

Capital Set-Aside/Build Portland Methodology Refresh Concept

Executive Summary

In 2014, the City Budget Office and the City Asset Managers Group (CAMG) developed the Capital Set-Aside validation tool to evaluate, compare, and prioritize asset needs across bureaus and asset types. This tool has been used for four years and recommended prioritization of nearly \$62 million of funding among six bureaus¹. In FY 2017-18, the CAMG employed this tool to evaluate and rank proposed projects for the Mayor's Build Portland project seeking to minimize the asset maintenance (repair/rehabilitation/replacement) gap across the City.

While the tool has served as a practical and effective starting point for a Citywide prioritization of shared capital resources, CBO recommends that a) CBO and the CAMG further develop the tool to address some of the lessons learned through implementation over these first four years, and b) that this refreshed methodology be used uniformly for the prioritization of the City's capital needs, and specifically, for both Build Portland and Capital Set-Aside funding in order to be more responsive to the goals of both programs.

Background

In 2014, CBO convened asset managers from around the City to develop a prioritization tool to allocate a shared General Fund resource – the Capital Set-Aside. In January 2015, in response to the recommendations of the October 2014 [Funding Options Report](#), Portland City Council amended City Comprehensive Financial Management Policy 2.03 to state that at least 50% of GF discretionary revenue that exceeds budgeted beginning balance shall be allocated to infrastructure maintenance or replacement (Resolution 37107).

As part of the Capital Set-Aside tool development, the group overcame a number of challenges, including developing an approach that a) could be applied to a diverse array of services – from firehouses to parks to spectator venues – and b) could address the differing levels of data availability across the subscribing bureaus. Since then, CBO has worked with asset managers on the validation committee to successfully utilize the tool to help allocate \$110.8 million over the last four years, including, in a slightly modified form, \$50 million for the first tranche of Build Portland allocations.

Perhaps more valuable than the tool itself has been the process of regularly convening asset management from across the City to validate this tool and reach a greater common understanding and approach to asset management. Through the practical application of the tool, the group has identified a number of opportunities for improvement. A refresh of the methodology using these lessons learned will further optimize evaluation, prioritization, and programming of the City's resources towards these valuable ends.

¹ Non-rate-payer funded services are eligible for these discretionary funds.

Current State

Currently, the Capital Set-Aside tool scores each project across five categories: 1) Human health and safety impacts, 2) Service impacts (including equity impacts), 3) Environmental impacts, 4) Legal/Regulatory compliance, and 5) Financial impacts. The overall score is then multiplied by the likelihood of the particular 'failure mode' associated with the scoring. For a full explanation of how the tool works, please see the latest version of the guidelines on the [CBO website](#).

Proposed 'Refresh' Framework

A 'refresh' of the current methodology would move away from a points-based approach, which tends to a) reward failed or failing assets because of the 'likelihood' multiplier, b) reward non-critical assets because the 'service impacts' is based on the 'number of people served' and not on the value of the service, and c) reward low return-on-investment projects because the financial impacts cap out at 20% of total score and at a relatively low gross dollar figure (\$2 million). (See Appendix for more detail on issues of current methodology.)

CBO proposes the following principles for a revised framework:

- High and extreme risks *must* be managed as the City's top priority; however, assets should be eligible for Capital Set-Aside/Build Portland resources based on this high/extreme risk threshold only if they are *critical assets*, and only where other risk mitigation approaches are impractical.
- Critical assets where high and extreme risk cannot be mitigated through operational adjustments will be the top priority for Capital Set-Aside and Build Portland funding.
- After this risk-based priority, all remaining available resources should be allocated to achieve the greatest public value over time (i.e. benefit-cost/business case analysis or 'public value analysis').
 - Beyond a traditional return-on-investment/lifecycle cost analysis, the public value analysis (PVA) must take into account the retained or enhanced service that the assets provide as well as other benefits.
 - The PVA methodology would move beyond the points-based approach of the current method and achieve an apples-to-apples comparison of projects that includes a valuation of the economic, policy, and risk-mitigation outcomes.
 - The PVA must be practical and implementable by asset management staff in the bureaus and transparent to non-asset managers in and outside the bureaus; the analysis should provide sufficient nuance while still being simple enough to apply without excessive dedication of staff resources and to be understandable to non-experts.
- The methodology will be developed with consideration for the evolution of key components – the risk matrix and public value analysis – in mind; through a precedent/case-based approach, these tools would become more nuanced and practical over time as the group fine-tunes them through regular use.
- Build Portland, Capital Set-Aside, and any other shared asset-funding resource will use the same investment framework; multiple frameworks result in excessive process for asset managers, budget staff, and executive/oversight functions.

