

# WHAT ARE LOCAL FUNDING OPTIONS?

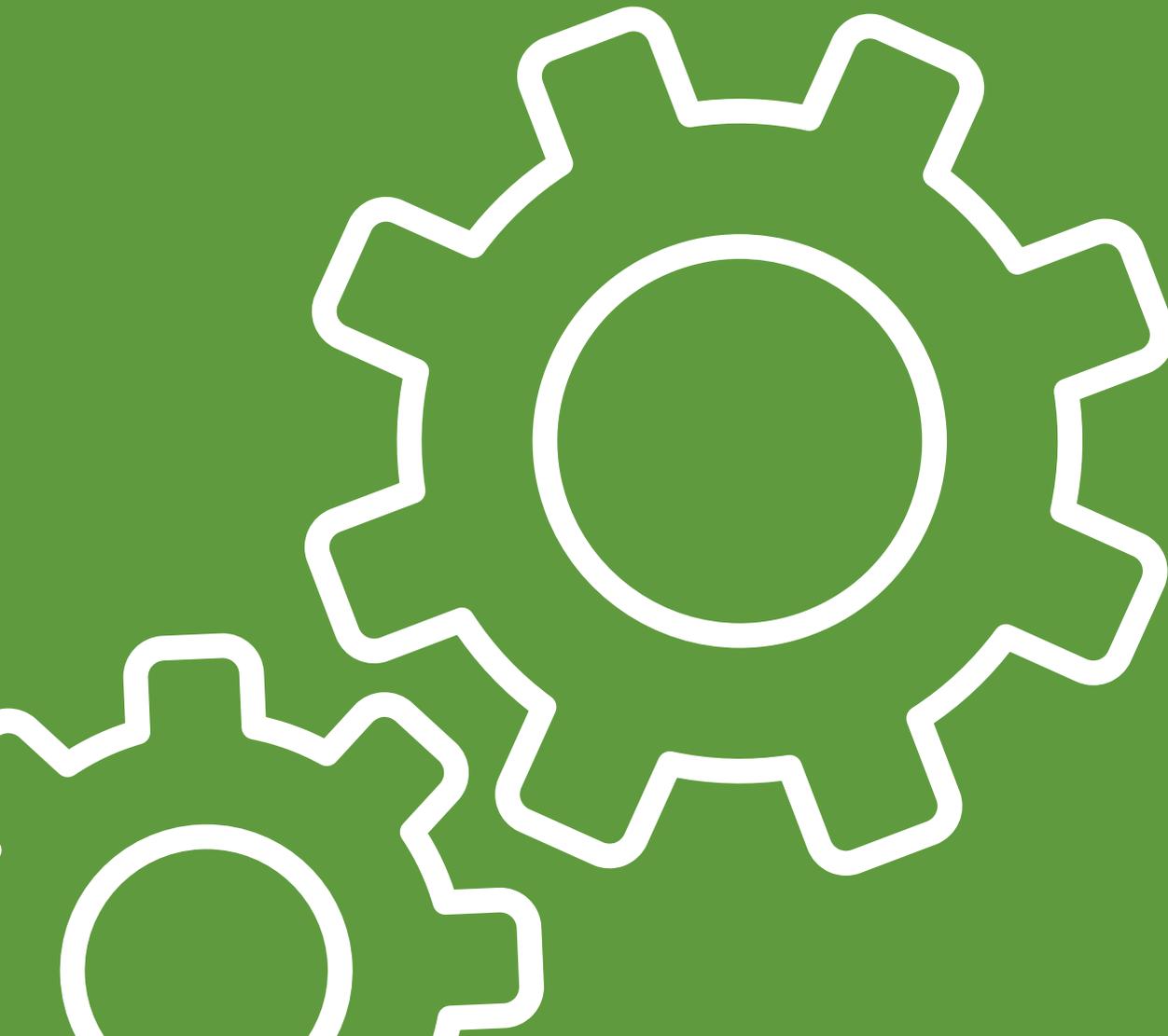
There are a number of funding mechanisms available to local communities in North Carolina for early learning investments. This section provides a menu of options that are both currently available and those that could be available through state or local policy change. Details to assist toolkit users in assessing the options for their local context are included.

