



# Funding Methods and Revenue Generating Capacity

## Executive Summary

The purpose of this paper is to examine the funding mechanisms available to the Township to support a stormwater management program. The information is intended for use by the Township to help make policy decisions regarding the right mix of funding tools to achieve the Township's target level (and extent) of service for their stormwater program. The paper helps to highlight issues of funding equity (linking revenue sources with revenue purpose) and funding adequacy (the ability of a potential source to produce a sufficient and stable revenue stream). The paper also divides revenue into those sources with the capacity to fund an entire program (primary sources), and those with the capacity to fund specific program elements (secondary sources).

While there are several potential secondary sources of revenue discussed in this paper, there are only two commonly recognized primary sources of revenue for stormwater management that are available to the Township. These are the General Fund, supported primarily through the earned income tax and real property tax, and a fee for service. As a result, after considering how secondary sources can fund specific program elements, the Township's major options for stormwater funding include the following:

- Maintain the status quo (same level of service and funding sources)
- Shift existing General Funds from other programs to fund stormwater management.
- Raise earned income tax and/or real property taxes and dedicate a portion to stormwater management.
- Implement a dedicated fee for service (similar to drinking water and wastewater charges).

## A. Overview of Stormwater Funding Mechanisms

Stormwater funding mechanisms commonly used by local governments in the United States include taxes (e.g., on property, retail sales, real property sales, income, and business gross or net profits taxes), exactions, special assessments, and service fees (sometimes also termed user fees or service charges). Each has a different underlying philosophy that guides the structure of the funding mechanism and the use of the revenues.

Funding mechanisms can also be distinguished as *ad valorem* or *non-ad valorem*. *Ad valorem* simply indicates that something is imposed based on a percent of value. By contrast, *non-ad valorem* is associated with or conditioned upon the performance of an act, the engaging in an occupation, or the enjoyment of a privilege. The following is a brief overview of the different types of funding mechanisms.

**Table 1: Summary of Common Township Funding Mechanisms**

<b>Taxes</b>	<p>Most general purpose local governmental functions are primarily funded through taxes that simply generate revenue. For example, an ad-valorem property tax is often imposed upon real (and sometimes personal) property based on its value. The purpose is simply to provide revenue to defray the expenses of general government, as distinguished from the expense of a specific function or service. It is not necessary for a tax to have a demonstrable association with any particular purpose or function. Dedicated tax policies also play an important role in many municipalities. Earned income tax is used locally levied on all income earned as salary and wages. Passive income such as interest, dividends, capital gains, and pensions are exempt from this tax. Tax Increment Financing is a specific type of tax that can be used by a municipal agency in PA to support public works activities.</p> <p>Ferguson established a dedicated, tax-based, Transportation Improvement Fund to address specific capital projects for roadway improvements. The Township's primary source of revenue is the Earned Income Tax.</p>
<b>Exaction</b>	<p>An exaction, or excise tax, is most commonly associated with franchise rights and development-related activities or impacts. Over many years the term has come to mean and include practically any tax that is not an ad-valorem tax. An example is a franchise fee on a cable utility. The franchise fee is imposed based on the privilege of running wires along public rights-of-way, rather than any assessment of the value of the information transmitted. However, like other taxes, the ultimate use of the revenue does not need to be associated with its source.</p>
<b>S p e c i a l Assessment</b>	<p>The essential characteristic of a special assessment is that it must confer some direct and special benefit to the property being assessed. A special assessment is based on the premise that the property assessed is enhanced in value at least to the amount of the assessment. Like service fees, special assessments are intended for a specific purpose rather than simply as a revenue generating mechanism. Assessments may be based on property value (ad valorem) or other factors (non-ad valorem) such as frontage along a street or sidewalk improvement.</p>
<b>Service Fee/ Stormwater Utility</b>	<p>A stormwater service fee, often referred to as a stormwater utility fee, is for charges that are related to the cost of providing the services and facilities. User fee funding establishes dedicated resources that cannot be authorized for other government purposes. Dedicated enterprise accounting provides a mechanism for receipt and allocation of multiple revenue sources allocated to stormwater management only. A service fee is imposed on persons or properties for the purpose of recovering the cost of providing service. A stormwater service charge rate methodology is adopted to set the appropriate fees and charges.</p>

