POLICY REPORT

City and County Issue Guide 2011

John Locke FOUNDATION

Policymakers in the many local governments of North Carolina face a host of important challenges. This issue guide offers solutions to problems that confront North Carolinians at municipal and county levels. The common thread in these recommendations is freedom. By increasing individual freedom, local governments can foster the prosperity of all North Carolinians and keep open avenues to innovative solutions from enterprising citizens.

The John Locke Foundation research team offers the following policy analyses and recommendations. Please feel free to contact the policy expert associated with each recommendation for further information. For more detailed research on these and other issues facing local governments in North Carolina, visit www.JohnLocke.org and select Research from the drop-down menu.

The research team would like to thank research interns Nicole Fisher, Alissa Whatley, Adam Barrett, and Daniel Simpson for their help and contributions to this guide.

The views expressed in this report are solely those of the authors and do not necessarily reflect those of the staff or board of the John Locke Foundation. For more information, call 919-828-3876 or visit www.JohnLocke.org.
©2011 by the John Locke Foundation.
On the cover: Cherokee County Courthouse. ©2006, Maarigard. Image from Bigstock.com.

Cherokee County Courthouse. ©2006, Maarigard. Image from Bigstock.com.

City and County Issue Guide 2011

Table of Contents

Finances

2 Spending and Taxes
4 Retiree Health Benefits
6 Debt
8 Transparency
10 Economic Development Policy
12 Competitive Sourcing

Services

14 Education
16 Fresh Water and Wastewater Services
18 Parks and Recreation
20 Air Service
22 Public Transit
24 Stadiums, Water Parks, Restaurants, etc.
26 Convention Centers

Land Use and Property Rights

28 Land Use and Zoning
30 Smart Growth
32 Affordable Housing
34 Eminent Domain
36 Forced Annexation

38 Additional Resources

Recommendations

Local governments need to define the appropriate scope of government. Families, charities, or for-profit companies can better accomplish some goals.

Before seeking higher sales taxes, governments should demonstrate that they have used their existing money wisely.

Background

Few people object to paying taxes if the taxes are fairly assessed and if the money is properly used. Local governments in North Carolina all have two ways to tax their citizens: the property tax and the sales tax. Some have additional taxes on rental cars, hotel rooms, meals, home sales, or the privilege of opening a business there. Cities and counties also often charge separate fees for construction, water and sewer, solid waste removal, recycling, or electricity.

As part of a 2007 deal that swapped sales tax revenue for Medicaid payment obligations, counties also received the right to seek approval from their citizens to impose a new tax. The tax could be either a 0.25-cent increase on the 2.0-cent local sales tax (6.75 cents total) or a 0.04-percentage point increase on the 0.02-percent tax (to a 0.06-percent tax) on land transfers.

Sixty-five counties have sought one or both tax increases since 2007. Before giving up on the land-transfer tax in early 2009, counties invariably chose whichever increase had the higher projected revenue even though the land-transfer tax increase never won in 23 attempts. Voters rejected a sales-tax hike 57 of 69 times it was on the ballot during a primary or general election. County commissioners have won sales-tax hikes seven of nine times a vote was held at other times, including a May 17, 2011, vote in Cabarrus County that had a 3.5 percent turnout.

Some local officials argue that growth does not pay for itself and therefore new taxes are to compensate. These same counties, however, often provide economic incentives to attract businesses to the area, effectively ensuring that new revenue will not keep pace with spending demands. For example, the town of Holly Springs in 2006 offered (with help from the Golden LEAF Foundation and the state) a $20 million incentive for Novartis to build a new plant, nearly its entire income that year.

Unfortunately, too many local governments have misused the money they now have. In Wilmington, the city council has set aside money for a convention center while the municipal sewer system leaks. Charlotte built a convention center and a short section of light rail instead of expanding road capacity to alleviate traffic congestion. Spending comes first with governments; if they did not spend money, they would not need to tax their citizens. There are many legitimate needs facing local governments, but officials need to convince their citizens that they are spending wisely before imposing new taxes, fees, or other costs.

