CAPITAL PLANNING
AND THE DC GOVERNMENT

BY SHAYNE C. KAVANAGH, DAVID A. CLARK,
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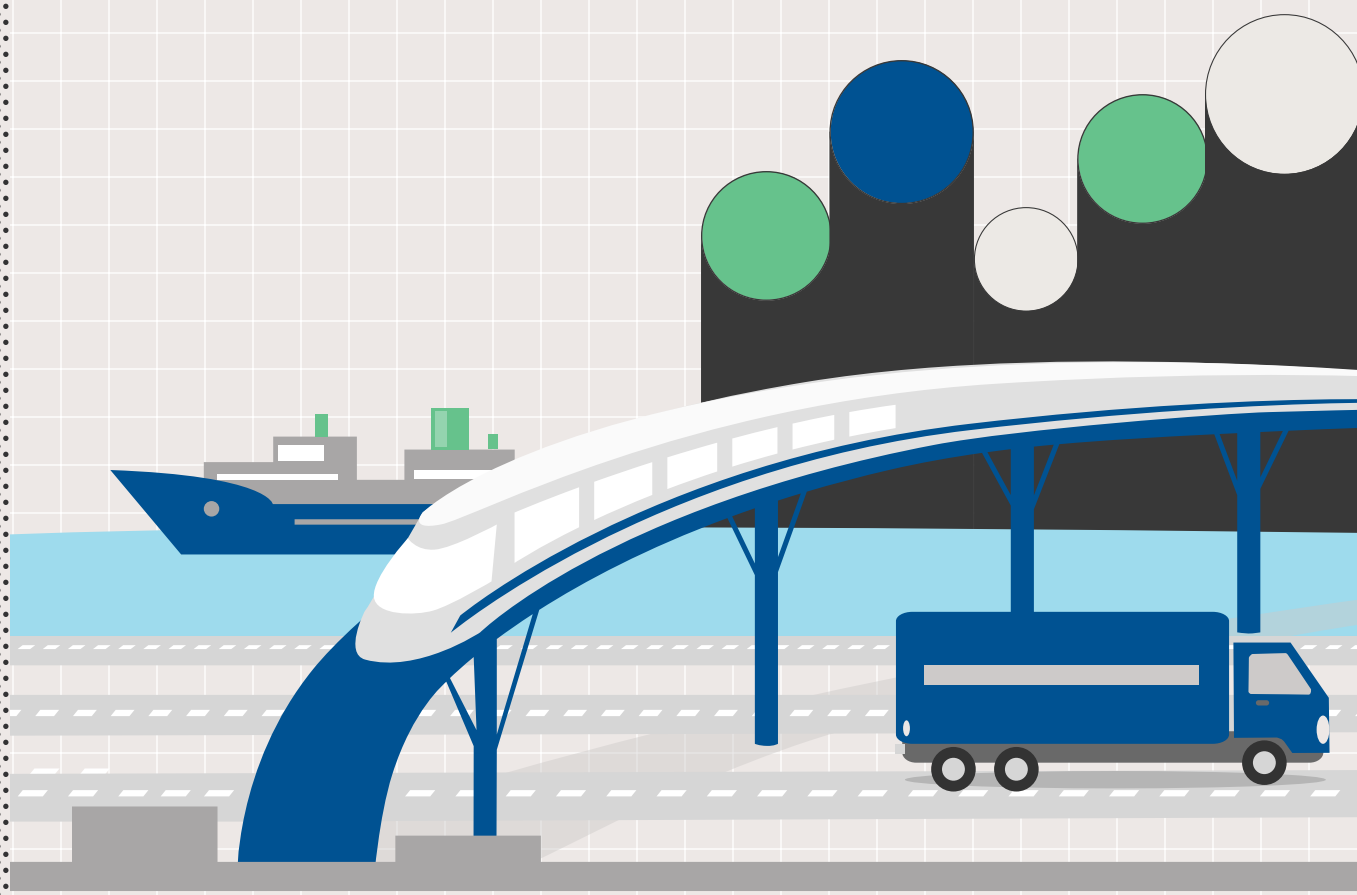

Government Finance
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ABOUT FINANCIAL FOUNDATIONS FOR THRIVING COMMUNITIES:

Created by GFOA, the Financial Foundations Framework helps facilitate collaboration and support for public policies and programs. Organized into five pillars, the Framework shows you how to improve your financial position now and create a strong foundation for a thriving community over the long-term.

