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Capital Budget Development Process for FY 2018 and FY 2019

Successful capital planning and budgeting require long-term planning, looking well beyond the current biennium to determine the investments that need to be made to maintain, and possibly extend, the useful life of the asset, and to ensure that capital investments are closely aligned with agency and program goals. To that end, additional emphasis is again being placed on the planning and execution of preventive maintenance (PM). With proper long-term planning and timely PM, additional large and/or unexpected capital investments should be minimized.

Agencies are expected to prioritize the reduction of deferred maintenance over line item projects and capital expansion.

The goal is to provide safe, clean, and efficient worksites for state employees and the taxpayers and the citizens whom we serve.

The accomplishment of this goal will be measured in the following ways:

1. Demonstrated relationship between the agency's proposed capital budget and its mission and program objectives, as defined in each agency's operating budget requests.
2. Effective use of a master plan in the development of an Agency's or Facility's request. Long-term, master planning is key to the success of capital budgeting as it ensures proper maintenance of existing facilities, provides transparency into future needs, and requires decision-makers to consider and plan for programmatic changes that may affect future capital needs.
3. The completion of a capital forecast that analyzes the lifecycle and replacement costs of certain assets. This includes assets that require periodic replacements.
4. Detailed calculation of the impact the capital requests will have on future operating costs, and a well-crafted plan of how the agency will manage these costs within available funding. It is of the utmost importance that agencies understand the costs associated with a capital asset throughout its lifecycle, including acquisition, management in-use (including both capital and operating expenses), and disposition.

In summary, proposed projects should contribute to statewide and agency objectives while improving productivity and/or customer service at the lowest practical cost. Or, put another way, the State's capital assets should be maintained as if they were our own personal property, and state tax dollars should be spent as if we were spending our own money.

I. INTRODUCTION

These instructions set forth the process to request and justify PM, repair and rehabilitation, construction, capital lease rental, and other capital projects for FY 2018 and FY 2019. These instructions apply to all state agencies, institutions and other entities, except state universities, planning to make capital budget requests for FY 2018 and FY 2019. Capital budget requests should continue to be submitted by agency, by division or by institution/site. Please note the following areas in particular:

1. Agencies must submit capital budgets through the Hyperion system. See the Operating Budget Instructions for more information on this process.
2. **Agencies are required by Indiana statute to have a master plan for each major facility or campus.** The master plan should be updated annually depending on which projects were or will be accomplished in the current biennium and which projects need to be adjusted and/or added to future years. The master plan must follow the format detailed by the Division of Public Works, including a checklist of PM items to be completed each year and a schedule of prioritized projects. Agencies should focus their efforts on two important components of the master plan: (1) Schedule of PM and repair and rehabilitation projects required to maintain the asset, and (2) Planned agency and program changes that will impact the use or lifecycle of the asset (e.g., change in mission, expansion or disposition plans, etc.).

The Division of Public Works will assist agencies in completing/updating master plans, and must approve all plans. If you do not have a master plan, you should submit a request by Friday, June 10 to the Division of Public Works (with a copy to your Budget Analyst) to develop a plan. The status of your agency's master plan(s) should be addressed in your capital transmittal letter, and a copy of your master plan(s) should be submitted to your Budget Analyst by no later than **Friday, July 29**.

Note: For bonded facilities, agencies should continue to work with the Indiana Finance Authority and the Division of Public Works (IDOA) to ensure that the facility master plan is being adhered to.

Note: Master Plans must look out at least 10 years and should include a detailed list of anticipated capital projects, including PM, over that time period. Although capital budget development is a biennial process, the State Budget Agency and the Division of Public Works are dedicated to continuing a more disciplined budgeting process that includes both long-term planning and additional details about lifecycle costs of state assets. These plans should be adjusted and updated annually to account for changes in project timelines, needs, costs, funding and/or agency missions and objectives.

