



## DEBT ISSUANCE AND ADMINISTRATION SERIES FOR ELECTED OFFICIALS' TRANSCRIPT

### ***What you Need to Know Before Issuing Debt | Part 1: Key Planning Processes***

Module 2 discusses the relationship between long-term planning and short-term decision making, the role and responsibilities of elected officials in capital finance, and the risks of short-term decision-making. Other topics include key principles of capital finance that will enable elected officials to assess the long-term impacts of budgetary decisions and the value of strategic financial management.

*Editor's Note: This transcript has been prepared by the California Debt and Investment Advisory Commission (CDIAC) and it believes it to be a fair and accurate reproduction of the comments of the speakers. Any errors are those of CDIAC and not the speakers.*

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**News Reporter 1:** In local news, the vote to fund the new...

**News Reporter 2:** Agency plans a twenty-three million dollars bond issue...

**News Reporter 3:** Public reaction was sharp to the news that the project is delayed.

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**Narrator:** Whether elected or appointed, you as a member of an agency's governing body are a fiduciary charged with preserving the assets and authority of the organization you oversee. To do so, you must understand that the short-term financial decisions you make may impact the long-term viability of your organization and the community you serve.

In the process of administering your duties, you will likely come face to face with the inherent tension between the organization's short-term goals and its long-term mission. This tension, if not managed, may present you or your successors with the unenviable task of choosing between funding essential facilities like libraries, roads and parks, and laying off staff. The challenge of balancing short and long-term goals is made more difficult when the agency uses debt to finance capital facilities.

Debt financing freezes a portion of your budget and obligates your agency to certain financial and administrative commitments for as long as the debt remains outstanding. It's essential, then, that you understand the full weight of these decisions on the agency today as well as tomorrow.

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**Narrator:** This module provides concepts and tools to help you make better-informed capital financing decisions that will ensure the long-term sustainability of your organization. You'll review the key planning processes used by nearly all public agencies, and you'll see how these plans drive budgetary decisions involving capital



improvements. Then you'll be introduced to three basic concepts of capital finance; life cycle costing, asset management, and financing options.

These concepts relate to your role in reviewing and approving the agency's budget. Why is the budget important? Your responsibility to review and approve the budget is the most substantial action you will take as a member of the governing body. The budget is commonly the very battleground between short-term goals and long-term impacts. It requires careful planning to guarantee that this conflict does not undermine your organization's ability to meet its mission.

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**Narrator:** Communities differ in their approaches to planning, but all go through some type of exercise to thoughtfully consider the questions: who are we, what do we want to be in the future, and how do we pay for it? Your agency may develop one or more plans to answer these questions, including a strategic plan, capital improvement plan, and a long-term financial plan.

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**Narrators:** Organizations use strategic planning to set priorities and evaluate existing resources. The planning process itself can strengthen operations and identify expected outcomes, and it informs stakeholders of who, when, where, and how the organization and community will thrive. Once the community has identified and prioritized capital improvements, the results are recorded in a capital improvement plan or facilities plan.

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**Narrator:** A capital improvement plan lists and rank specific projects to be delivered within a specific period. It evaluates competing demands for resources, and it links the strategic plan with the fiscal capacity of the agency. The plan can also be used to inform the public about how service levels and resources will be delivered through capital investments. That is, the use of public funds to build, expand, and maintain facilities. Projects that appear in the capital improvement plan must be financeable. Revenues must be available in the amount and at the time needed.

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**Narrator:** A long-term financial plan is used to ensure this by forecasting revenues and expenditures related to the organization's strategic goals. It should identify strategies for financial sustainability in light of anticipated economic conditions and provide a vision of financial capacity by identifying risks and alternatives. In sum, a long-term financial plan aligns finances with the service expectations of the community.

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**Narrator:** You, as an elected official, may or may not have participated in the development or approval of these plans, but it's essential you understand that they answer the community's basic questions who are we, what do we want to be in the future, and how do we pay for it?



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**Narrator:** The budget is your agency's spending plan. It is the means by which you achieve the vision spelled out in your strategic, capital improvement, and long-term financial plans. It offers, at most, a two-year look forward for committing available resources to fund the agency's operations, capital facilities, and debt service.

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**Narrator:** These four plans form an integrated, coherent system that guides both short and long-term decision making. What happens if the plans aren't integrated? Well, consider this. Most public agencies must operate within the limits of their financial resources. If they have issued debt, this repayment obligation represents a long-term, rock-solid claim on those resources. When revenues fall unexpectedly and prior-year surpluses can't make up the difference, the only adjustments that elected officials can make are to operations or capital facilities. That helps explain why, in times of stress, the school auditorium doesn't get the new roof it needs, or positions in the building department don't get filled. The decision to issue additional debt to build a new fire station ties up more of the agency's available financial resources.