Each pillar includes different leadership strategies and/or institutional design principles. Understanding that local governments cannot order people to collaborate, leadership strategies help inspire pride and public support for a strong financial foundation. Institutional design principles, meanwhile, are the "rules of the road." They provide the context for leadership strategies and ensure continuity of good financial practices through changes in leadership.

You can buy the book at **gfoa.org/materials/financial-foundations-thriving-communities-ebook**

The Government Finance Officers Association (GFOA) represents approximately 20,000 public finance officers throughout the United States and Canada. GFOA's mission is to promote excellence in state and local government financial management. GFOA views its role as a resource, educator, facilitator, and advocate for both its members and the governments they serve and provides best practice guidance, leadership, professional development, resources and tools, networking opportunities, award programs, and advisory services.

GFOA's Financial Foundations for Thriving Communities describes how local governments can make better financial decisions. The Financial Foundations Framework consists of five pillars:

Establish a long-term vision. Give people a reason to work together in supporting a financially strong local government.

Build trust and open communication. Create the conditions for people to work together.

Use collective decision-making. Develop forums for working together.

Create clear rules. Reinforce constructive behavior.

Treat everyone fairly. Promote and protect mutual trust and respect.

These pillars apply to many types of financial decisions, including capital improvement planning and budgeting.

The municipal government of the District of Columbia (the "District") is a leader in asset management and infrastructure renewal planning.[i] The purpose of this paper is to describe the District's approach through the lens of Financial Foundations for Thriving Communities. By using this lens, we hope to make it easier for local governments to not just replicate the technical aspects of what the District has done but also invent approaches to asset management that best fit local conditions. Success at asset management does not require copying all of the technical details of the District's approach, but it does require that each of the five pillars of the Financial Foundations Framework is put in place. At the end of this paper, we will touch upon how the District's approach to capital assets has allowed it to navigate through the financial challenges caused by COVID-19.

IS DC A USEFUL EXAMPLE FOR LOCAL GOVERNMENTS?

Because Washington, DC, is the nation's capital, it is reasonable to wonder if it is a useful example for other local governments. DC provides the full range of local government services, including police, fire and public works services, and operates a school district. It also provides many services comparable to state governments, like workers' unemployment compensation programs and a department of motor vehicles. Despite being the nation's capital, it does not appear that DC receives any remarkable financial benefit from its status. For example, DC receives about 23% of its revenues from the federal government. This is about equal to the average percent of revenues the 50 states get from the federal government.[ii] However, unlike most local governments, DC gets no revenue from the state governments. The contribution from the federal government must account for the "state-like" services provided by the DC government and act as a stand-in for state-shared revenue. Furthermore, a portion of the real estate in DC is tax-exempt (federal buildings, foreign mission buildings, nonprofits, etc.), resulting in the DC government forgoing about $640 million in property tax revenues annually.

PILLAR 1—ESTABLISH A LONG-TERM VISION

Successful capital planning and asset management require sustained cooperation between many people. Here are a few examples:

- People must agree on a long-term capital spending strategy, including prioritizing projects.
- They must decide how to pay for long-term capital assets. This often requires tying up resources in a single project for a long time.
- They must make regular investments in the upkeep of purchased assets.

The last point can be difficult because the short-term consequences of underinvesting in asset maintenance are usually negligible. The consequences become apparent after years of neglect.

In the District, the Mayor and the CFO saw firsthand the effects of consistently deferred maintenance in the District's school buildings. The buildings were in poor shape. Air conditioning, window replacement, security doors, roof replacements, athletic fields, and playgrounds needed attention. Yet, the education system is needed for any community to thrive. The children of existing residents would be less able to learn, and schools would be less attractive to prospective residents. Hence, there was a strong case to address the deferred maintenance of the school buildings.

