Capital Exclusion
- II. Debt Exclusion
- III. Free Cash (available reserves)
- IV. Special Purpose Stabilization Fund

Capital Exclusion

A capital expenditure request can be funded:

- **By Capital Expenditure Exclusion** (Ch. 59 Sec. 21C(i 1/2))

Capital Exclusion - A temporary increase in the tax levy to fund a capital project or make a capital acquisition. Exclusions require two-thirds vote of Town Meeting and a majority vote in a community-wide election.

The exclusion is added to the tax levy only during the year in which the project is being funded and may increase the tax levy above the levy ceiling.

Capital Exclusion cont'd

Key Term –
“Exclusion”....

- What does “Exclusion” refer to?”
- What is exactly *is* an “Exclusion”

In a municipal finance context, the word “**exclusion**” refers back to MA tax regulations, specifically Proposition 2½ limits of taxation. “Proposition 2½” allows a community to raise funds for certain purposes **above the prescribed amount of its levy limit or levy ceiling.**

“Exclusion” is an *temporary* increase in the annual tax levy for a specific authorized purpose.

Capital Exclusion cont'd

- **A Capital Expenditure Exclusion,**
 - **Covers the complete (General fund) cost of the capital expenditure**
 - **Most used/useful for moderate to large sized projects**
 - **Does not involve borrowing over time**

Capital Exclusion cont'd

- **Sudbury's recent use of capital exclusions**

2008	2014
<ul style="list-style-type: none">• \$405,000• Fire Engine	<ul style="list-style-type: none">• \$700,000• Town Center Traffic Safety/Improvements

Capital Exclusion cont'd

- **Sudbury's recent use of capital exclusions suggests that,**
 - As individual or bundled projects a target of between \$100,000 to \$1,000,000
 - May be appropriate for "Group B" and "Group C" items
 - Approvals at Town Meeting and Town Election may depend on several factors specific to each budget cycle

Debt Exclusion

A capital expenditure request can be funded:

- **By Debt Expenditure Authorization**

Debt Authorization – Formal approval by a two thirds vote of town meeting or city council to incur debt, in accordance with procedures stated in [MGL Ch. 44 §§1, 2, 3, 4a, 6-15.](#)

Debt Exclusion cont'd

- **For a Debt Expenditure Authorization, Town Meeting**
 - **Must identify the source of funds necessary to pay debt service on the borrowing**
 - **If excess revenues already exist, may authorize the annual debt service to be paid within the operating budget (as part of the normal tax levy process)**

Debt Exclusion cont'd

- **For a Debt Expenditure Authorization,**

Otherwise, Town Meeting must authorize debt as a “Debt Exclusion”

Debt Exclusion (Ch. 59 Sec. 21C(j))-raises tax revenue, beyond Proposition 2½ limits, to pay debt service costs on borrowing to finance a capital project, i.e., new school construction.

The additional tax from a debt exclusion remains a part of the tax levy only for as long as the term on the underlying bond.

Debt Exclusion cont'd

- **Sudbury's recent use of debt exclusions**

2012	2013	T/B/A
<ul style="list-style-type: none">• \$1.58 Million• Noyes Green Repairs	<ul style="list-style-type: none">• \$430,000• Nixon Roof Repairs	<ul style="list-style-type: none">• \$627,000• Police Station (Phase I)

Debt Exclusion cont'd

- **Sudbury's recent use of debt exclusions suggests that,**
 - As individual or bundled projects a target issue of \$1.5M and above
 - Most appropriate for "Group A"
 - Also appropriate for "Group B" and "Group C" items depending on bundling and timing of permanent bonding
 - Approvals at Town Meeting and Town Election may depend on several factors specific to each budget cycle
 - Bonding for outright purchases (i.e. equipment, land, CR's, etc.) involves minimum 4-6 month timeline for issuance
 - Bonding for construction projects involves minimum 6-8 month timeline for issuance. (Also generally requires temporary internal borrowing and/or BAN's)

Debt Exclusion cont'd

- **Additional notes on Long-Term Borrowing,**
 - **Governed by [Ch. 44](#).**
 - **Sections 7 & 8 speak specifically to purposes of borrowing, allowable terms, etc.**
 - **Permanent bond issuance costs generally consist of credit rating, bond counsel services, fiscal advisory, printing and underwriter's discount. (ex. Noyes issue for \$1.58M cost \$33,000)**
 - **For last several years we have issued for premiums equal to or in excess of issuance costs.**

Free Cash (Available Reserves)

A capital expenditure request can be funded:

- **By Free Cash**

Free Cash - Remaining, unrestricted funds from operations of the previous fiscal year including unexpended free cash from the previous year, actual receipts in excess of budgeted revenues and unspent budgeted expenditures.

