

Memo: Contemporary Issues in Capital Budgeting for Public Decision Makers

To: Pengju Zhang, Professor

From: Brian J. McDermott

Subject: Summary of Contemporary Issues in Capital Budgeting

Date: August 11, 2023

The public budgeting process is in a constant state of flux. It is critical to recognize the challenges you will face when entering this process. This memo will identify the challenges and concerns brought about while considering capital budgets. It will also provide recommendations to overcome those challenges to develop a solid plan that will aid in the preparation of this essential component of the budgeting process.

### **Introduction**

Capital budgeting is an extremely important aspect of the overall budget process. When developing a capital budget, you will be deciding how a community will look for many years in the future. This process will decide which projects move forward and which do not, based on cost and need. Making community-based decisions in capital budgeting is essential for responsible allocation of funding and project completion.

### **Body**

There are many Challenges and Concerns regarding capital budgeting. Many governments face a substantial stock of buildings that are behind in maintenance and renewal due to lack of timely investment. Let's face it, buildings and other such assets are not getting any younger. A stock review and a long-range plan that is prioritized based on community impact, cost, and severity of problems must be at the forefront. Another challenge to this process is inadequate funding to handle the upgrade/repairs. Out-of-the-box thinking is important when attempting to secure adequate funding for capital projects. Using your traditional line-item budget may not support a large expense. Bonding, leasing, cooperatives with private entities, grant offsets and other such creative funding will come into play. Traditional revenue sources may not suffice, necessitating exploration of innovative financing mechanisms such as public-private partnerships, user fees, or municipal bonds. Large capital projects can be risky due to inflated costs from delays and changing economic conditions. For example, lumber prior to COVID was reasonable and post COVID, the prices skyrocketed causing canceled projects or significant unforeseen cost increases. Administrators must have vision to forecast these problems, and even then, it may still be a surprise. Also, effective capital budgeting requires that you prioritize project requests based on available funding and need. This can be handled by performing a cost-benefit analysis to demonstrate the overall cost and the value it will add to the community. Lastly, Political considerations and pressure from various stakeholders can sometimes lead to the prioritization of projects based on short-term gains rather than long-term benefits. Striking a balance between political interests and sound economic decision-making is essential.

In researching scholarly articles, it was found that following a process is crucial to success. According to Natalia Ermasova, Control of capital expenditures is of paramount importance at

any time, but especially when resources are scarce as after the current economic downturn. From an economic stand- point, capital expenditures have future utility, whereas operating expenditures produce benefits of limited duration. Capital investments are commitments of resources made with the expectation of realizing future benefits over a reasonably long period of time.” (Ermasova, 2013). It was also found that efficiency, accountability, and equity are important aspects of a capital budget.

Recommendations for a capital budget process begin with developing a method of evaluating and selecting projects. Furthermore, using multiple funding sources will expand the available cash to successfully complete projects. Ensure that stakeholders are part of this process since these projects directly impact them. Finally, constantly review, evaluate, and revise your capital plan because there may be new priorities emerging.

### **Conclusion**

There are numerous challenges and concerns when handling the capital budget process, especially in a world that has changed so drastically after the pandemic. Understanding that you must diversify funding sources, include stakeholders, and constantly evaluate your infrastructure will put you on a path to success when attempting to tackle the capital budget process.

### **Citations**

Ermasova, N. (2013). Capital Budgeting in the States After the Great Recession. *State & Local Government Review*, 45(2), 119–130. <http://www.jstor.org/stable/42002372>