The following is a list of some of the factors to be considered when developing a solid master plan:

- a. Facility condition assessment including age and condition
 - b. Deferred maintenance impacts (when initiating a smaller project today will prevent the need for more expensive repairs in the future)
 - c. Health and safety concerns (previously referred to as Life/Safety factors)
 - d. Code compliance (including Americans with Disabilities Act and other structural codes)
 - e. Environmental concerns (will the investment have detrimental or beneficial environmental impacts)
 - f. Future operating costs (e.g., utilities)
 - g. Agency efficiency (for instance, will a given capital investment allow a more efficient staffing pattern)
 - h. Financing structure (if applicable, debt service impacts on spending)
 - i. Matching support from federal, local, or private sources
 - j. Agency program needs (e.g., caseload or enrollment trends)
 - k. Customer service focus (preference is given to investments that benefit Indiana residents or the clients of agencies directly)
 - l. Statewide space needs considerations (for instance, considering whether an agency could co-locate with another, rather than building new space)
 - m. Strategic priorities (does the investment support state government core missions such as economic development and job creation, education, public safety, and health)
 - n. Long-term plans for demolition, sale, or disposition of assets (avoidance of investments in structures that will not be needed in a few years)
3. Agencies must submit a capital forecast by facility. This forecast must address the age, remaining useful life, and replacement costs for replaceable assets such as roofs, boilers, HVAC systems, water systems, electrical, plumbing, pumps, generators, pavement, building facades, windows, etc. A forecast template is attached which includes an example. The capital forecast should be submitted to your Budget Analyst by no later than **Monday, August 15**.
 4. Agencies must submit an inventory of deferred maintenance by facility to the State Budget Agency. The inventory should be submitted to your Budget Analyst by no later than **Monday, August 15**.

The inventory of deferred maintenance by facility must contain:

- a. Plan for addressing the deferred maintenance
- b. Cost for addressing the deferred maintenance
- c. Consequences of continuing to defer the maintenance
- d. Current use of the asset
- e. Future use of the asset once the deferred maintenance has been addressed

- f. Buildings to be demolished and estimated cost of demolition
5. All project requests must be prioritized. Generally, projects should be prioritized according to agency objectives as well as statewide objectives established by the Budget Agency (See “Prioritization Criteria” within Section V). An agency may deviate from the statewide criteria if it includes a specific description of the alternative agency criteria/objectives/metrics used to prioritize capital projects. The criteria used to prioritize projects should be addressed in your capital transmittal letter.

Agencies are expected to prioritize the reduction of deferred maintenance over line item projects and capital expansion.

Agencies will not have access to funds for projects that received appropriations in the FY 2014-2015 biennial budget if they have not already been initiated prior to June 30, 2017 (meaning approval by the Budget Committee, or by Budget Agency via administrative action for projects of less than \$100,000).

It is important that agencies prioritize previously planned projects along side new projects, as agency priorities or circumstances may have changed since the last budget development process. For instance, the Family and Social Services Administration may have received an appropriation to build a new state hospital, but the demographics of the current population may now call for the expansion of an existing facility instead. The prioritization of all uninitiated projects, whether they have received an appropriation in a prior budget or are being requested for the first time, should be included in your capital transmittal letter.

The prioritized list of projects must include the following information:

- Capital project name
- Project priority
- Type of project
- Initial biennium of appropriation
- Legal fund (e.g., General Fund, Post War Construction Fund, etc.)
- Biennial budget appropriation

These changes are explained in more detail in each appropriate section of the instructions. If you have questions regarding any part of these instructions, please contact your Budget Analyst.

II. DEFINITIONS

Each capital budget request must fall within one of the three categories defined below:

1. **Preventive Maintenance (PM)** – Budget Agency defines PM as expenditures for goods, supplies or services related to the routine upkeep of existing structures and other assets. PM expenditures do not result in a function, use or mission change, and do not collectively constitute a repair and rehabilitation or construction project. For instance,

lumber, building supplies, and paint needed to repair minor damage resulting from ordinary wear and use of an existing structure would be appropriately considered PM.

2. **Capital Project** – There are three types of capital projects as follows:

- **Capital Lease Rentals** – This category includes payments made to a financing authority under the terms of one or more leases or similar agreements as consideration for use and occupancy of a capital asset financed by the financing authority. For example, the Indiana Finance Authority (IFA) financed construction of a new state hospital for use by the Family and Social Services Administration (FSSA). Under the indenture securing the bonds, the Indiana Department of Administration (IDOA) is responsible for making lease payments to the IFA. Those lease payments are capital lease rentals.
- **Repair & Rehabilitation (R&R)** – This category is defined as a broad range of expenditures (generally grouped together as a project) related to the ongoing upkeep or improvement of existing assets, to address deferred maintenance, or to maintain or increase their utility, such as the replacement of a roof or HVAC system on an existing building.
- **Line Item Projects** – This category is defined as a broad range of expenditures (grouped together as a project) resulting in the creation of a new or different fixed asset such as a building or structure which may be free-standing or affixed to an existing asset. For example, expenditures necessary to construct a new State Police Post (whether it resulted in an additional new structure or replaced some existing building) would be considered a construction project.