The District's CFO pointed out that the problem DC was having with the schools could repeat itself with other asset classes. For example, deteriorating streets or subway systems reduce citizen's mobility. Without mobility, the community can't thrive. This meant that DC needed a vision for a comprehensive program for asset maintenance.

However, a vision without action is a hallucination. Given the size and scope of asset maintenance needs in the District, a comprehensive asset management program in DC might seem like an "aspirational" goal. Fortunately, GFOA's research shows a way for local governments to connect a vision to implementation: "rapid incrementalism." "Incrementalism" is a time-honored approach to many things in government, but it implies a visionless approach of muddling through, step by step. Rapid incrementalism is guided by a vision and relies on small, planned changes that add up to a large change. Changes happen rapidly enough that momentum is maintained but not so rapidly that the government gets ahead of its capacity for change.

GFOA's research shows a way for local governments to connect a vision to implementation.

The District started its asset program with three classes: school buildings, school busses, and streets. These were asset classes where the case for better asset management was clear. The managers of these asset classes were willing, if not eager, participants. The District built a data model to represent the assets in each class. It sought the "goldilocks" amount of data: not too much and not too little. Too much would waste the District's limited resources for building the model, and too little would not result in a model that was useful for guiding decisions.

As the data model grew and proved its usefulness, more asset classes where added. Also, more data was collected when it would add decision-making power to the model. For example, when the District built its database for school buses, it focused on mileage and age as conditions of a bus that could warrant a replacement. However, when vehicles from other departments were added, the District learned that mileage and age alone were not sufficient measures of vehicle condition. Vehicles used in public safety spend a lot of time idling, which puts wear on the engine. Hence, engine hours were added to the data model as an indicator of asset quality. Later, the amount of money spent on maintaining a vehicle was added as an indicator of its condition. The indicators of vehicle condition evolved into a point system that summarized the condition of any given vehicle.

Today, 100% of the District's assets are recorded in the District's data model, which is called the Capital Asset Replacement Scheduling System (CARSS).

> A vision without action is a hallucination.

Questions and Conversation Starters:

- Does your community have a vision that supports good asset management? Is there an area of service that elected officials are concerned about that could be a starting point for better asset management?
- Which departments in your government are willing to support better asset management?
- Given your answers to the first two questions, which areas of your government appear to be the most promising starting point?

PILLAR 2—TRUST AND OPEN COMMUNICATION

In any resource allocation process within a local government, not everyone can get everything they want. Open communication and trust are required so the people feel they can "show their cards" without risk and can trust that other participants in the process will not seek to take advantage. Without trust and open communication, people will be less likely to support the common good and more likely to focus on self-interested outcomes.

The GFOA Code of Ethics is designed as a way for finance officers to build and maintain trust. The code asks government finance officers to live five values that research shows contribute to a trustworthy reputation. Let's examine how the District lived those values through its asset management program.

Honesty and integrity. The District's asset management system, the CARSS, is the system of record. It is seen as the truth when it comes to assets. The CARSS uses data contributed by the District's operating departments. Hence, the departments trust the data because it is their data. The CARSS is accessible to the District's departments, so they can see how the data is used and raise questions as needed.

Produce valuable results. In 2018, the District's bond ratings were upgraded by all three of the major rating agencies. Among the reasons cited for the upgrade was the District's commitment to long-term capital planning.[iii] This led to lower borrowing costs and, thus, the capacity to do more capital projects. For example, in November 2019, the District issued about $1.3 billion in income tax-secured revenue bonds, with a 25-year term at a borrowing cost of less than 3%. This was followed in February 2020 by another sale of more than $1 billion of income tax-secured revenue bonds, also with a 25-year term at a borrowing cost of less than 2.5%. These successful bond sales were among the largest borrowings in the District's history. Both were sold at record-low borrowing costs for the District at the time.

Treat people fairly. The CARSS helps the District make decisions about where its available money will do the most good. Because fairness is an important part of a decision-making system, we will revisit it later in this paper.