Key Points

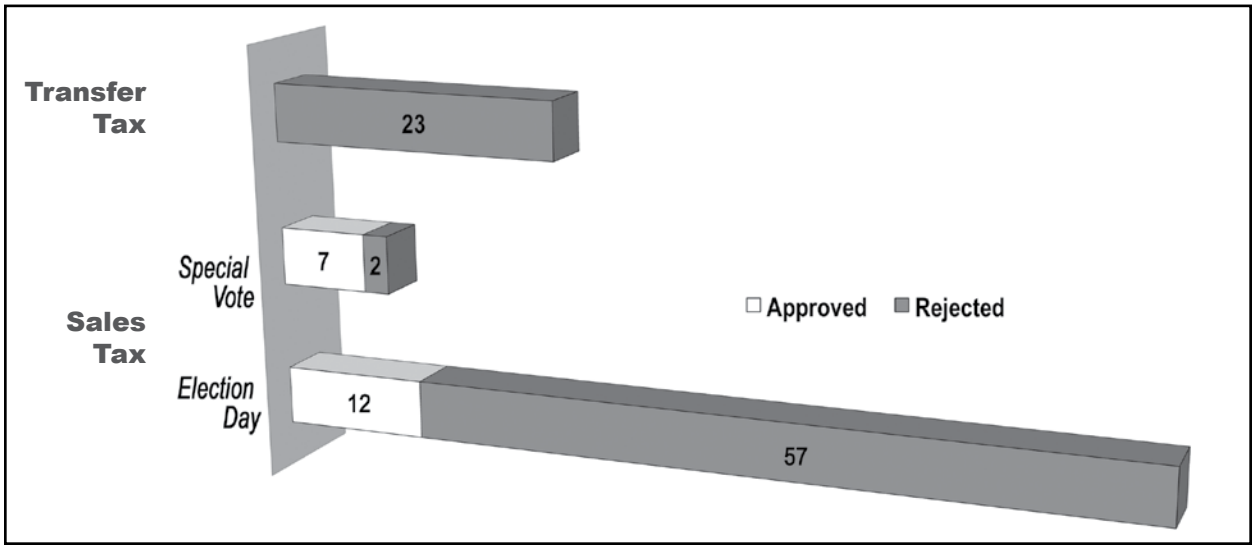
After a decade of property value increases, governments need to prepare for a reset.

Local taxes and fees cost each person $1,304 in fiscal year 2009. That figure represents 4.3 percent of per-capita personal income. For a family of four, the cost of local government is $5,216.

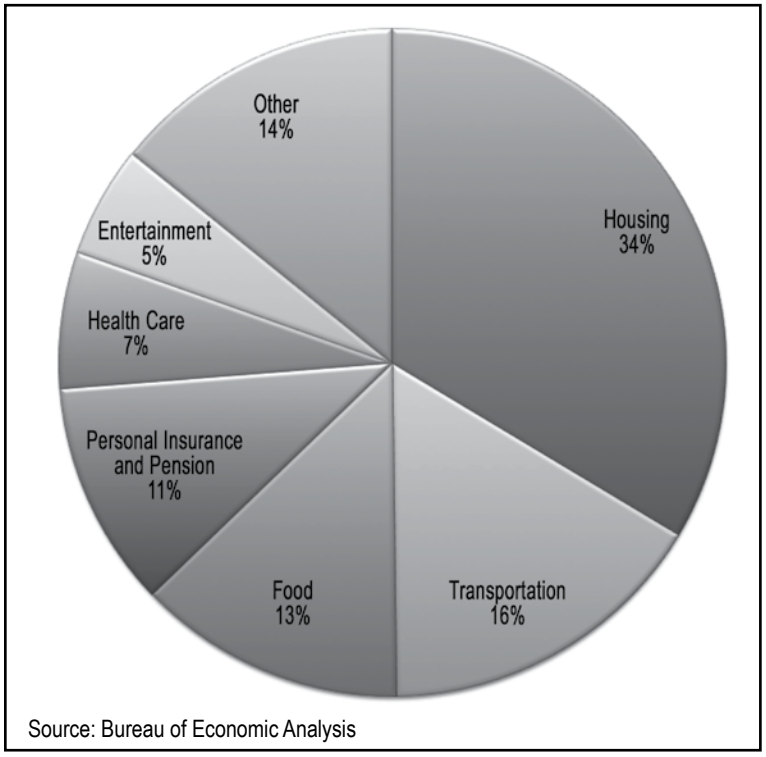
Local governments must earn the trust of taxpayers. Spending on municipal golf courses, economic incentive packages, convention centers, and other nonessential services has received higher priority in local budgets than school buildings, sewer systems, and roads.