Line Item Projects also may also reflect a change in an asset's function, use, or mission. For instance, expenditures necessary to transform a cold storage facility into a vehicle repair facility would be considered a Line Item Project because it would result in a major upgrade and mission change for an existing structure.

3. **Other Capital Requests** – This category includes expenditures that do not fall within the foregoing definitions and for which incorporation into the capital budget is in the best interest of the State. These requests may be submitted to Budget Agency with appropriate supporting information. For example, expenditures required to acquire land would be considered a project, and may be included in your capital budget request.

All other requests must be made in your operating budget submission.

III. CAPITAL TRANSMITTAL LETTER

The agency must submit a Capital Transmittal/Overview Letter to Budget Agency no later than **Monday, August 15**. The agency overview letter should be submitted electronically to your

Budget Analyst separately from loading actual budget data via Hyperion. The letter should include the following:

- A general statement of the condition of the agency's physical plants – include a discussion of progress made in the current biennium and special challenges facing the agency for the next biennium
- A summary of the agency's current mix of owned (including IFA bond-financed) vs. leased (rented) facilities – include a discussion of how the decision is made whether to own or lease facilities
- A description of how each of the agency's facilities fits into the agency's current and long-term plans
- If current master plans are not available for all facilities, an explanation as to the status
- A prioritized list of projects
- A discussion of the criteria used to prioritize requested projects

IV. PM BUDGET REQUEST

Preventive maintenance requests are entered as PM-type change packages. A priority number does not need to be assigned to a PM request. For those agencies with multiple PM appropriations, list all PM requests for the agency with the appropriate division or institution. For example, the Department of Correction should submit a PM request for each correctional institution.

Generally, your PM budgets for FY 2018 and FY 2019 should not exceed your PM appropriation for the current FY 2016 and FY 2017 biennium.

Your PM request may exceed your FY 2016 and FY 2017 PM appropriation if a new facility that did not receive a PM appropriation in the current biennium is included in the request. For simplicity, increased PM expenditures associated with repair and rehabilitation or construction projects to be completed, or which commence operation, in FY 2018 or FY 2019 may be incorporated into the PM budget request, but the increased amount should be discussed and justified in the narrative.

If you are an agency or facility that receives PM funds (or will be seeking PM funds in the FY 2018-2019 budget), then you must develop a PM plan that details how the funds will be spent for FY 2018 and FY 2019. The PM spending plan must include an itemized list of specific contracts (e.g., HVAC, elevator maintenance), scheduled projects (e.g., painting, roofing patchwork, tuck pointing brick, etc.) and other building maintenance (e.g., snow removal, landscaping, mowing).

The PM spending plan requires the following information:

- Project name
- Project description
- Project category (i.e., contract, scheduled project, other building maintenance)

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- Fiscal year of expenditure
 - Name of contractor
 - Estimated duration of project
 - Actual/estimated costs

This information must be submitted to your Budget Analyst no later than **Monday, August 15**.

Note: Inadequate maintenance of capital reduces the asset's ability to meet agency needs efficiently and effectively and also causes a decline in capital asset value. Agencies and facilities that have failed to use PM funds in prior years may have their requests for R&R and construction projects prioritized below those agencies and facilities that have maintained their existing assets. PM, if properly executed, should minimize the need for more expensive repairs and capital projects in the future.

V. CONSTRUCTION PROJECT REQUEST

Agencies are asked to focus their construction project requests upon facility needs in line with the priorities outlined below.

Requests for individual projects (capital lease rentals, R&R, and line item projects) will be entered on the Capital Spending Request forms. Narratives will be used to define and justify requests and explain how the projects were prioritized. A copy of this form is attached.

Prioritization Criteria

Budget Agency has established statewide objectives as follows to assist agencies in setting priorities for requested projects. Budget Agency will consider the following order of priority for statewide objectives when balancing with agency priorities. Please indicate on the project information form the priority category that applies to each project request.