> "This rating is a recognition of the hard work our community has done to build a fiscally responsible city—a city that is a great place to not only live and work but to invest in and do business. More importantly, for our city and our residents, it means that we are going to have more funds to build on our progress and create pathways to the middle class for Washingtonians across all eight wards."
>
> **–Mayor Muriel Bowser**

Diversity and inclusion. Within the District government, departments are involved in developing and maintaining the capital improvement plan. With respect to the community, the scoring system for evaluating capital projects is designed to make sure that all geographic areas within the city have quality basic services and can get their share of needed assets in their community.

Reliability and consistency. The capital planning process remains the same each year, with some incremental improvements made. This consistency means people know what to expect. The criteria used to select the projects that go into the plan are transparent and are applied to all types of projects.

Questions and Conversation Starters:

- Is there a source of information about capital assets in your government that is seen as the "single version of the truth"? Do people trust the data in this system?
- What is the benefit that better asset management can produce for your community?
- Do stakeholders have a consistent experience with the capital planning process? This doesn't mean that the process can't change, though. If you need to change the process, what steps can you plan that will get you there gradually? (Recall rapid incrementalism.)

PILLAR 3—COLLABORATIVE DECISION-MAKING

When people participate in making a decision, they are likely to support it. A supported decision has a better chance of being implemented. This applies to capital planning and asset management. If a broad group of people is involved in making the decisions, the resulting plan will have greater support and is more likely to become a reality.

The need for collaborative decision-making applies inside and outside of government. Inside of the District government, a team of representatives from across the District meets to score the capital projects that have been proposed for the capital plan and budget. Everyone is given a chance for input, and everyone is privy to how the final scores were arrived at. We'll explore this scoring process later in this paper.

The public's participation in the capital planning process is robust but indirect. Every year, as part of the Mayor's budget development, there is a series of meetings in every ward at a neighborhood school. The meetings do not directly address the District's capital management plan. Rather, the meetings are focused on understanding the big-picture priorities of the public, which the Mayor uses to shape the budget. The resulting budget policies impact the District's capital planning by shaping the criteria used to evaluate proposed projects. Hence, the District's asset management

process gives the Mayor the ability to imprint the public's priorities onto the capital plan by setting relevant, aligned evaluation criteria.

This approach of indirect public input to the capital plan allows the District to give the plan democratic legitimacy and benefit from the technical expertise of departments in picking the best projects within the criteria the public helped define.

Questions and Conversation Starters:

- In your government, is there an opportunity for all departments that have a stake in capital planning to be a part of the decision-making process?
- How are the public's views brought into capital planning? Is there an opportunity for indirect influence, like the District has done?

PILLAR 4—CREATE CLEAR RULES

A budget process is a complex system with many moving parts and many people involved. Rules are needed to maintain order. Participants in a budget process will be tempted to get extra resources for themselves, even if that is not the best thing for the community as a whole. A strong set of rules provides support for wise decision-making.

The District has rules that support good asset management.

First, the funding that departments receive for assets is based on the quality of their asset plan, not how much money they got last year. When the District instituted this rule, departments surmised that it was in their best interest to collect high-quality asset data and contribute it to the asset management system.

Next, the District has established a local law that requires the CFO to file a report each year with the Mayor, the Council, and the public on the condition of the District's assets as well as the amount of unfunded or deferred maintenance. This helps create the discipline to stick to a good asset management process because everyone wants to report progress each year. The report includes data visualizations like charts, graphs, and maps of where assets are being built in the community. These elements make the report more accessible and of greater interest to its audience. Greater interest in the results of the report reinforce its value for encouraging the District to stick to good asset management policies.

The District has a rule to ensure funding for asset maintenance. The District's elected Council adopted legislation to increase pay-as-you-go funding for asset maintenance until these revenue streams reach the level of the District's annual depreciation. This way, depreciation and pay-as-you-go funding are in balance. It is easier to commit to regular asset maintenance when you have a rule that some revenue streams can only

> A strong set of rules provides support for wise decision-making.

