

# Commonwealth of Virginia

## Best Capital Budgeting Practices

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2013 Fiscal Analysts Seminar  
Annapolis, Maryland  
October 8, 2013

# Six-year Planning Process

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- In 2008, the Virginia General Assembly codified the requirement for a six-year capital outlay plan:
  - Beginning in 2009, Governor must submit annually a tentative bill to the General Assembly for next six fiscal years.
    - Initial plan adopted in 2009 is a dynamic document.
      - As projects are completed, they come off the plan and can be replaced with new projects.
    - Major updates to the plan are made in even years to coincide with biennial budget.
      - However, adjustments to the plan can be made annually.
  - The goals of this plan are to provide for a more business-like approach to capital budgeting, while reducing parochial and partisan pressures, and produce a smoother, more reliable and predictable capital outlay program.
  - Projects are placed in a range for budgeting purposes, since precise costs are not known at this stage (i.e. \$10 to \$25 million, \$25 to \$50 million, \$75 to \$100 million).

# Six-year Project Advisory

## Committee

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- The “Six-PAC” reviews, analyze and recommends projects to the Governor for inclusion in the six-year plan.
  - Committee consists of the Secretary of Finance, and the Directors of Department of Planning and Budget, Department of General Services, State Council of Higher Education for Virginia, House Appropriations Committee and Senate Finance Committee.
  - The “Six-PAC” was also tasked by the 2013 General Assembly with managing the cash-flows of a \$1.1 billion project pool.
    - Budget language requires that no more than \$250 million in bonds be issued each year as this pool is completed.

# Planning is Critical to Project

## Approval

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- First steps in General Assembly approval.
  - Preplanning to obtain detailed definition
    - Space requirements and functional adequacy
    - Review of options (renovate vs. new construction)
    - Site analysis
    - Site plan, floor plan, elevations, exterior
    - Building Code compliance, permit requirements
    - Initial cost estimates.
  - Detailed planning
    - Preparation of architectural and engineering documents up to preliminary design phase.

# Use of Project Pools

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- Beginning in 2008, the General Assembly has budgeted groups of capital outlay projects into large “pools”.
  - Senate and House staff maintain confidential working papers for budgeting purposes (not subject to FOIA).
  - Projects are authorized in the Appropriation Act in a pool that includes a total for all projects, but not specific dollar amounts for each project.
- This process provides for more competitive bids since contractors no longer know exact budget for project.
  - Virginia saved over \$87.5 million based on initial estimates from projects authorized in 2008 and 2010.
- The process also allows flexibility for projects costing more than originally estimated as funds can be moved from one project to another.

# Construction and Professional Services Manual

## (CPSM)

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- The Virginia Department of General Services is responsible to maintain the CPSM to provide uniformity across state agencies, including:
  - Detailed procedures for state agency management of capital outlay appropriations.
  - Procurement process for professional services and construction contracts to ensure maximum competition and best value.
  - Process for inter-agency coordination and review of capital budget proposals.
  - Design standards to prevent “gold-plating” while ensuring long service life of assets.
  - Building Official practices for permits, inspections and certificates.
  - Best Professional Practices, including minimum energy performance criteria.

# Design–Build Contracts

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- Fixed price or not-to-exceed-price Design-Build (D/B) contracts are authorized by the Code of Virginia as an exception to the competitive sealed bid process.
  - Intended to minimize project risk while reducing delivery schedule by overlapping design and construction phases of a project.
- Two step process conducted by an Evaluation Committee:
  - Selection of “Qualified Offerors” through a Request for Qualifications (RFQ).
    - Qualification of offerors evaluated in relation to unique requirements of a project.
    - 2 to 5 offerors selected from RFQ responders are prequalified on short list.
  - A Request for Proposals (RFP) is then sent to those on the short list.
    - Sealed Technical Proposals responsive to the RFP are evaluated.
    - Separately sealed Cost Proposals are not opened until Technical Proposal evaluation is completed.
    - Contract is awarded to offeror determined to have provided the best value in response to the RFP.