As mentioned earlier, the stormwater funding options available can also be described as “primary” and “secondary.” Primary methods are those that have the capacity to support the entire program, while secondary methods are applicable to special needs or situations, but are not capable of funding a full program. The primary funding methods discussed in this paper might be used as the sole sources of funding for a program, but are more typically used in combination with secondary sources.

**Table 2: Primary and Secondary Stormwater Funding Mechanisms**

Primary Funding Methods	Secondary Funding Methods
General Fund Appropriations Tax Increment Financing Stormwater Service Fees (Stormwater Utility Fees)	Other Service Fees Special Assessments Pro Rata Shares Watershed Improvement Districts Federal and State Funding/Grants/Loans In-Lieu-Of-Construction Fees General Obligation and Revenue Bonding

Local governments across the United States have used all the funding mechanisms examined in this paper to some degree. Legislative and/or charter authority and the mission and priorities in each community have guided the selection of a preferred approach. There is no single funding mechanism that is best for every setting. Some funding sources are better suited to operations and maintenance, while others are used strictly for capital improvements. Adequate, consistent funding of a stormwater program is the most important factor for long-term success for the delivery of services to the community.

## **B. Primary Funding Methods**

### General Fund Appropriations

As adopted in the 2018 Budget for the Township, the total expenditures for all governmental funds in 2018 is \$21,563,730. In the General Fund, the Township's largest fund, expenditures are projected to be \$12,318,932. This represents a decrease of -\$110,815, or -0.9% below the 2017 Operating Budget.

The majority of General Fund (GF) revenues are derived from Earned Income. Other major sources of GF revenues may include real property taxes and other local taxes including the local sales tax and Business, Professional, and Occupational Licenses. Typically, the revenue sources that support the GF are based on a "taxation" philosophy – the purpose of which is to raise revenue for a broad range of local services. It is not necessary that there be any association or relationship between the source of revenue and the purpose to which it is applied.

Dedicated tax structures such as the Transportation Improvement Fund are adopted with specific restrictions for use of the funds. The Board of Supervisors authorizes the expenditure of those funds for road-related improvements and capital projects. Some improvements for the drainage system located within the bounds of a roadway capital project are completed using Transportation Improvement Funds based on the understanding that the drainage component are part of the overall roadway network.

Using GF revenues produce a level of imbalance on who pays, for both Earned Income tax and property tax. Ad-valorem taxes (based on value of real and personal property) may exempt some properties or populations from taxes, resulting in no contribution of revenues to address system needs. Similarly, some private properties, e.g. parking lots and storage warehouses that have large expanses of impervious coverage, do not pay real property taxes proportional with the demands they impose on the stormwater system. Conversely,

some properties that have little impact on stormwater runoff but pay proportionately higher property tax contribution may be paying more for stormwater management through the GF than they would through funding methods such as service fees. Similarly, income tax revenues as a basis for GF revenues does not have a correlation to the need for a publicly operated drainage infrastructure or water quality protection programs.

General Fund appropriations are for any specific purpose unless considered a dedicated “tax” and they can be highly uncertain from year to year as shifts occur between with real and perceived priorities. Stormwater management needs are likely to receive a higher priority in a year following severe storms, creating drainage problems than in a year following a drought. This makes it difficult to engage in long-term planning for services needed.

One option considered by local governments to provide for stormwater functions is to dedicate a portion of the tax structure. The Transportation Improvement Fund in Ferguson is an example. Fairfax County in VA adopted, as their primary revenue for stormwater, a Special Tax District (countywide), with dedicated revenue for stormwater services accounted for in an Enterprise Fund currently raising approximately \$70 million in revenue annually.