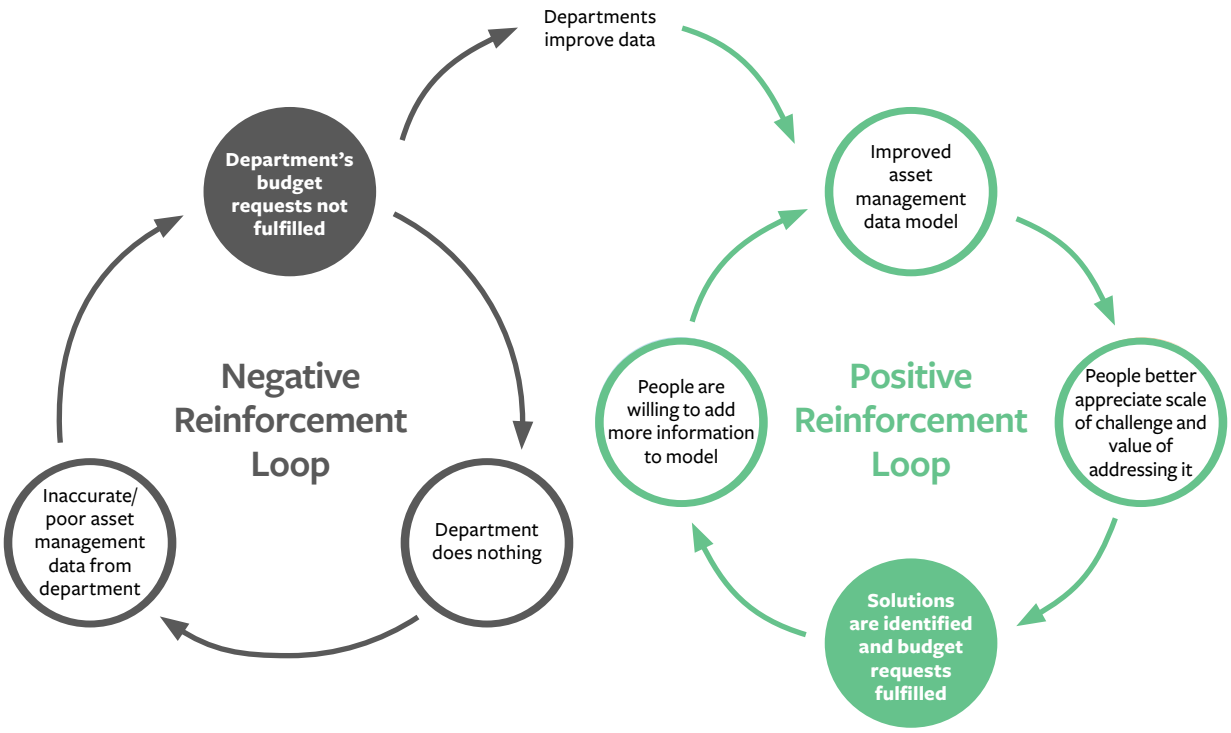
be used for asset maintenance. This rule frees up the District's debt capacity for new assets and is supported by the District's accounting rules for depreciation: Depreciation has been structured to be a close proxy for real-life deterioration in the District's assets. The District's accounting practices book each asset as it is placed into service, and each asset is depreciated dependent on the useful life of the asset. The sum of the depreciation is published in the District's Comprehensive Annual Financial Report—and that's the target number for the District's pay-as-you-go strategy.

Finally, the District has a rule that its four-year financial plan must be balanced. Sometimes in local government, long-term financial plans do not make an effort to balance revenue and expenditures over the long term. By making balance a rule, the District encourages more rigor in the planning process.

In any local government, not everyone will respect the rules all of the time. Some people may bend or break policies or other rules of the process to gain an advantage for themselves. Let's see three important ways the District encourages people to work within the process.

First, the District has set up negative and positive reinforcement loops for departments to participate in the CARSS, as shown in Exhibit 1. If departments do not provide good asset management data, their budget requests will not be successful. If they provide good data, their requests are likely to be successful. This is the power of the purse strings.