# Construction Management Contracts

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- The Code of Virginia also allows for the use of Construction Management (CM) Contracts (aka Construction Manager at Risk) under certain circumstances:
  - Fast tracking is needed to meet agency program requirements.
  - Value engineering and/or constructability analysis concurrent with design is required.
  - Project value is greater than \$10 million (can be waived for smaller/complex projects).
- Two-step process similar to D/B, but can be done as a one-step solicitation if adequate justification is provided.
- Required CM contract terms include:
  - Guaranteed Maximum Price
  - No more the 10% of construction may be performed by CM
  - Remaining 90% of work must be performed by subcontractors procured by publicly advertised competitive sealed bidding.

# Use of Value Engineering

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- Value Engineering (VE) is required by the Code of Virginia for all projects over \$5 million.
  - Systematic review and analysis by a multi-discipline team of 5 qualified professionals not previously involved with the project.
    - Team includes a Certified Value Specialist, Architect, Structural Engineer, Mechanical Engineer and a Electrical (or Civil) Engineer.
  - Team offers suggestions to improve project quality and reduce total project costs by combining or eliminating inefficient or expensive parts or by redesigning the project using different technologies, materials or methods.
    - Each item in the VE review must be either accepted, declined or accepted as modified.
    - The agency must provide justification for any recommendations that are not accepted.

# Debt Capacity

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- Virginia maintains a self-imposed debt ceiling policy so that no more than 5% of blended revenues will be required for debt service, which is what is also reported to rating agencies.
- A Debt Capacity Advisory Committee (DCAC) meets each year prior to the General Assembly session and determines the amount of debt that can be prudently issued while staying within the debt ceiling.
  - Virginia now uses a ten year average, which allows that debt service could exceed 5% in a given year, as long as the ten-year average remains below 5%.
- Debt Ceiling policy of 5% is a standard adopted by DCAC, which is much more conservative than what the VA Constitution allows:
  - 25% of an amount equal to 1.15 times average of 3 prior year annual collections of sales and income tax revenue.

# Debt Capacity Model

## with 2013 General Assembly Actions

### DEBT CAPACITY MODEL

(Dollars in Millions)