### Tax Increment Financing Program Summary

*What is Tax Increment Financing (TIF)?* It is a public financing tool, typically for private residential, commercial or industrial development or revitalization, used to fund public works or improvement projects. It is typically generated through the allocation and dedication of all or a portion of the additional taxes resulting from increases in property values or from the increase in commercial activity as a result of the development or revitalization project. Tax Increment Financing can be used to support capital projects, rather than general operating costs such as salaries and materials. It has limited ability to fund all services provided by Public Works for stormwater management.

#### *Uses and Purposes of Funding*

- Capital costs, including costs of actual construction, rehabilitation, remodeling or repair of buildings, structures or fixtures
- Acquisition, upgrade or rehabilitation of machinery or equipment
- Acquisition, clearing or grading of land
- Financing costs
- Real property assembly costs
- Professional fees of architects, planners, engineers, and lawyers
- Administrative costs
- Relocation costs
- Capital costs may also include costs of construction, rehabilitation, or repair of publicly owned infrastructure outside the tax increment district that is of direct benefit to a project Issuing Authority

*Who Can Use This Approach?* A redevelopment authority, an industrial and commercial development authority or by agreement with a redevelopment authority, a municipal authority is designated as the issuer of the TIF Bonds or notes, receives the allocated tax increments and deposits them into a tax increment fund.

*What is a TIF District?* A contiguous geographic area within a “redevelopment area” which a planning commission has found to be “blighted” in accordance with the Urban Redevelopment Law so as to require redevelopment under that Act or the TIF Act. The term of the TIF District may not exceed 20 years unless an amendment is made to the initial project plan.

*How is the Tax Increment Allocation set?*

- Determined by the local taxing bodies (county, school district, municipality) levying taxes in the TIF District.
- Based on the program defined to address the needs within the TIF District.

Stormwater Service Fees (Stormwater Utility)

Service fees are becoming an increasingly popular source of dedicated stormwater funding, throughout the United States and Canada. User fee funding for stormwater began in the early 1970's and it is estimated that several thousand programs are now funded primarily through stormwater user fees.

The general standard applied to utility fees is that the rate methodology must be fair and reasonable with resultant charges that must bear a substantial relationship to the cost of providing services. However, the local government has a great deal of flexibility in attaining these objectives in the context of local circumstances. When stormwater user fee rates have been subjected to legal challenges, the courts have tended to apply "judicial deference" to the decisions of locally elected officials. Under judicial deference, the courts will not intervene unless a plaintiff can demonstrate that the decision was arrived at arbitrarily and capriciously or that the result of the decision discriminates illegally.

Stormwater service fees typically provide more stable revenue than other funding options, offer the opportunity to design a service fee rate methodology that results in a balanced allocation of the cost of services and infrastructure, and, in some cases, can provide an opportunity to shift a portion of the community's stormwater management program costs from the GF. Service fee rate structures are designed to generate funds to cover program costs based on the correlation between the need for a public drainage system and the contributions of runoff from developed property.

The revenue generation capacity of a stormwater utility is similar to that of other general revenues of the Township. The utility fee billing unit is typically a measure of impervious area present on the property, serving as the "meter" for allocating costs rather than income or assessed property values. Determining a legally defensible rate needed to generate revenue sufficient to finance stormwater needs requires a "stormwater user fee rate study." During this study, important policy decisions are made that can have significant implications for the selected measure of the billing unit and the calculated rate.

In addition to technical determinations, a local government must address a range of policy questions that ultimately impact the structure of the program and user fee, as well as the stormwater fee rate. Major policies questions are presented in Table 3 below.