EXHIBIT 1: Negative and Positive Reinforcement Loops



The second way people are encouraged to stay within the rules is the District's capital budget team, whose members are drawn from across all departments. This team makes decisions on how to score all capital projects across all agencies. This keeps scoring more honest. If one of the team members were tempted to inflate the scores for a project that belonged to their home department, they know that the score will be scrutinized by representatives from other departments on the team. Because all the team members are technical experts, the score inflating would likely be discovered. This would cause the perpetrator's reputation to suffer in the eyes of their teammates. In general, people care about their reputation among their peers, so the disincentive the District has set up is effective.

A third way the District encourages people to stay within the rules is the capability of the CARSS to model the long-range financial impact of alternative spending proposals (known as "what-if" capabilities). This helps combat the "it's all good problem." It is rare for someone to propose extra spending on an objectively bad idea. Rather, the additional projects or asset that is being advocated for is usually desirable in some way. This makes it hard to say "no" *in isolation*. The CARSS takes the proposal out of isolation and requires the District to consider how the proposal would be paid for within capital plan. This makes the proposal less attractive because people must consider what they have to give up to accept the proposal.

An example of this what-if capability was when a proposal was made to build extra park amenities in the community. The proposer had to suggest where the money would come from, and they suggested a reduction in the large sum of money the District spends on vehicle replacement. The CARSS was then used to see how this plan would work and showed that it would result in higher maintenance costs on the vehicles the District would be forced to keep in service and would pay more to replace those vehicles later. This led the District's Council to decide against building the park amenities.

Questions and Conversation Starters:

- Does your budgeting process base allocations to departments on what they got last year or the quality of their asset management planning?
- Have you committed to a transparent, regular reporting process on asset condition? Is the report understandable by elected officials, the public, and other nonexperts?
- Do you have a dedicated stream of funding for asset maintenance?
- Do you have a rule that your capital plan must be balanced across multiple years?
- Do you use a collaborative and transparent scoring process that puts the participants' reputation for objectivity on the line?
- Does your capital planning process require people to consider the trade-offs inherent in new spending proposals?

PILLAR 5—TREAT PEOPLE FAIRLY

Fair treatment is needed to maintain support for the decision-making system. If people feel unfairly treated, they are likely to try to overturn the results of the system and possibly the system itself.

The designers of a decision-making system, like a capital planning process, must be mindful of two kinds of fairness. The first is "procedural justice" and concerns the objectivity of the process and how people are treated during the process. The second is "distributive justice," which means people get what they deserve as a result of the process.

Let's start with how the District has addressed procedural justice. Procedural justice can be understood to have four elements.

First, decisions should be based on information that is perceived to be accurate. Developing a comprehensive asset inventory, with the right amount of detail, will help to convince people that decisions are based on good information. An asset inventory allows for a better comparison of the costs of funding new projects versus the cost of deferred maintenance on existing assets. As discussed earlier, the information in the CARSS is contributed directly by departments. This gives departments confidence that the data is accurate.

Fair treatment is needed to maintain support for the decision-making system.

Second, a transparent and consistent set of decision-making criteria should be applied equally. We saw earlier that the District's capital planning team applies the same criteria to all project proposals from all departments. Furthermore, the criteria are rooted in the priorities of the District's elected officials. This confers a sense of legitimacy to the criteria. To illustrate, in fiscal year 2019, the Mayor had three major priorities:

- Improve outcomes for children and youth.
- Increase prosperity across all eight wards [of the city].
- Back to basics: Enhance DC government services.

Each priority was associated with two to four subpriorities. For example, the priority for increasing prosperity included subpriorities on affordable housing, reducing health disparities, and reducing homelessness. All capital projects considered for funding had the opportunity to show how they support one of these priorities. For example, roadway projects improve mobility (a subpriority of "back to basics"), and library enhancements contribute to improving outcomes for children and youth.