Debt Capacity Maximum Ratio

Debt Service as a % of Revenue =

**5.0%**

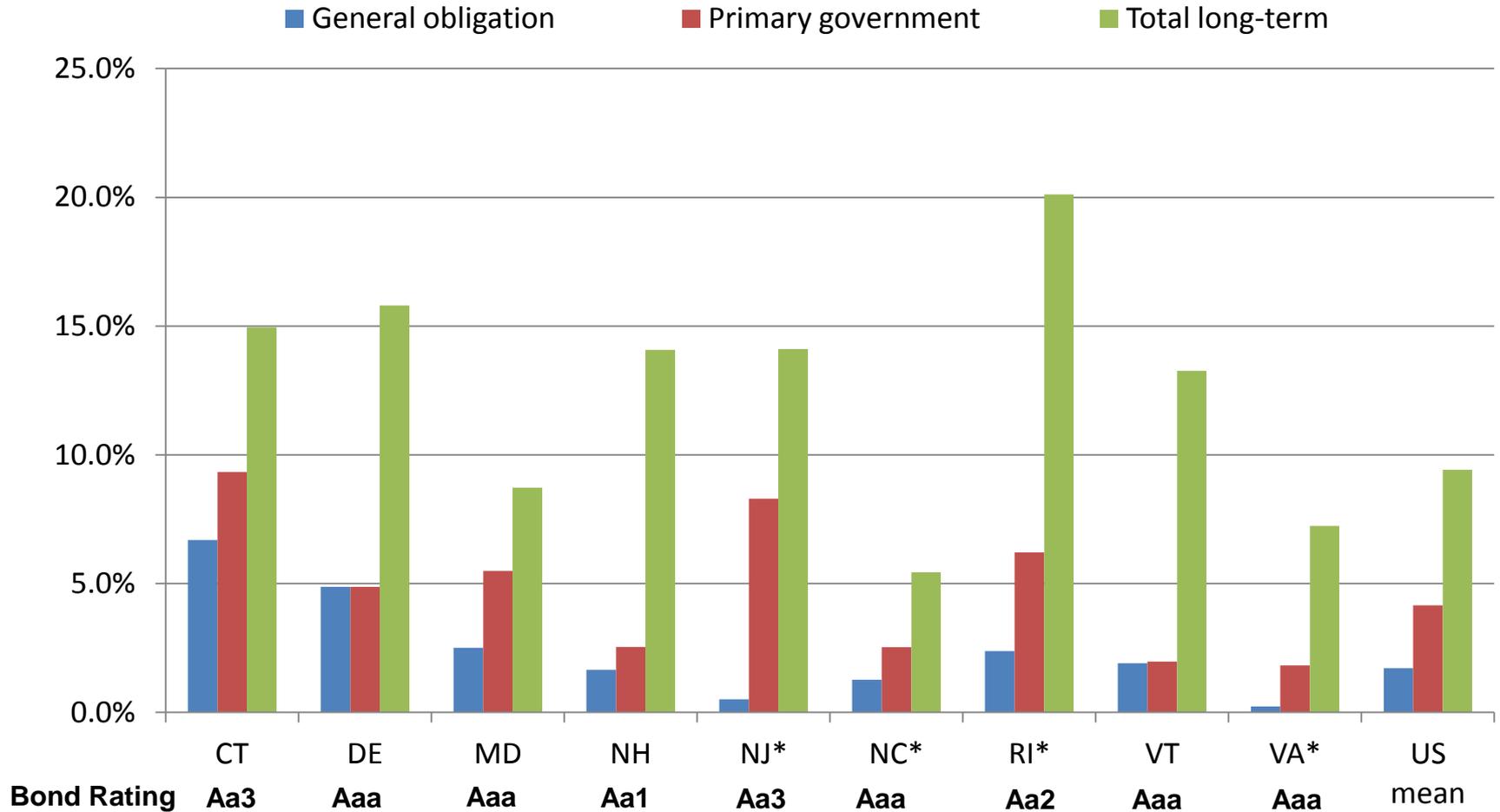
AVG Base @ \$1.08 Bil TOTAL New (Clyde's Request #2)

