

Issue 170, July 8, 2005

A CFO Special

FUNDING—A STRATEGIC CHOICE

Funding is important because it provides the resources to get the job done.

It can also influence *which jobs get done*

In previous issues we have looked at some of the inadvertent downsides of this – for example, the tendency to favour new over renewal when funding is achieved by way of public-private-partnerships.

Here we look at the positive side, how you can choose the funding option that meets your strategic targets.

“Funding for Strategic Outcomes” is an extract from the much longer “Alternative Funding Mechanisms”, (59pp) one of 50 ‘best practice’ guides now available on the Canadian InfraGuide website.

The InfraGuide is the result of an unusually wide collaboration between public and private municipal stakeholders, the Infrastructure Canada Program and the National Research Council of Canada.

You can find the full document at www.infraguide.ca

There are best practice guides on decision making and investment (9) (water (9), sewer and drainage (13); roads and footpaths (11); and others.

Also in this issue:

- **Customers Pay; Clients Consume**
- **FM as Educator: Be pragmatic; be patient!**

—two messages from Owen Hammond who, when he was with the Defence Department, helped the Department to be recognised Australia wide for its excellence in asset management.

And

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Enjoy

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FUNDING—A STRATEGIC CHOICE!

'Alternative funding mechanisms are a best practice because they can assist in fulfilling unmet needs. Some alternative funding techniques can better allocate costs to those benefiting from the service thus increasing equity in provision of services. Some can increase accountability by clear allocation of funds, while others can increase flexibility or service levels through contractual arrangements or partnerships.'

The Canadian "InfraGuide" shows the way to use funding to achieve strategic goals

More information, case studies, examples, details can be found at www.infraguide.ca

The Infrastructure Best Practice Guide on Alternative Funding Mechanisms takes a fresh look at some funding mechanisms that have been around for a while and some of the newer mechanisms – and looks at the potential for strategic application.

It looks in detail at three mechanisms:

- Special Levies
- Development Fees
- Utility Models

For these three it describes each mechanism, considers how they may be used to further strategic objectives, cites numerous applications, and looks fully at the costs (financial, resource and political) and considers the limits to its application.

Other alternative funding mechanisms identified

- Sponsorships
- Innovative Transportation Revenues and Incentives
- Government Service Partnerships
- Funding Partnerships
- Strategic Budget Allocations

The following excerpts will give you a flavour of the work – but do visit the original - and try out the other Best Practice Guides too!

SPECIAL LEVIES MECHANISM

What it is: 'This method refers to economic instruments that ensure a funding source exists to cover needs that are difficult to fund through user pay, and for which there is a benefit in explicitly identifying them separately from the general tax levy. Typically, this method is accompanied by a special fund established by the municipality to manage the special levy revenues.'

What it does: 'This approach can be used as a strategy to generate more funding for a municipality to cover a new service not traditionally covered by the general tax base, or a specific service offered to only a portion of the community, such as environmental protection.

Alternatively, special levies may subsidise certain existing services, such as public transit and storm water management. A municipality can use a special levy to increase a level of service, establish a strategic allocation fund for future investment or extend service to previously uncovered areas. Ideally, the method would be used to achieve a strategic goal for the community.

The ability to demonstrate the link to community priorities is a fundamental component of success in adopting this method.

A key feature of this method is that it collects revenues that are distinct from the general tax levy in support of an identifiable goal.

Clear communication is the key

There should be a clear benefit from the goal and, to be successful, the supporting rationale needs to be well communicated to the public.

Through communication and consultation, it is necessary to get public and political “buy in” for the new funding strategy.

The public generally appreciates transparency in how resources are spent for all taxes collected, and clarity of rationale is even more important for a special levy.

In addition, there is a higher standard of accountability with this method since it will be a higher-profile funding source.

A municipality must ensure it communicates how the levy revenues are spent, and report back regularly on it. Municipalities that have identified a need or goal that is important to the public, and that have successfully communicated the benefits of a special levy in meeting that need, have experienced high levels of public support for the levy.