**Table 3: Policy Decisions Affecting User Fee Rate and Structure**

### Policy Decisions Affecting Utility Rate and Structure

1. **Program:** Will all, or only part of the current program/service elements identified in the program evaluation be shifted to the Enterprise Fund?
2. **General Fund:** Will the enterprise fund be used to pay for services received from the GF such as general overhead? (Indirect Cost Allocation)
3. **Special Fees and Other Revenues:** What additional revenue sources will be used, or created, to support stormwater program functions (existing or future increases in fees for erosion and sediment control; fees for inspection of private BMPs; grants, etc.)?
4. **Financial Factors:** What is the fund balance test that must be maintained by the Enterprise Fund? Is interest earned by the cash generated from the utility credited to the Enterprise Fund? What is the "bad debt" factor (based on history of collecting fees)? Are fund balances appropriated in the following year?
5. **Reserves:** Will an emergency reserve be established to address catastrophic system failures? What level of operating reserve will be maintained?
6. **Bonds:** Will bonded debt or short-term bank financing be used to pay for the capital improvements program?
7. **Rate Allocation:** What is the basis for the rate? Impervious area? Other factors? Are their unique circumstances that must be accounted for in allocating the fee (e.g., diversity in housing types and impervious coverage ratios)?
8. **Exemptions:** Will exemptions be established other than those legally mandated?
9. **Credit Policy:** Will credits be adopted for those private properties that provide a public service (i.e., privately owned stormwater management facilities that treat and/or detain stormwater from a specific site or sites) under the program? Will the program only recognize credits related to real world benefits, or are soft benefits (such as public education) grounds for credits?
10. **Billing:** What portion of the billing administrative costs will be funded by the stormwater Enterprise Fund? What portion of customer service costs are funded?
11. **Rate Policy:** Is there a goal that the rate be held constant for 3 years? Or 5 years? Or will the rate be adjusted annually based on fiscal analysis of revenue vs. expenditures?
12. **Bill Receipt:** Who will receive the bill, owners or current utility customers (such as renters and leasers)?

All of these policy decisions are considered as part of a rate study.

## **C. Secondary Funding Methods**

### Plan Review, Development Inspection, and Special Inspection Fees

Most jurisdictions offset part of the cost to review plans and issues permits related to stormwater management by imposing various fees. Although increased fees are an option, limitations in the amount of development occurring will arbitrarily limit the amount of revenue that can be generated in this way. Fees for these services typically do not completely cover the cost of service due to variability in the demand for these services from year to year.

### Special Assessments

The essential characteristic of a special assessment is that it must confer a direct and special benefit to the property, or properties, being assessed. A special assessment is based on the premise that the work being done enhanced the value of the properties assessed in an amount at least equal to the amount of the assessment. Like service fees, special assessments are intended for a specific purpose rather than simply as a revenue generating mechanism. A common requirement of assessments is that there must be a rational linkage (nexus) between the use of the revenue derived from the assessment and the benefit to the party to whom it is applied. Assessments may be based on property value (ad valorem) or other factors (non-ad valorem) such as frontage along a street or sidewalk improvement. Special assessments for stormwater are most workable in very localized applications. For example, improving a ditch or channel that directly serves a few properties or a relatively small or distinct area is an appropriate project for special assessment funding.

One tool that may be available is the creation of a special assessment for localized areas of a jurisdiction called a service district. Service districts may be created to provide additional, more complete, or more timely services of government than are desired in the locality. Service districts can provide a wide variety of services, and are usually used for water and sanitary sewer services, garbage removal and disposal services, and private street and road maintenance. Typically, these service districts also have the power to levy and collect an annual tax upon any property in such service district subject to pay, either in whole or in part, the expenses and charges for providing the governmental services authorized. These funds must be segregated from GF dollars and be expended in the district in which they were raised. They are usually implemented within a subarea of the jurisdiction, not community-wide.