Now, an unexpected revenue drop is even more significant because there are fewer resources. The agency may be able to finance construction of the fire station with debt but may not be able to staff it because of a tight operations budget. This is how financing decisions, even though well-intentioned, can sometimes undermine the agency's ability to provide mission-critical services.



## DEBT ISSUANCE AND ADMINISTRATION SERIES FOR ELECTED OFFICIALS' TRANSCRIPT

### ***What you Need to Know Before Issuing Debt | Part 2: Concepts of Capital Finance***

Module 2 discusses the relationship between long-term planning and short-term decision making, the role and responsibilities of elected officials in capital finance, and the risks of short-term decision-making. Other topics include key principles of capital finance that create long-term budget impacts and the value of strategic financial management.

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**Narrator:** In the next section of this module, you will take a look at some basic principles related to capital finance that will help you to better understand your agency's spending plan and whether it meets the expectations of your constituents and sustains the organization for the long term.

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**Narrator:** Let's say your organization has decided to build a new road. As an elected board member, your first question is likely; how much does it cost? The cost of a project must include not only the upfront expense, but the cost of materials and operations needed to maintain it over time. Total cost of the road, then, is the cost of construction, maintenance, ongoing financing, and repair and replacement. This is known as the road's life-cycle cost. Once you know the full life-cycle cost of the project, you must budget for it.

If you do not plan and budget for the full life-cycle cost, you may be forced to cut other projects or programs to find the money to resurface or replace the road when needed. And what is the asset's useful life? How much do you commit to maintenance and repair and when do you replace it? The principles of asset management help you answer these questions.

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**Narrator:** There's a relationship between the value of an asset and the passage of time. Over time, the investment and the condition of the asset declines or depreciates. If no action is taken, the condition of the asset falls below a standard of use expected by the community as outlined in the strategic plan. Before service levels fall below expectations, the agency must undertake a maintenance program to restore it to the needed service level. That continued investment maintains quality and functionality and extends its useful life, but eventually, the asset will reach its terminal value and can't be restored. The asset must then be replaced. How do you fund the cost of replacing the road?



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**Narrator:** Public agencies have three ways to pay for facilities; cash, debt, or a mix of cash and debt. With debt, the organization borrows a sum of money from a lender and commits to repay those funds over time, typically in the form of semi-annual payments composed of principal and interest. Cash financing relies on available cash reserves to finance the project. Instead of paying principal and interest on debt, the agency redirects these funds to a savings or cash reserve account. When that account reaches a sufficient amount, it is drawn down to finance the project.

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**Narrator:** To examine a mix of cash and debt, let's consider the relative benefits and risks of each using our road example. In the relationship between dollars and time, the cost of the road rises over time, since it is assumed that these costs will increase in the future. If the agency chooses debt financing, it is able to build a road as soon as the proceeds from the debt are available. What's more, the agency absorbs the cost of the financing over the useful life of the road. This is often referred to as "pay-as-you-use" financing. The downside of debt financing, however, is that it locks the agency into paying principal and interest for years to come. This limits the agency's financial flexibility and in times of financial stress, may force it to cut programs and services.

The benefit of the "pay-as-you-go" approach is that the agency does not have to make principal and interest payments to bondholders. This affords greater flexibility, particularly in times of financial stress. But the organization must exercise the discipline to hold on to available cash savings until it accumulates enough to begin the project. This means that the road may not be completed for years. Delays may result in higher project costs or introduce other project risks. The more projects the agency pursues with "pay-as-you-go" financing, the more these risks compound.

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**Narrator:** When the agency combines cash with debt to finance a project, the benefits of the one can soften the risks of the other. Paying for the road with a combination of cash reserves and debt might allow the project to begin sooner than if it was financed with cash alone. Because of this, the agency may be able to complete the project for less than if it had waited to accrue sufficient cash reserves. It also means that the agency will have a lower debt service obligation, providing more flexibility than if it had financed the roadway with debt alone. Repaying a portion of the project over the lifetime of the road also allows the agency to match some of the costs of the road with its use.

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**Narrator:** A good financial management practice used by many public agencies is to finance the capital costs with debt and to pay for the ongoing maintenance, financing, and repair costs with cash. So, what is the correct mix of debt and cash financing? It depends. What may be an appropriate mix for one agency may not work for another.

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**Narrator:** As an elected official, you must balance the obligation to remain fiscally sound with the need to provide facilities that meet the strategic objectives of the agency. This leads you back to the budget. As an elected official, your job is to know whether the budget you are approving provides for the full cost of assets,



achieves the highest return on investment by maintaining those assets, and reflects the benefits and risks of alternative financing strategies. Allowing the agency's strategic plan, its capital improvement plan, and its long-term financial plans to drive your budgeting decisions will increase the likelihood that the agency balances its short and long-term goals. The budget also must incorporate the concepts of life-cycle costing, asset management, and alternative financing options.

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**Narrator:** If you apply these principles and underlying concepts, you will be in a position to produce a positive and sustainable outcome for your agency and your community now and in the years to come.