What it costs: “Municipalities would have to consider the costs involved in establishing a special levy. They can be considerable, especially for the initial public consultation to gain support for the proposal, unless it is coordinated with strategic planning or another consultation process. In addition, there would be administrative costs and costs associated with communicating results to the community to demonstrate responsibility and accountability for the special levy.

A key feature of a special levy is to delineate clearly what the levy is to be used for (i.e., what strategic goal it is going to achieve), and why it should be distinct from the general tax fund. This is necessary to justify the levy to the public.

DEVELOPMENT FEES, CHARGES

What it is: In its basic form, this method is an economic instrument that ensures municipalities have a revenue source to fund the municipal infrastructure (e.g., roads and buried systems) required as a result of new private developments. Development fees can also be used to ensure a future reserve fund exists for operations and maintenance of infrastructure.

In their basic form, development charges are not particularly new or unique; however, they can be used innovatively by municipalities to influence development in accordance with the community's strategic planning and economic goals.

Ultimately, a well-designed development fee structure is a tool linked to planning processes for the delivery of infrastructure that suits the community's vision and for which new needs are proportionately funded by new users of the infrastructure.

What it does: ‘Development fees or development cost charges (DCCs) can strategically influence development in a community by affecting the urban form of the city. As a minimum, they can be set as a straightforward cost-recovery mechanism. Development fee structures can influence:

- Whether or not development actually occurs;
- The amount of funding revenue collected to cover the current costs of the new infrastructure;
- Where development occurs to suit the desired land-use planning goals of the community's official plan;
- Whether existing infrastructure is used optimally (i.e., encouraging infill or developing greenfield areas); and
- Infrastructure design or innovation.’

What it costs: Effort! - ‘The first step in establishing this system is to prepare a 10-year plan that is adopted by Council. This proposed plan includes:

- Growth projections for the next 10 years;
- The impact of this growth on current infrastructure;
- An outline of specific infrastructure that needs to be developed (e.g., roads, drainage, parks acquisition) to the required 10-year level; and
- The specific costs to take current infrastructure to the 10-year levels.'

Austin, Texas, uses a point system to match development projects to city's goals

'Austin, Texas uses DCCs (called impact fees) to encourage growth according to its municipal land use planning goals. The city uses a smart growth matrix as a tool to assist Council in analyzing development proposals within the desired development zone. A points system measures how closely a development project matches the city's smart growth goals.

Factors considered include:

- The location of development;
- Proximity to mass transit;
- Urban design characteristics;
- Compliance with nearby neighbourhood plans; and
- Increases in tax base, and other policy priorities.

If a development project, as measured by the matrix, significantly advances the city's goals, financial incentives are available to help offset the high cost of developing in urban areas. These incentives may include a waiver of development fees or public investment in new or improved infrastructure, such as water and sewer lines, streets or streetscape improvements, or similar facilities. Incentives available under the smart growth matrix require Council review and approval.

A full account of the points system applied to developments in Austin is available on its Web site.

Brisbane, Australia is establishing a plan to lower or waive development charges for developments not connected to the storm sewer or sanitary sewer system, that use alternative water management systems to recycle rainwater for domestic household use. The city's goal is to avoid having to build a new sewage/storm sewer treatment plant.

The program has been formalized into the Integrated Water Cycle Management Program. (Further details on this program can be found in the description of utility models in the Best Practice Guide.)

In general, development charges are a well-established practice. However, their strategic use as incentives for infrastructure-friendly development is less common.

The approach is not new, but the ability to use it in different ways to achieve different land use goals is potentially innovative.

UTILITY MODELS MECHANISM

What it is: 'The utility model entails management of capital assets, operations and maintenance on a cost-recovery basis through fees for service. The fee for service must be sufficient to fund the needs of the infrastructure and overhead operations, such as administration, bill collection and management. Only users of the service support the service through the fee for service. The amount paid by users is normally proportional to their use of the service.

Municipalities have begun exploring innovative practices for charging user fees for some traditional municipal services. A utility model exists where user fees collected are dedicated to the service, and the service is managed autonomously relative to other municipal services. Such practices are well established in many municipalities for potable water services and sewage treatment. However, two other services are also emerging with high potential for utility model approaches: storm water management and solid waste management.