1. **Lease Rentals:** If your agency is required to pay capital lease rentals, these requests must be listed as the top priorities for capital funding. Identify the lessor to which the lease payments will be made, and briefly describe the project which is subject to the lease. In addition, please include the following cost information: Principal, Interest, Replacement Reserves, Operation & Maintenance, and Total. **Agencies must consult with IFA in order to acquire this information.**

NOTE: Lease rentals should NOT be included in R&R requests and should be a separate line item when entered into the budget system. This will ensure that time-sensitive lease payments can be made without waiting for State Budget Committee approval.

You may prioritize remaining requested projects as you believe best meets your agency's needs. That said, projects that are included in an agency's or facility's master plan will be prioritized above those projects that are not included.

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2. **Master Plan Projects:** If your master plan is not updated, accurate, or tied to your objectives, contact the Division of Public Works by Friday, June 10 to discuss the status of your master plan. It should again be emphasized that this document should be updated annually to reflect changes. Projects included in the master plan will be prioritized in the following order:
 - a. **Health and Safety:** Agencies should propose projects designed to improve the health and safety of those who live in, work at, and visit state-owned and state-operated facilities. This includes sewer, water, energy, fire prevention, removal of hazardous materials, and other projects designed to modernize campus utilities and promote a clean environment or to fix dangerous conditions. An agency should first check with the State Revolving Fund (SRF) office under the IFA to determine SRF eligibility before including any sewer and water projects. These projects will be given a higher priority in the budget process.
 - b. **State or Federally Mandated:** In some cases, a project may be mandated by statute or by a state/federal licensing entity. This is often in the area of code compliance and should be incorporated into the master plan.
 - c. **Repair & Replacement (Preservation):** Projects designed to repair existing facilities will be given a higher priority than projects designed to expand or create new facilities. This includes projects focused on avoiding and/or reducing deferred maintenance via replacement or repair of worn obsolete building systems and restoring facilities to good working order. Major preservation projects must be identified in, and be consistent with, a facility master plan.
 - d. **New Facilities:** Budget Agency will consider requests for construction of new facilities; however, such requests will generally receive less support than requests designed to promote health and safety and maintain existing facilities.
 3. **Projects Not Included in the Master Plan:** Any request not included in the master plan will be prioritized below those in the master plan except in special circumstances, such as emergencies caused by natural disasters or other unforeseeable events.¹

It is of the utmost importance that agencies create or update their master plans to include requested Capital Projects if they want the projects to receive higher priority in capital budget development.

¹ When such emergencies or other unforeseeable events happen, agencies are expected to re-prioritize projects that have received appropriations so that health and safety issues are addressed within an agency's or facility's existing appropriations.

Problem/Need Statement/Justification

This statement will be entered in the “Project Description” field on the Construction Project Information form. Briefly explain the need for the proposed project. Identify whether it relates to a current or a proposed new initiative, and explain how it will improve the effectiveness and productivity of the agency, protect the agency’s existing capital investments, or enhance/expand services. Explain how you assigned the priority ranking, especially by linking it to your agency’s mission, objectives, and key performance indicators. Finally, explain the financial analysis performed to determine that the proposed project has an appropriate scope and cost. This could include a cost-benefit analysis, a net present value (NPV) calculation, life cycle costing, or other types of analytical methods as appropriate. Please contact your Budget Analyst with questions.

Include in the narrative any additional information necessary to explain the estimate of total operating costs, or decreased operating costs, that you expect to result from the proposed capital project. This estimated impact should be calculated by facility for each fiscal year, with a grand total for the agency for each fiscal year.

Solution Alternative and Estimated Cost

When feasible, document at least one alternative solution which you believe addresses the Problem/Need discussed above. The alternative should be described in enough detail to demonstrate that serious analysis was devoted to allow for proper ranking and consideration. Include a cost estimate for the alternative. Again, results of a cost-benefit analysis, a net present value (NPV) calculation, lifecycle costing, or other types of analytical methods should be included. Since capital lease rentals represent contractual obligations, an alternative for these requests need not be provided. Include this information in the “Project Description” field.

Other Information to include in the Project Description field:

- Related Projects – Indicate any current or proposed projects which affect or are affected by this proposed project request. Explain how the projects are related, and the impact of funding only one, some, or all of the projects. Use the Division of Public Works project number(s), if available.
- Deferral Consequences – Note the cost, policy, or programmatic consequences of deferring (postponing) this project request as it relates to the Problem/Need Statement described above.
- Previous Project Appropriations – This category applies only to the continuation of R&R and new construction projects for which additional funding is requested. Enter the fiscal years and amounts appropriated and allocated for the requested project.