The calculation of **free cash** is based on the balance sheet as of June 30

Free Cash (Available Reserves) cont'd

- Free cash is not available for appropriation until certified by the Director of Accounts.
- Free Cash is synonymous with adjusted available reserves by GASB standards (previously referred to as “unrestricted”)
- For purposes of this discussion the adjustments to reserves are not important
- What is important?

Free Cash (Available Reserves) cont'd

What is important?

When Free Cash is used for any purpose,

- Authorization is granted by Town Meeting vote only
- Considered “within the levy” (e.g. no Town-wide election)
- Immediate, permanent reduction to available reserves

Free Cash (Available Reserves) cont'd

What is important?

When Free Cash is used for any purpose,

- Best suited for one-time, non-recurring expenditures of any size because,
 - future additions to (replacement of) available reserves is unpredictable
 - hard to produce during tight budgetary and fiscal constraints
 - reserve use and levels has a direct correlation to bond credit rating

Special Purpose Stabilization Fund

Special Purpose Stabilization funds

- Adoption of legislative amendments in 2003 to M.G.L. Ch. 40 s.5B
 - Municipalities can create multiple stabilization funds
 - Assign a different special purpose for each
 - Take advantage of a new funding option

Special Purpose Stabilization Fund cont'd

Special Purpose Stabilization funds

- Adoption of legislative amendments in 2003 to M.G.L. Ch. 40 s.5B
 - Municipalities can create multiple special stabilization funds
 - Assign a different special purpose for each
 - Specific purpose pertaining to **capital asset** expenditures
 - Purpose may be amended at subsequent Town Meeting and Town-wide referendum

Special Purpose Stabilization Fund cont'd

Special Purpose Stabilization fund

- Most effective as a revenue source, or savings account, for anticipated expenditures
- Works best when used to build moderate balances
- To pay mid-level recurring expenditures such as like building maintenance, road repairs and vehicle purchases

Special Purpose Stabilization Fund cont'd

Two funding options for building Special Stabilization Fund balance:

#1 Traditional individual appropriations from any available source by Town Meeting

- Operating budget line-item or other articles using General fund money
- Free Cash
- Transfer in from any other available funds
- One-time authorization and “within” the normal levy

Special Purpose Stabilization Fund cont'd

#2 Prop 2 ½ override for Special Purpose (only)

- Resembles both an Override and an Exclusion
- Override + 2.5% can be raised for special purpose year-after-year without subsequent referendum vote
- However, an override need not be permanent (see “underride” regulations)

Special Purpose Stabilization Fund cont'd

#2 Special purpose override cont'd

Key points –

- 2.5% increase is on allowable or designated override base
- Town Meeting vote to lower, suspend and later resume **appropriation**
- Town-wide referendum required to increase the current level (base) of the special override or authorize an override

Special Purpose Stabilization Fund cont'd

#2 Special purpose override cont'd

Key Summary on Special Funding—

- Overrides of any kind are contingent upon/controlled by Town-wide referendum
- Appropriations including any monies transferred in or used from the any Stabilization fund is contingent upon/controlled by Town Meeting vote*

* Such action requires two-thirds vote by legislative body

Additional Resources

- MA DOR - Division of Local Services at <http://www.mass.gov/dor/local-officials/>
 - Technical bulletins, information guide releases (IGR's), legal opinions, etc.
- Town of Sudbury website at <http://www.sudbury.ma.us/>
 - Sudbury's budget and other financial policies, budget documents, CAFR statements
 - Sudbury's official bond issue statements
 - Sudbury credit ratings and industry bulletins issued by Standard & Poor's
 - Sudbury's Strategic Financial Planning Report issued in April 2013