
Coates' Canons Blog: Redistribution of Lottery Fund Proceeds Results in Loss of Revenue to Counties for Public School Construction Projects

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UPDATE August 2013: In 2013 the General Assembly repealed the statutory allocations of lottery proceeds and corporate income tax proceeds to the Public School Building Capital Fund. The effectively means that funding for the PSBCF will be subject to yearly budgetary appropriations by the General Assembly. See S.L. 2013-316 and S.L. 2013-360.

North Carolina General Statute § G.S. 115C-408 provides that “it is the policy of the State of North Carolina to provide from State revenue sources the instructional expenses for current operations of the public school system as defined in the standard course of study. It is the policy of the State of North Carolina that the facilities requirements for a public education system will be met by county governments.” In practice, however, the division of financing responsibilities between the State and counties is not quite so clear. As I discussed in a previous **post**, counties are responsible for some public school operational expenses. And, over the years, the State has responded to the need for new and improved school facilities by offering direct and indirect assistance for construction costs.

For example, the State authorized counties to levy two additional local sales and use taxes in the mid-1980s, totaling one cent. A portion of the revenue generated by each of these taxes is statutorily earmarked for public school construction projects or debt service obligations on public school construction projects. See **G.S. 105-487**; **G.S. 105-502**. These local sales and use taxes reasonably may be viewed as a form of state revenue-sharing because retail sales taxes are traditionally a state revenue source. In the late 1980s, the General Assembly also established the Public School Building Capital Fund (PSBCF) to allocate State monies to counties to directly support school construction projects and, in some cases, school technology projects. The PSBCF contains funds from two different sources—corporate income tax proceeds and the State’s education lottery proceeds. This year, the General Assembly made several changes to the statutory allocations of the education lottery proceeds which will result in a loss of funds to many counties.

Allocation of Funds to PSBCF

Corporate Income Tax Proceeds. **G.S. 115C-546.1** directs a portion of the State’s yearly corporate income tax proceeds to the PSBCF. And, **G.S. 115C-546.2** allocates these funds among the counties on the basis of average daily membership (ADM). (ADM is a statutory measure of student enrollment.) A county and its local school administrative unit(s) may **jointly apply to the Department of Public Instruction (DPI)** to use the county’s allocation for capital outlay projects, including the planning, construction, reconstruction, enlargement, improvement, repair, or renovation of public school buildings (instructional buildings only) and for the purchase of land for the public school buildings. A county also may use the funds to purchase equipment to implement a local school technology plan that meets certain criteria. If a county does not need all or part of the funds allocated to it for capital outlay projects, the unneeded funds allotted to that county may be used to retire any indebtedness incurred by the county for public school facilities. A county must match monies allocated for capital projects (but not technology projects) on the basis of one dollar of local funds for every three dollars of State funds.

In Section 2.2(f) of last year’s **Appropriations Bill (S.L. 2009-451 (S202))**, the General Assembly diverted all of the corporate income tax distributions for FY 2009-10 and FY 2010-11 from the PSBCF to the State’s general fund to support public school operations. Thus, counties will not receive any corporate income tax proceeds to support school construction or school technology projects this year.

Education Lottery Proceeds. **G.S. 18C-164** directs roughly 40 percent of the State’s education lottery proceeds to the PSBCF. **G.S. 115C-546.2** allocates 65 percent of those monies among counties on the basis of ADM and allocates 35

percent of the monies to local school administrative units located in counties that have an effective county tax rate that is greater than the State average effective tax rate. A county and its local school administrative unit(s) may **jointly apply to DPI** to use the county's allocation for public school capital outlay projects or to make debt service payments on debt incurred by a county for public school construction. Lottery proceeds may not be used for technology projects, and no local matching funds are required.

As stated above, the General Assembly made several changes to the allocation of the State's education lottery proceeds to the PSBCF in the State Appropriations Bill (**Section 5.1 of S.L. 2010-31 (S897)**). Notwithstanding the statutory allocations outlined above, the Appropriations Bill reduces the percentage of lottery proceeds appropriated to the PSBCF from 40 percent to 25.8 percent. Effectively, this diverts all of the projected growth in lottery sales from school construction projects to classroom teachers and scholarships. The total appropriation of lottery proceeds to the PSBCF is \$113.7 million, down from a projected \$176.5 million, resulting in a \$62.8 million loss to counties to support public school construction and debt service obligations.