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## POTENTIAL FUNDING MECHANISMS

### WHAT YOU'LL LEARN

- ▶ The basics of local funding mechanisms
- ▶ How to determine which funding mechanism is best for your community



There are a number of tools—taxes, fees, funds and grants—available at the local level in North Carolina to fund early childhood. In this section, several funding mechanisms are described, including a description of funding structures, who pays, who collects the funds and how the funds are used.

# CURRENTLY AVAILABLE LOCAL FUNDING OPTIONS

1

## ITEM IN A MUNICIPAL OR COUNTY BUDGET

A municipal (town, village or city) or county budget allocates funds to departments or functions. For example, the budget will provide a specific amount to the County Department of Social Services.

Local governments cannot make binding commitments at the line-item level, meaning they cannot specify funds to be used for a specific purpose (e.g., planting trees). Instead, they can state a commitment to fund a specific government activity or program and allocate funds to a department to implement that funding through a resolution.

Early childhood programs are included in some county budgets as commitments. For example, in 2015 Wake County Commissioners pledged for the first time an investment that will provide high quality prekindergarten for more four-year-olds. The School District has agreed to allocate the funds.

**HOW DOES IT WORK?** When making its budget request, a department or function (such as public schools) identifies the full scope of funding needed. County, municipal managers and local elected officials can outline the financial resources needed to provide identified services or programming; however, they cannot make commitments at the level of specific activities or programs. Such commitments are made by department heads or with guidance from elected officials. Once passed by the city council or county commissioners, local budgets are available on county or municipal websites and provide summary level detail of appropriations.

**WHAT IS IT USED FOR NOW?** Municipal and county budgets are used to provide a variety of services from emergency management, planning, water and sewer to police, social services, public health and recreation. Each municipality and county determines what services are provided as only some are mandated by federal or state law. *More details can be found in Section 1.2.*

## 2

**A BOND**

Local governments can issue bonds to secure funding for capital projects to build new or renovate existing facilities. Bonds are debt obligations by municipalities and counties. Investors purchase the bonds that are paid back by a municipality or county with interest by a specific date.

A number of recent local bond proposals, including one proposed in Forsyth County, have focused on new prekindergarten classrooms.

**HOW DOES IT WORK?** Generally, the school board is the best source of bond funds for early childhood. The school board develops a proposal for various bond packages for approval by county commissioners. If approved by county commissioners, voters must approve the final bond package.

A bond is issued against future anticipated revenues and thus local governments are required to prepare a feasibility study of their capacity to incur new debt and demonstrate an ability to repay the debt.

**WHO COLLECTS IT?** The Local Government Commission at the State Treasurer's Office provides technical assistance in the design of the bond, ensures the bond sale is scheduled for the most appropriate time and supports local governments in the repayment process.

**WHAT IS IT USED FOR NOW?** Bonds are used for long-term capital investments such as water systems and buildings like courthouses or schools. They may not be used as a funding source for the day-to-day operations of local government programs or services because the ongoing nature of this need does not align with the time-limited revenue available from bonds.

## 3

**LOCAL SALES TAX<sup>14</sup>**

Counties can increase their local sales tax by one-quarter of a penny provided that the public approves the increase by referendum. The ballot cannot say how the funds will be used, but the county board of commissioners can adopt a resolution that stipulates how it plans to use the revenues. In NC, only Durham County has resolved to allocate some of the funds raised through a local sales tax to early childhood education.

**HOW DOES IT WORK?** The local sales tax applies to most of the goods and services currently taxed through the state sales tax with the exception of food purchases and local motor vehicle and utility taxes.

Local sales tax options are limited to between 2 percent and 2.75 percent. As of 2015, only two counties have authorized 2.75 percent local sales tax options and a state-approved additional ¼ cent sales tax is available only to a few counties—Mecklenburg, Wake, Guilford, Forsyth, Orange and Durham. Twenty-seven counties have a 2.25 percent local sales tax<sup>15</sup> and 70 counties have a 2 percent local sales tax. Of the 106 referendums proposed from 2009 to 2014 to increase sales tax, only 29 passed.

