

Paying for Pipes: Financial Planning for Infrastructure

By Lori Raineri, Bradley L. Baxter and Zarka Popovic

Every administrator, public works superintendent and operations manager who builds infrastructure knows the value of the adage, “a penny saved is penny earned.” Well-planned capital projects deliver returns many times over in reduced maintenance and enhanced service delivery.

Traditionally, a capital improvement plan should include a list of projects that need to be constructed along with the available funding sources, and this should be true even if there is just one key project to be built. However, because funding and financing are not necessarily exciting topics for people who like to build things, a simple list of funding sources and projected construction cost estimates, even if the budgeted expenditures are insufficient, confirms that the agency has given consideration to developing a full funding plan.

Presumably, most infrastructure managers are familiar with the funding sources in their area of expertise, and utilize reasonable staff time to identify, quantify and qualify possible revenue streams. If not, then some effort needs to be committed in this area.

Beginning with a thorough understanding of the timing of each element of construction, and breaking down the budget for the project(s) into needed expenditures over time, a financial plan presents the funding resources according to when they are available. This is the beginning of a cash flow analysis. When revenues and expenditures match up well, there will be excess cash balance on which interest can be earned and hopefully dedicated to ensuring the success of the capital improvement plan. When revenues and expenditures do not match well, there are cash deficits, meaning fund balances of less than \$0. These cash flow deficits can be addressed by financing, meaning borrowing against future revenues in order to capitalize those monies into dollars that can be spent today, or more specifically, when they are needed for the project expenditures.

Financing Should be Used with Caution

Often the funding that is used is on a pay-as-you-go basis – as the revenue comes in, it is budgeted and spent on project expenditures. For example, a program to add several sewer trunk lines may be paid for from annual rate revenue, as the revenue is available. However, when the revenue that is derived from the rate cannot cover the construction cost of the sewer trunk line during the time that the project is to be built, then there is a need to finance the project.

Financing that same project means that while an agency has a revenue source, such as the sewer rate revenue, the revenue is insufficient to pay for the project when it is needed, but will be sufficient to pay for the project and the borrowing costs over time in the future. Financing brings future dollars into today, saving inflation on construction. However, the value of the future dollars is eroded by the costs of the financing by both up-front (costs of issuance) and over time (interest). For example, if an agency has \$1 million in rate revenue available from the annual budget, it can do a pay-as-you-go project that costs \$1 million. If the agency has a project that costs \$10 million today, and wants to allocate that same \$1 million in annual budgeted revenues to debt service, it will be doing so for more than 10 years. That is, a \$1 million annual payment, paying a debt of \$10 million with an overall interest cost of 5 percent, will require approximately 15 years to

repay, due to the costs of borrowing (costs of issuance and annual interest on the outstanding balance).

Occasionally, an agency cannot finance its projects without increasing its revenues. To finance any project, the existing revenue must be sufficient to pay the annual loan principal and interest. If additional revenue is needed for one or more projects, the agency may need to place a ballot measure before voters to pay for the improvements and provide a plan for building the projects to gain voter approval.

Creating and Implementing a Financial Plan

Creating and implementing a financial plan is much like the process used to develop a capital improvement plan wherein staff works together to review all financial resources that are available from the general fund, rates for service, grants and any other special taxes, etc. The agency then prioritizes the infrastructure needs and matches them with the available funding. Gaps in funding are reviewed for financing opportunities and shortfalls are noted. At this point, the agency staff members may have exhausted their knowledge of how to pay for all of the capital needs but can rely on external consultants to help them complete the plan and to borrow money to bridge funding gaps.

To augment in-house financial expertise an agency can confidently turn to an independent financial advisor to assist with the creation and implementation of a complete financial plan. An independent financial advisor will work closely with staff to develop a timeline for funding projects that meet the agency’s construction schedule and will coordinate borrowing money, if it is needed. Think of them as a project manager in financing akin to a project manager in construction.

Just as most individuals shop around to obtain a loan for a house, so must agencies shop around for loans. A financial advisor provides this shopping service on behalf of the agency. A financial advisor will source the most competitive rates on loans, and competitively bid out each of the services in the actual cost of the borrowing.

One of the costs of borrowing money is the fee that is paid to obtain the money (cost of issuance). Always enquire as to how the financial advisor is normally paid and review what fees will be included in the cost of issuance. Independent financial advisors are not affiliated with any underwriter (bank) and do not receive any additional compensation from other parties in a financial transaction; they are directly paid by the agency. Moreover, they should not be compensated on the size of the borrowing (on a percentage basis) or on contingency: This ensures that they are not motivated to do the fastest, biggest and easiest financing.

Once an agency is working with an independent financial advisor it can rest assured that it has a member of the team to help borrow money at the most competitive rate and navigate the world of complex financial transactions. In doing so, the agency can focus on the capital projects to be built.

Buying Money at its Lowest Cost

Borrowing money is buying money. We’re all dealing in the same currency and there is no qualitative difference between money coming from one lender or another. The differences are in terms and price. In the world of finance, we use words like

conditions, covenants, interest, etc. to describe the terms and prices at which money will be lent.

The only difference between lenders is the price of the money, which is expressed in terms of interest rates. Municipal issuers receive lower interest rates by using competitive bidding to solicit and receive the interest rate bids from lenders, thereby "buying money" at the lowest cost. A financial advisor will also assist in a competitive bid solicitation for bond counsel, bond insurance and any other costs of services for which competitive bidding is feasible.

Once money is borrowed it can be refinanced in the future should interest rates change or the agency wants to borrow more money. Good financing will enable the agency to maximize every dollar possible for construction and provide the flexibility to refinance.

Summary

Good planning, including financial planning, will ensure that capital projects get built in an efficient and economical manner. When the time comes to develop or implement a financial plan it helps to know when to employ the services of a financial advisor. A financial advisor will guide their client agency from the

inception of a capital project all the way through to completion of construction.

To find a financial advisor check with the National Association of Independent Public Finance Advisors (NAIPFA) for a listing of members by state. Other good sources include your state treasurer's office for list of transactions with both underwriters and financial advisors. Agencies can also refer to the Bond Buyer's Municipal Marketplace "Red Book" which has contact information for financial advisors. Lastly, ask other agencies and professional associations for referrals.

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NAIPFA

The National Association of Independent Public Finance Advisors (NAIPFA) is a professional organization of independent financial advisory firms located throughout the U.S. that specialize in providing financial advice to public agencies related to financing of public projects and issuance of bonds. NAIPFA member firms must be completely independent of underwriting of municipal securities by banks and securities dealers. Member firms must also be structured such that financial advice is not incidental to any other service. For a complete list of office locations and Certified Independent Public Finance Officers, visit www.naipfa.com.

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