### Pro-Rata Shares (PRS)

In some states, by direct authorization of powers to a local government, a locality may provide in its subdivision and land development ordinance (SALDO) for payment by a developer of land of the pro rata share of the cost of providing reasonable and necessary sewerage, water, and drainage facilities, located outside the property limits of the land owned or controlled by the subdivider or developer but necessitated or required, at least in part, by the construction or improvement of the subdivision or development. Funding is typically held in a cash escrow account until such time as the stormwater management facility or BMP is constructed. Funds must be utilized for facility or BMP construction within a timeframe set forth in the authorizing legislation. Pro-rata accounts are typically most effective in communities experiencing significant, sustained growth. Another form of “pro-rata share” is “in-lieu-of-construction” fees.

## In-Lieu-Of-Construction Fees

In-lieu-of-Construction Fees are payments to the local government by developers who cannot implement on-site stormwater controls. They are collected by the local government for investment in a public facility that will be built to serve multiple properties within the same drainage subbasin. The major advantage of in-lieu-of-construction fees is that revenue from smaller projects can be combined to be used on a regional basis, or where measures can have the most impact. In-lieu-of-construction fees also allow a locality to gain some benefit if it is determined that a stormwater requirement should be waived or reduced due to site specific constraints. A disadvantage of in-lieu-of programs is that the revenue stream is dependent upon the pace and nature of development from year-to-year. As a result, in-lieu-of fees are usually best applied to one-time projects or programs.

## Federal and State Funding Opportunities

There are very limited federal and state funding mechanisms available to provide ongoing support for local stormwater management programs. Federal involvement in stormwater management (other than regulatory programs) is typically limited to advisory assistance, cooperative programs such as those provided by the United States Geological Survey and the United States Army Corps of Engineers, and emergency response. Some states provide access to the federally support loan funds that address water, sewer and stormwater capital construction projects. Though not a direct funding source, but a competitive one open to all local jurisdictions in the state, it can provide large sums of cash to support major capital investments/improvements for stormwater systems on a pay-back basis.

One way that many communities have succeeded in acquiring limited funding for stormwater management projects is through grants. Federal and state governments, as well as select foundations, have provided project funding for communities that are willing to propose and implement innovative projects to control stormwater runoff or restore streambeds to a more natural condition. Some funding has been provided for grants to local governments to address the Chesapeake Bay regulatory mandates. Those funds are very limited year to year and competition is significant (and growing). A common requirement of grant funding is local cost-share. One advantage of having a dedicated source of revenue for stormwater is a greater ability to take advantage of state and federal cost-share programs.

## General Obligation and Revenue Bonding

Bonds are a form of borrowing used by local governments to generate funds for projects that are pledged as assets to guarantee the payment of the debt. They are sold in markets (similar to the stock market) and are not a revenue source, but a method of infusing cash into the program to construct large capital projects. They are most commonly used to pay for major capital improvements and acquisition of other costly capital assets such as land and major equipment. Capital improvements can also be funded through annual budget appropriations, but annual revenues are often not sufficient to pay for larger capital investments.

The chief advantage of bonding is that it allows construction of major improvements to be expedited in advance of what can be funded from annual resources by spreading the cost over time. In the case of stormwater management, expediting a capital project by several years through bonding may result in significant public and private savings if flooding, other damaging impacts, and inflation of land acquisition and construction costs are avoided. It changes “who” pays for the capital investment so that future users of the infrastructure are involved in payment of the infrastructure that they use. The major disadvantage of bonding



is that as a loan it incurs an interest expense, which increases the overall cost of capital projects, land acquisition, etc.

The two most prevalent types of bonding available are general obligation (GO) bonding and revenue bonding. GO bonding incurs a debt that has “first standing” with regard to public assets and is backed by the “full faith and credit” of the issuing agency. Because of this, it is often a requirement that the public approve of bond indebtedness through referendum. All revenues, including various taxes, may be used to service GO debt. Revenue bonding is supported and ensured solely by revenues that are typically linked to the capital expenditure and recovered through some type of fee or specific tax. Creation of a separate source of revenue that is earmarked specifically for stormwater management (e.g., a stormwater service fee) would allow a jurisdiction to sell revenue bonds if market acceptance was attained.