Next Steps and Timeline

CBO proposes the following next steps:

Step 1 - Agreement: CBO will work with City Asset Managers to develop a project charter for the 'refresh' project based on the framework discussed above.

Step 2 – Development & Testing: The primary components – risk matrix (and 'critical asset' definition) and public value analysis will be developed by CBO and City Asset Managers using projects from the existing Capital Set-Aside and Build Portland lists. Rather than a theoretical exercise, we will use real projects to arrive at a practical methodology that addresses the framework discussed above.

Step 3 – Process: After successful testing, CBO and City Asset Managers will work to incorporate the methodology into existing planning processes – i.e. budget development and supplemental budgets.

Step 4 – Implementation: Once the tool is developed, tested, and well-supported with process documentation synched to the budget process, CBO would expect to lead the first allocation round using the new methodology as part of the **FY 2019-20 Budget Process**. We propose deferring the Fall 2018 capital set-aside allocation to that process.

Appendix: Current Challenges and Proposed Solutions

What follows is a discussion of some of the weaknesses of the tool and CBO's recommended changes to the selection methodology:

- *Project size:* The tool does not adequately deal with variable project sizes. Points are allocated to projects regardless of project size. To the degree that return on investment is incorporated in the scoring, it is as a gross figure in the Financial Impacts scoring section. This is problematic for two reasons: a) it caps at 20% of total score if a project might result in lifecycle savings of over \$2 million and b) it does not look at that lifecycle savings relative to the size of the investment. The practical consequence is that a \$1 million project with \$2 million in lifecycle savings will earn the same number of points as a \$20 million project with the same savings. If the \$20 million project beats the other by even a single point overall, it would be recommended for funding over the \$1 million project. **A revised approach should incorporate a percentage rate of return on investment.**
- *Savings horizon:* No time horizon for savings was specified, nor has any discount rate been applied to identify a present value for savings and avoided costs. **A revised approach should use traditional net present value calculations using a universally applied discount rate.**
- *Scope:* The tool does not adequately address issues of scope wherein the scope includes features (and costs) not relevant to the project characteristics driving the scoring. For example, if a public fountain scores highly because an electrical issue that results in health and safety, regulatory compliance, and service impacts, it could be addressed through the replacement of the electrical cabinet. However, the bureau may have included a full renovation of the entire fountain asset, generating a considerably higher cost. **A revised approach would move past a points-based prioritization to a business case (or 'public value analysis', PVA) prioritization that would create an apples-to-apples comparison of projects wherein bigger scopes would need to be justified by greater value created.**

- *Failure Bias*: The tool puts inordinate weight on assets that have already failed. Because of the 'likelihood' multiplier, an asset currently in failure (e.g. a playground that is shut down) receives 100% of its points whereas a playground that is expected to fail within 3-5 years receives only 50% of the total score. Following this example through, a playground whose equipment merely needs some basic maintenance may not score highly enough until it has deteriorated to a point where it requires much more expensive replacement. **A revised approach using a PVA would prioritize the less costly intervention, thus generating more overall value at any given level of investment.**
- *Leverage*: The tool does not address the value of leverage adequately. Outside resources in the form of state, federal, or private funds can provide leverage (i.e. a multiplier effect on the City's return on investment). Leverage is currently reflected in maximum 2% points bonus. **A revised approach using a PVA that looks at the return on only the City investment will greatly advantage projects that use outside funding as a lever.**
- *'Unlocked' Funding*: Often confused with 'leverage', some internal sources can be 'unlocked' by combining them with maintenance resources. The tool does not address this type of resource adequately. The most typical example of this unlocking dynamic is the use of SDC resources to enhance the scope of a maintenance project – and thus to enhance the value of the service delivered by the asset. The tool currently provides a bonus for this type of funding enhancement. **A revised approach would provide a bonus for any 'positive sum' benefits of doing the enhancement as a part of the proposed project (versus making a similar enhancement elsewhere).**
- *'Grant Gaming'*: The tool is agnostic on the uses of other bureau resources and priorities. Therefore, the tool encourages bureaus to put forward those projects most likely to score highly, regardless of whether those projects would more appropriately be funded with existing bureau resources. **A revised approach would include having the CBO Analyst assigned to the requesting bureau being included in the validation discussion to ensure that internal bureau prioritization decision-making is addressed. A more long-term change could be the more global and consistent use of an asset management framework for all capital investment decisions, regardless of funding source. This would be the primary value of a 'Citywide Capital Investment Program'.**
- *'Service Level Comparability'*: The tool treats all services as equally valuable; only the number of individuals served is taken into account. Moreover, the tool does not distinguish between different levels of service. For example: At what point has a road deteriorated to the point where service is 'disrupted'? **A revised approach would calibrate the consequence though using a common denominator to value the services and create more of an apples-to-apples comparison of projects.**