In most Canadian municipalities, including Ottawa, storm water revenues are typically generated through a combination of property taxes, DCCs and surcharges on water bills. Direct volume meter readings are not feasible for storm water, so fees for service to date are calculated based on lot size. In some sophisticated storm water fee models, additional lot features, such as imperviousness, slope and soil type, may be taken into consideration.

The utility model method is being applied in theory to solid waste programs. These are not typically run as separate utilities, although they could be. The idea would be to charge for waste collection per bag generated, but to provide full recycling collection services through the general tax fund. The system could include a variant of user pay, whereby there is a bag limit collected under the general tax system, and generators must buy special tags for additional bags. Use of this system is aimed more at demand management than revenue generation to cover costs. Demand management is important to prolong the life of existing landfills, which defers significant waste management costs.

(For more on this topic see the InfraGuide)

SPONSORSHIPS

Corporate sponsorships allow private companies to get some form of public recognition through advertising, signage or monuments, for example, in exchange for significant donations or strategic funding arrangements to cities to pay for the O&M of facilities or recreational areas. The approach could also include the involvement of local groups and organizations in the actual labour for O&M of recreational areas. Sponsorships typically increase the profile of the private contributor or group among members of the public. The technique can be used in any type of municipality, for a variety of aspects of O&M needs. It could also involve expertise or, in some cases, a form of capital investment, such as energy retrofits (see the example in the InfraGuide). Generally, a municipality fosters such arrangements to reduce its O&M demands.

INNOVATIVE TRANSPORTATION REVENUES AND INCENTIVES

This approach involves a specific revenue structure, or funding mechanism, for road funding. This could involve an agreement in which a portion of the provincial fuel taxes collected at gas pumps is redistributed to municipalities for road O&M or capital road infrastructure. This specific approach involves negotiation with provincial levels of government and, as such, is somewhat limited in regard to being within a municipality's control. Other options for innovative

road revenue are road tolls, pavement cut fees/ graduated pavement fees, advertising fees (along major routes/bus shelters/bike racks) and local road improvement with community funding partnerships.

GOVERNMENT SERVICE PARTNERSHIPS

Governmental partnerships can take place in the form of inter-municipal partnerships, provincial-municipal partnerships or federal-municipal partnerships. Inter-municipal partnerships, termed "regionalization" of services, are viewed as an alternative form of service delivery. This method is used to manage ongoing O&M costs for infrastructure services. Full amalgamation may not be economically achievable or politically desirable for many small towns, therefore partnerships can be a solution for more efficient infrastructure service delivery. The approach would be a strategic negotiation of service delivery arrangements, on a contracted basis, between two or more municipalities, with the goal of providing (and receiving) a higher level of service at a lesser cost. This approach could take the form of a regional authority to run a service (e.g., public transit) or it could take the form of contracting out a package of services.

FUNDING PARTNERSHIPS

While not strictly a funding method, since the municipality still has to pay, this approach does offer some benefits. The method typically involves private sector capital financing, often including private operation and maintenance services for a set period.

STRATEGIC BUDGET ALLOCATIONS

The method entails strategically setting aside certain moneys collected from a portion of the tax bill or a portion of a rate bill into a special fund. The special fund is invested, and interest earned is reinvested, with the goal of having a special fund for certain types of capital for future needs. . This is apparently becoming popular with Canadian Councils.

For lots of application examples and other information on all funding methods see the InfraGuide.

Owen Hammond occupies our "15 Minutes of Fame" slot this week. Owen spent a number of years with the Department of Defence at a time when it acquired a high reputation for the quality of its asset management. He spent 2003 and 2004 in the UK, during which time he observed efforts to improve infrastructure management. He is currently based in Canberra and leading a small team in the delivery of a major building works portfolio.

Owen Hammond's Messages to Facility Asset Managers

When asked for his key messages for facility asset managers, Owen presented me with an entire menu! I was spoilt for choice. I selected the following two.

- There has not been enough communication between the head office and the troops at the front line to ensure full understanding of, and cooperation with, the corporate policy (far too often!)