Note: Please refer to Appendix A for a more complete list of questions that should be addressed in your project justifications.

VI. COST ESTIMATE

Enter a project cost estimate for your project request by using the following applicable categories on the “Construction Projects” cost form:

- Site Investigation
- Land Acquisition
- Site Development
- Hazardous Materials Abatement
- Design Fees (10% of estimated construction costs)
- Construction Costs
- Contingency
- Furnishings – Equipment
- Utilities
- Capital Lease Payments
- Other

The source of the estimate should be documented in the Project Description field.

Note: Insufficient details supporting your request will negatively impact the ability to prioritize your project(s) against other state priorities, potentially placing funding for your project(s) at risk.

VII. FUNDING

Funding source information is entered at the bottom of the “Construction Projects” form, below the total of the cost categories. This identifies the legal fund that will support the appropriation request. In Hyperion, total funding must match total spending for each fiscal year.

VIII. DEDICATED FUNDS

Projects funded partially with the General Fund and other dedicated funds must demonstrate that they are using their dedicated funding sources to the fullest extent while maintaining the integrity of the legal fund. Please contact your Budget Analyst if you have questions regarding your legal fund balances.

IX. SUBMITTING CAPITAL BUDGET REQUESTS

The capital and operating sections will be submitted as one budget. **Please submit in Hyperion by the deadline of Monday, August 15.**

Key Tasks and Deadlines:

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| Friday, June 10 | Request that the Division of Public Works develop a master plan (if you do not have a master plan) |
| Friday, July 29 | Master plans submitted to your Budget Analyst |
| Monday, August 15 | Capital forecast submitted to your Budget Analyst |
| Monday, August 15 | Inventory of deferred maintenance submitted to your Budget Analyst |
| Monday, August 15 | FY 2018 and FY 2019 PM spending plan and Capital Transmittal/Overview Letter submitted to your Budget Analyst |
| Monday, August 15 | Electronic submission of FY 2018 and FY 2019 agency budget |

Appendix A

Project Priority

- What is the priority ranking of this project? Please explain how you established the priority ranking for this project.

Project Description

- What is the capital improvement the agency is requesting (scope-of-work), and what are the project deliverables?

Project Justification

- Why is this project necessary at this time?
- Is the project needed to bring the state into compliance with laws or regulations? Has the state been cited for violation of these laws or regulations or paid a fine?
- Will the project improve the health and safety of citizens or employees?
- How will the project improve services to citizens?
- How does the project fit within agency or statewide plans (e.g., agency strategic plans, facility master plans, etc.)?
- How would delays in the start of the project impact state services or the condition of the asset? What would be the impact of delaying the start of the project until the next biennium?

Cost Analysis

- Who prepared the cost estimates for the project (e.g., agency staff, another state agency, IDOA Public Works, an outside consultant, a potential contractor)?
- If quotes were obtained, how many contractors provided estimates?
- Do the cost estimates assume inflation in materials and service costs for each fiscal year of the biennium? If so, what inflation factor(s) was used?
- Upon completion, will the project impact the operating budget of the agency, including both personnel expenses (number of employees needed) as well as other operating expenses (e.g., utilities)? Will there be any savings in operating expenditures as a result of the project?
- If the project were delayed one fiscal year beyond the planned schedule, what would be the total expected cost of the project? What would be the cost if the project were delayed until the next biennium?

Financial Analysis

- What are the proposed funding sources for the project (e.g., general fund, dedicated funds, federal funds)? If dedicated or federal, please list the fund.
- Does the project involve bond financing or will it be cash funded? If you are proposing to bond for the project, have you discussed the project with the Indiana Finance Authority?
There will be a strong preference for cash-funding projects rather than incurring new indebtedness.

Time Frame Analysis

- What are the forecasted starting and finishing dates for the site acquisition, architectural/engineering studies, construction, and equipment purchase?
- What plans must be completed or approvals secured before construction begins?
- What other projects must be started or completed before this project can begin?
- What other projects must await the start or completion of this project before they may be started? What state of completion must this project reach before the other projects can proceed?

Alternative(s)

- When feasible, document at least one alternative solution that addresses the problem/need discussed above. Include a cost estimate for the alternative.