The priorities of elected officials often cover a range of issues, reflecting the broad mission of local government. Capital projects will rarely promote more than a handful of the elected officials' priorities. Therefore, additional criteria are needed to differentiate between capital investments. The District has two sets of additional criteria. The first set is "cost-benefit factors" that give points to projects that have a

positive impact on the operating budget by reducing costs or generating their own revenue stream. The second set is "project-specific criteria." This gives points for projects that extend the useful life of an asset or that co-locate projects/facilities (space is at a premium in Washington, DC).

The third element of procedural justice is that stakeholders are given the opportunity for input. The District uses a team of representatives from across the District government to score the projects. Everyone is given a chance for input, and everyone is privy to how the final scores were arrived at.

The fourth element is that mistakes are recognized and corrected. No evaluation system will be perfect. Perhaps the biggest risk for a mistake, in the context of capital planning, is failing to account for the future operating and maintenance costs caused by today's asset management decisions. The District staff regularly evaluate and report on future operating and maintenance costs, and they update their projections based on the estimated impact of new capital investments. This way, decision-makers understand the cost of their decisions. As we saw in our example of park amenities versus vehicle replacement, this can create momentum to avoid financially imprudent decisions.

Now let's turn to distributive justice. Inside the District government, because a cross-departmental team evaluates spending, there is a measure of equity across the missions and service expectations of each department.

Looking outside the District government, the CARSS data can be used to see where the money is going so the District can be sure each ward is getting equitable basic services and assets that are valuable for that ward.

At the Mayor's neighborhood budget meetings, the Mayor shares the proposed budget by project. Citizens provide feedback on the projects proposed for their area versus what they feel might be needed.

Finally, the Council members have the flexibility to adjust spending to address short-term needs. For example, park and pool repairs and other things that the public experiences are included in the CARSS, and elected officials can make sure each ward is getting what is most valued by that ward. At the same time, Council members serve on committees that advise in citywide service levels, so they balance citywide concerns against concerns specific to their ward.

Questions and Conversation Starters:

- Is the information you have on your capital assets and project proposals accurate enough to give people confidence in the decisions made based on this information?
- Do you have a set of decision-making criteria that are consistently applied to all proposed capital projects? Are the criteria linked to big-picture, elected official/public priorities? Do the criteria give weight to important technical considerations, like cost-effectiveness?
- Can your asset management system show decision-makers the long-term impact of the decisions they are making today? Do decision-makers get that feedback quickly enough that they have time to adjust decisions that have a negative long-term impact?
- Does your capital planning process take steps to ensure that different groups of stakeholders are receiving an equitable amount of basic services and that needs that are important to that group are being met?

CONCLUSION

We just viewed the experience of the District of Columbia through the lens of Financial Foundations for Thriving Communities. This showed us how local governments can put in place a high-performing capital planning and asset management system without having to copy all of the technical details of the District's system. Certainly, the technical details of the District's system are worthy of emulation, but it may not be practical to transfer all of them to other situations. By thinking about the five pillars, local governments can outline the requirements of a capital planning process, take inspiration from the District where it works, and find different approaches where it doesn't.

COVID-19 AND CAPITAL PLANNING

The COVID-19 pandemic and associated financial crisis required the District to lower its capital budget by about 13%. The District was able to reprioritize spending to ensure funding for critical investments, like maintaining core District assets in a state of good repair, maintaining timelines of existing projects, and addressing pressing maintenance and safety concerns. Because the District had a database of its assets and a priority ranking of its capital projects, the District was able to revise its nearly $8 billion capital budget in a matter of weeks to reflect the reduced revenues, while maintaining core priorities and delivering high-quality infrastructure for the District of Columbia residents.

[i] Jake Varn. "D.C. Leads the Way with a Comprehensive Asset Inventory." Bipartisan Policy Center. December 1, 2017.

[ii] Taxfoundation.org, based on U.S. Census Bureau "Annual Survey of State and Local Government Finances" for 2017.

[iii] "Moody's Upgrades District General Obligations Bonds to the Highest Possible Rating—Triple A (AAA)" Press release from Government of the District of Columbia, Office of the Chief Financial Officer. July 12, 2018.

[iv] Coined by Greg Devereaux, retired CEO of San Bernardino County.

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