**WHO COLLECTS IT?** The North Carolina Department of Revenue oversees collection of local sales tax revenue.

**WHAT IS IT USED FOR NOW?** By state law, the local sales tax provides general support for the operation of local government services. While counties may not define in law a specific use for the local sales tax (i.e., funds may only be used to fund NC Pre-K expansion), county governments can—and some have—adopted resolutions that identify the purposes for which they seek voter approval to raise the local sales tax. A resolution is a key tool for early childhood advocates to secure a public statement on the use of revenue for early childhood investments.

The local sales tax provides roughly 12 percent of local government’s annual budget.

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## PROPERTY TAX

At the county level, Boards of Commissioners have the ability to lower or raise property tax rates in North Carolina. Municipalities also have used property taxes to fund local services. Property taxes have long been used to fund education in other states and there are a growing number of localities and states across the country that allocate a portion of property tax dollars to early education.

Local governments in North Carolina have the authority to raise property taxes for specific purposes designated by the North Carolina General Assembly. Within the area of community development programs and activities, child care, health and education are listed explicitly. However, in consulting with several NC local government experts, it remains unclear if a broad set of early childhood programs or initiatives could qualify.

Typically, property tax revenue goes to the local government’s General Fund for a range of public services and expanded dollars can provide for new services and programs. North Carolina has low property tax rates compared to most of the nation. However, changes in housing values due to economic changes – the Great Recession for example—can impact the level of revenue raised from the local property tax, which in turn can make balancing local budgets using property taxes difficult.<sup>16</sup>

**HOW DOES IT WORK?** The property tax in North Carolina is levied on real and personal property. Real property refers to an asset that is fixed to one location like a house or commercial building. Personal property refers to an asset that is moveable, such as a car.

The tax is the value of property based on its assessment value, which is updated periodically. In North Carolina, counties conduct assessments or re-valuations at least every eight years, but many currently operate on a four-year cycle for assessments. The rates are presented per \$100 valuation. For example, Alamance County’s property tax rate is \$0.58 per \$100 in valuation.<sup>17</sup>

Certain types of property are exempt from property tax. Non-profits, government and certain academic and religious properties are exempt.

**WHO COLLECTS IT?** Local governments collect their own taxes, but some contract with other entities to collect property taxes on their behalf. Municipalities often contract with the county to collect the tax with the help of the County Assessor and tax collectors.

**WHAT IS IT USED FOR NOW?** Roughly 38 percent of local revenue comes from the property tax to support local services.

## LOCAL FINANCING OPTIONS THAT REQUIRE STATE POLICY ACTION

### OCCUPANCY TAX

The occupancy tax in North Carolina is a tax on the stay in hotels and other accommodations. While a potentially significant source of revenue for tourist-based economies, the occupancy tax has traditionally funded tourism promotion.

The North Carolina General Assembly sets the occupancy tax rate for each locality and the designation of funds raised is set out in a local bill that must be approved by the North Carolina General Assembly. In order for this revenue to be used for early childhood purposes, the North Carolina General Assembly would need to set the occupancy tax rate and allocate funds to early childhood education.

### ALLOCATION OF FEES

In some communities, the collection of fees could be designated for specific purposes. While this can be a volatile source of revenue, especially if the fees fluctuate with economic cycles, communities have found this a viable support for special projects or initiatives.

The source of fees could be building permits or the revenue from land trusts. The allocation of fees cannot be explicitly tied to an early childhood purpose, but through resolution and a public education campaign, efforts to raise a new fee or expand an existing fee to allow for expanded early childhood services is an option in North Carolina. The North Carolina General Assembly would need to allow local governments to collect fees for an expanded set of purposes inclusive of early childhood education.

## SPECIAL TAXING DISTRICT

Municipalities can establish a special taxing district in North Carolina to assess additional property tax on assets located within the designated district to fund projects and services specific to a district. Existing special taxing districts in North Carolina include efforts to address beach erosion, hurricane protection, downtown revitalization, transit oriented development, public schools and watershed improvement.