{ \$880 Mil New Pluse \$200 Mil WQIF }

Prepared January 23, 2013

|             | [1]              | [2]                               | [3]   | [4]  | [5]  | [6]  | [7]                              | [8]  | [9]  | [10]                                   | [11]                                  |
|-------------|------------------|-----------------------------------|---|--|--|--|----------------------------------|--|--|--|---------------------------------------|
| Fiscal Year | Blended Revenues | Base Capacity to Pay Debt Service | Annual Payments for Debt Service on Debt Issued | Actual Outstanding Debt Service as a % of Revenues | Annual Payments for Debt Service on All Planned Debt Issuances | Actual & Projected Debt Service as a % of Revenues | Net Capacity to Pay Debt Service | Amount of Additional Debt that may Be Issued | Debt Service on Amount of Additional Debt that may Be Issued | Remaining Capacity to Pay Debt Service | Total Debt Service as a % of Revenues |
| Actual 2004 | 12,761.52        | 638.08                            | 373.55  | 2.93%  | N/A  | 2.93%  | 264.52                           | N/A  | N/A  | 264.52                                 | 2.93%                                 |
| Actual 2005 | 15,099.55        | 754.98                            | 384.50  | 2.55%  | N/A  | 2.55%  | 370.48                           | N/A  | N/A  | 370.48                                 | 2.55%                                 |
| Actual 2006 | 16,066.10        | 803.31                            | 419.01  | 2.61%  | N/A  | 2.61%  | 384.30                           | N/A  | N/A  | 384.30                                 | 2.61%                                 |
| Actual 2007 | 16,847.70        | 842.39                            | 482.33  | 2.86%  | N/A  | 2.86%  | 360.06                           | N/A  | N/A  | 360.06                                 | 2.86%                                 |
| Actual 2008 | 17,076.40        | 853.82                            | 532.95  | 3.12%  | N/A  | 3.12%  | 320.87                           | N/A  | N/A  | 320.87                                 | 3.12%                                 |
| Actual 2009 | 15,680.70        | 784.04                            | 587.33  | 3.75%  | N/A  | 3.75%  | 196.71                           | N/A  | N/A  | 196.71                                 | 3.75%                                 |
| Actual 2010 | 15,871.20        | 793.56                            | 633.45  | 3.99%  | N/A  | 3.99%  | 160.11                           | N/A  | N/A  | 160.11                                 | 3.99%                                 |
| Actual 2011 | 16,751.10        | 837.56                            | 693.64  | 4.14%  | N/A  | 4.14%  | 143.92                           | N/A  | N/A  | 143.92                                 | 4.14%                                 |
| Actual 2012 | 17,787.10        | 889.36                            | 747.02  | 4.20%  | N/A  | 4.20%  | 142.34                           | N/A  | N/A  | 142.34                                 | 4.20%                                 |
| 2013        | 18,278.40        | 913.92                            | 820.77  | 4.49%  | 48.18  | 4.75%  | 44.97                            | 0.00   | 0.000  | 44.97                                  | 4.75%                                 |
| 2014        | 18,950.00        | 947.50                            | 809.97  | 4.27%  | 105.29   | 4.83%  | 32.23                            | 447.10                                       | 32.750   | (0.52)                                 | 5.00%                                 |
| 2015        | 19,809.20        | 990.46                            | 801.03  | 4.04%  | 198.80   | 5.05%  | (9.37)                           | 447.10                                       | 65.500   | (74.87)                                | 5.38%                                 |
| 2016        | 20,502.60        | 1,025.13                          | 770.63  | 3.76%  | 259.36   | 5.02%  | (4.86)                           | 447.10                                       | 98.250   | (103.11)                               | 5.50%                                 |
| 2017        | 21,270.60        | 1,063.53                          | 718.75  | 3.38%  | 316.59   | 4.87%  | 28.18                            | 447.10                                       | 131.000  | (102.82)                               | 5.48%                                 |
| 2018        | 22,004.00        | 1,100.20                          | 682.04  | 3.10%  | 346.54   | 4.67%  | 71.62                            | 447.10                                       | 163.750  | (92.13)                                | 5.42%                                 |
| 2019        | 22,771.16        | 1,138.56                          | 632.96  | 2.78%  | 353.10   | 4.33%  | 152.50                           | 447.10                                       | 196.500  | (44.00)                                | 5.19%                                 |
| 2020        | 23,558.94        | 1,177.95                          | 582.57  | 2.47%  | 341.56   | 3.92%  | 253.81                           | 447.10                                       | 229.250  | 24.56                                  | 4.90%                                 |
| 2021        | 24,605.75        | 1,230.29                          | 562.71  | 2.29%  | 348.12   | 3.70%  | 319.45                           | 447.10                                       | 262.000  | 57.45                                  | 4.77%                                 |
| 2022        | 25,700.03        | 1,285.00                          | 537.31  | 2.09%  | 354.69   | 3.47%  | 393.00                           | 447.10                                       | 294.750  | 98.25                                  | 4.62%                                 |
| Average:    |                  |                                   |   |  |  |  |                                  | \$447.10                                     | 2 Yrs Excess Avg Capacity:                                   | \$1,341.27                             |                                       |

# Comparison of Debt to Personal Income



Source: New England Public Policy Center, Federal Reserve Bank of Boston.

Note: General obligation and primary government debt for FY 2012 year-end; Census data for FY 2010 year-end. Does not include local government debt..

\* Designates states that require voter approval for GO debt.

# Issues for Future Consideration

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- Is self-imposed 5% limit too conservative to keep up with capital outlay needs?
- Should General Obligation bonds be used more frequently to obtain better interest rates?
  - 1992 and 2002 last two GO bond authorizations.
- How will public perception affect ability to meet future needs?
- How can we better address maintenance reserve needs of an aging infrastructure?