The Appropriations Bill also makes changes to the distribution of lottery proceeds within the PSBCF. Specifically, for FY 2010-11, it allocates all of the funds to counties on the basis of ADM. (Any excess lottery revenues for FY 2010-11 above appropriated levels also will be distributed on the basis of ADM. And, approximately \$31.8 million in excess lottery revenues realized in FY 2009-10 that were not previously appropriated are allocated among counties with an effective tax rate *below* the statewide average.) The North Carolina Association of County Commissioners provides estimates of the new county-by-county allocations **here**.

Finally, the Appropriations Bill allows a county to appropriate the lottery proceeds to local school administrative unit(s) for classroom teachers, in addition to using the monies for capital outlay projects or debt service payments on debt incurred for public school construction projects. A local school board must specifically request that the lottery funds be used for classroom teachers and the use of the lottery funds for this purpose may not supplant a county's existing local current expense funding for its public schools. Furthermore, allowing a county to divert some of its earmarked lottery proceeds to fund classroom teachers does not alter a county's responsibility to sufficiently fund both the capital and operating expenses of its local school administrative unit(s). Click **here** for a summary of a county's funding responsibilities for public schools.

Note that if the lottery funds are used for classroom teachers, the appropriation does not count toward the charter school current expense allocation under **G.S. 115C-238.29H**. Thus, a local school administrative unit need not share the lottery proceeds appropriated for classroom teachers with any qualifying charter schools.

Counties' Response to Loss of Lottery Funds

Several counties had adopted their annual budget ordinances before the State enacted its Appropriations Bill. What if one or more of these counties appropriated its expected lottery proceeds from the PSBCF for either public school construction projects or debt service payments on debt incurred for public school construction projects? Now these counties may be faced with a revenue shortfall. If so, what are a county's available options?

G.S. 159-15 authorizes a county to amend its budget ordinance at any time after its adoption, so long as it continues to be balanced in accordance with **G.S. 159-8** and continues to satisfy all the requirements of **G.S. 159-13**. If a county determines that it will receive less revenue than it budgeted in its annual budget ordinance, it must amend the budget to either reduce expenditures, appropriate revenue from other sources, or both.

Thus, if a county actually appropriated the expected amount of lottery proceeds (based on the 40 percent distribution instead of the 25.8 percent distribution) the county must amend its budget ordinance to make up the shortfall. A county could simply appropriate unrestricted fund balance to cover the difference. (A unit's unrestricted fund balance comprises its cash reserves that are not statutorily or contractually restricted to a specific purpose.) Alternatively, it may reduce expenditures to free up other unrestricted revenue to cover the loss in lottery proceeds. Note, however, that special restrictions apply if a county reduces its appropriations to its local school administrative unit(s). **G.S. 159-13(b)(9)** prohibits a county from reducing its appropriations to its local school administrative unit(s) for capital or operational expenses unless the local board of education agrees to the reduction by adopting a resolution or unless a "general reduction in county expenditures is required because of prevailing economic conditions." Thus, in all likelihood a county will not be able to reduce its appropriations because of the reduction in lottery proceeds unless it receives explicit approval from the



affected local boards of education.

Finally, if a county is unable, or unwilling, to make changes to its budget appropriations to make up the revenue shortfall due to the reduced lottery proceeds, may the county increase its *ad valorem* property tax rate to generate the additional revenue? Generally, a county may not change its property tax levy once the budget ordinance is adopted, unless pursuant to one of three statutory exceptions. **G.S. 159-15** allows a county to alter its property tax levy after the adoption of the annual budget ordinance if it is ordered to do so by a court or by an authorized State agency, or if it "receives revenues that are substantially more or less than the amount anticipated . . ." If a county's governing board determines that the amount of lottery proceeds allocated to the county is substantially less than what it anticipated when it adopted its budget ordinance, it may increase its property tax rate to raise the additional revenue. The board must take this action before January 1, 2011.

Links

- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_115C/GS_115C-408.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_105/GS_105-487.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_105/GS_105-502.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_115C/GS_115C-546.1.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_115C/GS_115C-546.2.html
- www.schoolclearinghouse.org/otherinf/ADMFund/ProceduresManual-PublicSchool_2003_.pdf
- www.ncga.state.nc.us/Sessions/2009/Bills/Senate/PDF/S202v8.pdf
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_18C/GS_18C-164.html
- www.ncleg.net/Sessions/2009/Bills/Senate/PDF/S897v8.pdf
- www.ncacc.org/documents/2010-11lotteryproceeds.pdf
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_115C/GS_115C-238.29h.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-15.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-8.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-13.html