Customers Pay and Clients Consume

It is surprising to me how few people make this distinction and how few recognise that it is *the customers' requirements that are paramount*.

Conflict is always possible because the interests of the clients (the building users) are focussed on an individual building (the one they are in) and not on the asset portfolio as a whole. The customer, on the other hand, (the building and portfolio owner) needs to consider the shape of the entire portfolio because this is what supports corporate objectives.

This can present difficulties for the Facility Manager, especially when

- Clients think of themselves as customers (often!)
- The Corporate Policy Objectives for the portfolio require that the building/asset in question be downgraded or operated at lower service levels – perhaps because **the** building is on track to be decommissioned or maybe because it is shortly to be extensively renovated.

In these circumstances, Facility Managers, who likely deal with the clients on a daily basis and are, by the nature of their chosen profession, of a 'helping disposition' may find themselves caught in the middle. It can be hard at such times to remember that *the customers' requirements are paramount*.

What is the Facility Manager to do?

Where corporate policy requires a downgrading (permanent or temporary) to the building, the occupants will frequently be dissatisfied but for the FM to give in to their demands for higher standards would undermine the corporate policy objectives. There are some things that can, and perhaps even should, be done.

The FM can broker a deal between the client and the customer (improving the communication channels – in many cases just knowing that their grievances have been heard will defuse an unpleasant client situation; in others, it may be possible to give ground in some areas in return for concessions where it is less significant for users.)

The FM can involve the customers in the operational detail of how the corporate objective is carried out – maybe just staging the adjustments that need to be made to work around pressing user workloads may be sufficient to improve the atmosphere.

But, especially, FMs should ensure that they clearly understand their customers' corporate objectives – they should know, for example, which objectives are essential and which are simply 'nice to have'.

However, when it all comes down to doing – *the customers' requirements are still paramount!*

The FM as Educator - Be pragmatic; be patient.

Like other professionals, it is very easy for Facility Managers, in their passion for the task, to get caught up in technical language and jargon. Unlike other professionals, however, most of our communication is to others outside the profession. Hard as it seems to me, I have noticed that non-FM people find our work boring and quickly turn away when subjected to some of the detail.

I used to get annoyed when comparisons were drawn between housing and major infrastructure developments, or between the family car and building plant, feeling that this trivialised the work we were doing. But I have learnt that the more I can make use of the practical experience I have gathered – on and off the job – to get my point across in words that can be understood by the listener, the better.

If we can use practical examples, of relevance to the audience, and relate these to their impact on the bottom line, or to time delay, we increase the communication and trust levels. This works with both executives and building users.

Providing examples of things that did not work – and allowing the listener to draw his or her own conclusions – generally works better than telling them the moral of the story.

Sure it takes more time, but the results are surer, and we don't alienate.

To be a good educator, we must be prepared to learn. I have discovered that a willingness to learn from others makes them, in their turn, more willing to learn from me. I guess it makes sense when you think about it. But often we are so focussed on the point we want to get across that we lose sight of this.

Finally, education is really communication, and we communicate better when we take the time to understand what it is that drives our audience, and speak to them in those terms. To executives (our customers) we focus on corporate objectives and cost savings; to building users (their clients) we focus on service outcomes.

The impact of Owen's messages on Customers and Clients—and on Education and Communication, cannot be underestimated.

For example, with better understanding and cooperation between the clients and the customer would we have been able to avoid the situation in the Victorian Royal Children's Hospital that we reported on in Issue 167 (May 27 2005).

You will remember that this was the case where, although the Children's Hospital has now been determined obsolete and is within a few years of complete renewal, the government (responding to public and media pressure) has allocated \$6 million to upgrade the cancer ward, \$7 million for a new kitchen, \$5m for a lift upgrade and \$8,9 million for ward rebuilding, all works to be started within months—and *torn down in a few years time!*

RESEARCH PROJECTS

It is time we took research in Asset Management seriously!

Are you involved in, or know of any current research project being carried out in asset management? Whether in academia, government, research organisations, or by professional groups (have I covered everything?)

Help us to document current activity so that we can

- increase exchange between researchers,
- suggest new topics for investigation,
- facilitate access to completed work

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