At this time, it appears that state-level legislation does not enable this kind of district to be established in North Carolina to collect revenue for early education purposes. There are, however, some special taxing districts that provide revenue to public schools.

The North Carolina General Assembly could enact changes to the statute governing Business Improvement Districts or other special taxing districts to allow for the allocation of these dollars to include early education.

## TAX CREDITS

Local governments conduct a range of economic development efforts to support business expansion and employment in their communities. Early childhood services represent an economic development investment and could be included when considering incentives that encourage the retention and growth of local businesses and employment. Some states (Maine, Oklahoma, Florida, Louisiana, Colorado and Oregon) have issued tax credits for early childhood businesses. A similar approach at the local level could be taken to expand the number of spaces available for early childhood services.

Another option is to offer tax credits at the local level to working families. While none of the three localities with working family tax credits (New York, San Francisco and Montgomery County, Maryland) have been used explicitly for early childhood expenses, such a local policy could improve families' ability to afford early childhood services. This does not have to be administered as part of a tax filing, but rather, as in San Francisco, via an application form made available at tax preparers or community sites. Neither tax credits for early childhood businesses or for families to afford early childhood programming are offered at the local level in North Carolina.

On the business side, no requirement is needed to change local policy regarding economic development incentives. However local governments would need to value early childhood providers as economic development engines and local job creators. On the working family tax credit side, a state child and dependent care tax credit would be an important step. For local level policies to be implemented, the North Carolina General Assembly would need to authorize these payments by local governments.

## SOCIAL IMPACT BONDS<sup>18</sup>

Social Impact Bonds (SIB), also known as Pay for Success, are a relatively new financing tool that enables government agencies to pay for programs that deliver results. This financing tool enables governments to set specific, measurable outcomes for a defined population, children birth through age three for example, and promise to pay an external entity, deemed an intermediary, an agreed upon amount if the desired outcomes are achieved.

Government agencies are not required to provide funding upfront. Instead, private investors, philanthropies and other non-governmental funders provide the upfront investment. If the intermediary fails to achieve agreed upon outcomes, the government agency does not pay, the external entity bears the cost. If the outcomes are met, the government agency pays the external entity the agreed upon sum with a return paid to the investors for taking the upfront risk. Payments typically rise for performance that exceeds the minimum target, up to an agreed-upon maximum payment level.

Salt Lake City has launched an SIB initiative to expand preschool. *A case study is included in the toolkit.* Several states either have launched or are considering SIB initiatives.<sup>19</sup> While SIBs are an emerging concept, this creative financial tool presents local governments with a funding structure that can leverage private funding sources to design and carry out successful early childhood initiatives. Enabling state legislation would be required in North Carolina for local governments to create Social Impact Bonds, primarily because payments based on defined outcomes are not currently authorized for local governments.

# ASSESSING FUNDING MECHANISMS

Assessing funding options is a complex mix of legal, financial and political considerations. Consider the following issues and then use the worksheet to help determine a funding mechanism that best supports your early childhood initiative.

### ► **Adequacy of a Financing Strategy**

The funding raised must be able to meet the needs for the early childhood system. This means first understanding the costs and demand for services now and in the future. It also means assessing the funding source for its ability to meet those costs and needs.

### ► **Sustainability of the Funding Source**

Consideration must be given to the stability and sustainability of the funding source. Since consistent programming for children delivers the best outcomes,

a funding source for systems change and ongoing service delivery needs more than one-time money. The possibility exists for one-time funds to be invested to generate a revenue stream that is sustainable over time, but absent such an approach, non-recurring funds may be problematic. Of particular importance is that new funding sources leverage and supplement existing funding, rather than replace it.

Consider these issues:

- Can this funding source be relied upon in the long-term?
- How would it be affected by an economic downturn?
- What other factors could influence its availability over time?