Generally speaking, bonds are not intended for use as a funding mechanism for day-to-day operations. However, some costs can be viewed either as a capital or operating expense. The lack of a clear distinction between remedial repairs and new construction, for example, results in bonding sometimes being used for major repairs that might also be considered an operating expense.

#### Other Innovative Funding Arrangements – Escrow Accounts

Use of maintenance escrow accounts that are established and dedicated for a specific group of public facilities is funded by property owners that benefit from public maintenance of the facility serving their properties. This is sometimes associated with innovative BMPs and low impact development techniques such as rain gardens. While the arrangement doesn’t represent a source of funding for new projects, it does create an insurance policy so that funds are not need for correcting for maintenance deficiencies on private property.

## D. Summary of General Applicability of Revenue Sources

The following is a comparative summary of the generating capacity, equitability, and stability of the primary and secondary revenue sources discussed in this paper.

	AREA OF APPLICABILITY								
Revenue Source	Generating Capacity			Balance and Equity			Stability of the Source		
	High	Medium	Low	High	Medium	Low	High	Medium	Low
<b>General Fund – Income and Property Tax</b>	General Fund revenues can provide for the full cost of service to the community.			Basis of tax is not correlated to the need for a public system for management of stormwater.			Stability of funding for stormwater dependent on other annual budget priorities unless a dedicated fund is established.		
<b>Stormwater User Fees</b>	High	Medium	Low	High	Medium	Low	High	Medium	Low
	Stormwater user fees can provide for the full cost of service to the community.			Rate methods typically based on need for the public system and impervious area as a meter.			Based on program costs to address stormwater needs.		
<b>Tax Increment Financing (TIF)</b>	High	Medium	Low	High	Medium	Low	High	Medium	Low
	Tax Increment Financing can provide for capital cost financing including equipment acquisition and is typically targeted for areas of redevelopment.			The tax is based on property values, typically, and the basis is not correlated to the general need for a public system and services; targeted to a specific area of the community.			Once established, it can be maintained over a period of time to support the capital investment program area that is targeted for the funding.		
<b>Inspection/ Review Fees</b>	High	Medium	Low	High	Medium	Low	High	Medium	Low
	Relatively minor, but can fund specific program functions.			Strong link between the revenue source and the service received.			Based on rate of development.		
<b>Special Assessments</b>	High	Medium	Low	High	Medium	Low	High	Medium	Low
	Assessment is determined by cost of improvements needed. Generation capacity significant for localized projects.			Used for a small area where a specific improvement is required and specific properties directly benefit.			Stable source of revenue once established.		
<b>Pro-Rata Shares</b>	High	Medium	Low	High	Medium	Low	High	Medium	Low

	AREA OF APPLICABILITY								
Revenue Source	Generating Capacity			Balance and Equity			Stability of the Source		
Charges	Medium to high depending on the watershed. Used to make regional improvements over time. Typically not sufficient to cover the cost of all improvements.			Funding provided by those that impact the drainage basin. In newly developing areas, this can be highly equitable.			Based on rate of development.		
In-Lieu-of-Construction Fee	High	Medium	Low	High	Medium	Low	High	Medium	Low
	Used to combine revenue for use in larger projects, or where greater water quality benefits can be realized.			Same issue as pro-rata shares. Depending on what the fee is in lieu of, there may need to be a nexus between how the funding is spent and water quality improvements.			Based on rate of development.		
State/Federal Grants	High	Medium	Low	High	Medium	Low	High	Medium	Low
	Typically less than \$100,000.			Use is dictated by the grant provider.			Used for specific demonstration projects, not a stable source of revenue.		
Bonding and Short Term Bank Financing	High	Medium	Low	High	Medium	Low	High	Medium	Low
	Capacity can be significant to fund major and small capital projects as well as equipment financing.			Debt paid by rate payers in a user fee financed program; paid by GF revenues if no user-fee system in place.			Applicable for one-time capital expenses and equipment purchases. Not meant as a source of revenue for ongoing expenses.		