# ASSESSING FUNDING MECHANISMS WORKSHEET Worksheet 3-1

LOCAL FUNDING SOURCE	REQUIRES NC GENERAL ASSEMBLY APPROVAL OR A CHANGE IN LAW	LOCAL VOTER APPROVAL NEEDED	REVENUE LIMITS	QUESTIONS TO CONSIDER
Municipal or County Budget Item			Must be renewed each year as part of the budget cycle	Are we prepared to go back to the budget process each year to maintain the investment?
Bond		X	Available only for long-term capital investments, not day-to-day government operations	<p>Since bonds are for capital investments, are there any capital investments that would be needed if the municipality or county invested in early learning?</p> <p>Do we have the political relationships and power to get an early childhood investment on the ballot for a referendum?</p> <p>Do we have the resources to support a campaign to encourage public support for the referendum?</p>
Sales Tax		X	Local sales tax is limited to between 2% and 2.75%.	<p>Does our community generate enough sales tax revenue?</p> <p>Since a sales tax represents a greater share of the income of low- and middle-income taxpayers, is this the best approach?</p> <p>Do we have the political relationships and power to get an early childhood investment on the ballot for a referendum?</p> <p>Do we have the resources to support a campaign to encourage public support for the referendum?</p>
Property Tax	Unclear. Refer to property tax in this section for further details.			<p>Is the real estate wealth in the community such that it can support needed investments?</p> <p>What property tax rate would be required?</p>
Occupancy Tax	X		NCGA sets the occupancy tax rate	<p>Does our community have enough tourism to generate occupancy taxes?</p> <p>What occupancy tax rate would be required?</p> <p>Do we have the political relationships and power to gain support from our county to support the use of occupancy tax for early childhood rather than only for tourism?</p>
Fees	X			<p>What types/amount of fees could generate the necessary investment in early learning?</p> <p>Do we have the political relationships and power to gain support from our community and the NC General Assembly to allow the allocation of fees for early learning?</p>
Special Tax District	X			<p>Is the real estate wealth in the community such that it can support needed investments?</p> <p>What tax rate would be required?</p> <p>How do we determine the special taxing district(s)?</p>
Tax Credits	X			Can we gain support for tax credits from economic development leaders in our community?
Social Impact Bonds <sup>20</sup>	X			<p>Do we have a set of foundations or venture capitalists that are engaged in early childhood issues that could be interested in investing?</p> <p>Does the proposed intervention focus on prevention?</p> <p>Do we have agencies that are prepared to define, measure and deliver the outcomes?</p> <p>Can the outcomes be observed in three to eight years?</p>

<b>LOCAL FUNDING SOURCE</b>	<b>OPPORTUNITIES FOR THIS OPTION FOR YOUR COMMUNITY</b>	<b>CHALLENGES FOR THIS OPTION FOR YOUR COMMUNITY</b>
Municipal or County Budget Item		
Bond		
Sales Tax		
Property Tax		
Occupancy Tax		
Fees		
Special Tax District		
Tax Credits		
Social Impact Bonds		



## PRIVATE FUNDING IN PERSPECTIVE

Private funding plays a critical role in the early childhood system and can serve as a catalyst for public efforts to secure local government commitment. Private funding can be secured through community foundations, donor advised funds, corporate foundations and individual donors. A key aspect of securing private dollars is to provide a gap analysis to show where government funds are not sufficient to address community needs.

In Kalamazoo, Michigan, private corporate donors funded college scholarships for every child who graduated from high school in that city as an incentive to keep families in their town. In Guilford County, NC community foundations are playing an instrumental role in catalyzing conversations about early childhood systems and funding efforts to align service delivery for young children through Ready for School, Ready for Life.

### **To explore private funding opportunities, consider:**

- ▶ Does my community have a community foundation?
- ▶ What is the role of United Way in my community, and do they talk about early childhood?
- ▶ Which major employers in my area have charitable giving programs?
- ▶ Are there individual donors and donor-advised funds through the community foundation that are interested in early childhood?

Given considerations of sustainability and adequacy, it is unlikely that private funding alone can support a significant system change effort in early childhood. However, the role of private funding as a source of matching dollars and leadership in local efforts can be critical in demonstrating need and support for initiatives to local elected leaders.