It's not just taxes. Although property and sales taxes are the main source of revenue for most local governments, 16 municipalities and counties collected more in permits and fees than in property and sales taxes. Those municipalities and counties had bigger swings in revenue than others. Holly Springs in Wake County, for example, collected $9.4 million in property and sales taxes in fiscal year 2006, but $9.6 million in building permits, inspection fees, and "other permits and fees." By 2010, property and sales tax collections climbed 62 percent to $15.2 million, but revenue from those permits and fees fell 72 percent to $2.7 million.

Catch 'Em Off Guard: A Referendum to Increase Taxes Is More Likely to Pass When the Vote Is Held in a Low-Turnout Special Election Rather Than a General Election



Where Should Families Cut? Average Southern Household Spending, 2009



Source: Bureau of Economic Analysis

Analyst: Joseph Coletti
Director of Health and Fiscal Policy Studies
919-828-3876 • jcoletti@johnlocke.org

Recommendations

Local governments should move to **defined contribution** pension (such as a 401(k)) and health (such as an HRA or HSA) benefits for retirees.

For the remaining promised health-insurance benefits, local governments should ensure they have a **reserve fund** to cover costs.

Another way for local governments to cut their long-term obligations is to tighten eligibility criteria and reduce the generosity of retirement benefits.

Background

Government employee pensions and health care obligations are a major concern for North Carolina's fiscal sustainability. The state employee health plan has required larger infusions of cash each year and in some years has needed help just to get to the end of the fiscal year. The unfunded liability to cover insurance costs for future retirees as of December 31, 2009, was $32.8 billion, or more than double the payroll for covered employees.

Pension costs are better funded, with estimates generally around 90 percent of liabilities. Those estimates, however, assume a rate of return 45 percent higher than the norm over the past ten years. Even with the generous assumptions and no cost of living adjustment (COLA) for retirees, the state will have to contribute 10 percent of payroll, or $1.5 billion in fiscal year 2015.

Local governments are not immune. Their contributions to employee pensions have climbed from 4.8 percent of payroll in 2009, and for decades prior, to 6.88 percent this year. The contribution is expected to climb to 8.3 percent of payroll in 2015 with assumptions of 7.25 percent annual investment returns and no COLAs. But the local government employee retirement system (LGERS) is managed by the same staffers in the Office of the State Treasurer who manage the state employee pension (TSERS) and has similarly failed to meet its goals in the past ten years.

While the legislature in 2010 could choose, for the first time in the 69-year history of TSERS, not to pay the full cost of pension obligations, local governments must make the required contribution. This means local government pensions are on stronger footing, but it also means those pensions are already crimping local governments' ability to provide other services.

Promised health benefits for retired county and municipal government employees, like those promised to state government employees, are woefully underfunded. A sample of five of the largest counties in the state (Mecklenburg, Wake, Guilford, New Hanover, and Cumberland) shows total liabilities of $868 million, but assets of just $22.5 million, leaving 97.4 percent of the liability unfunded. The $846 million unfunded liability is one-fourth larger than those counties' entire payrolls.

Looking at the largest city in each of those counties (Charlotte, Raleigh, Greensboro, Wilmington, and Fayetteville) reveals a less bleak, though still daunting, picture. Total liabilities are less than half the payroll of those cities. Charlotte has set aside assets to cover 16 percent of its liability, and Wilmington covers 19 percent of its liability.

Key Points

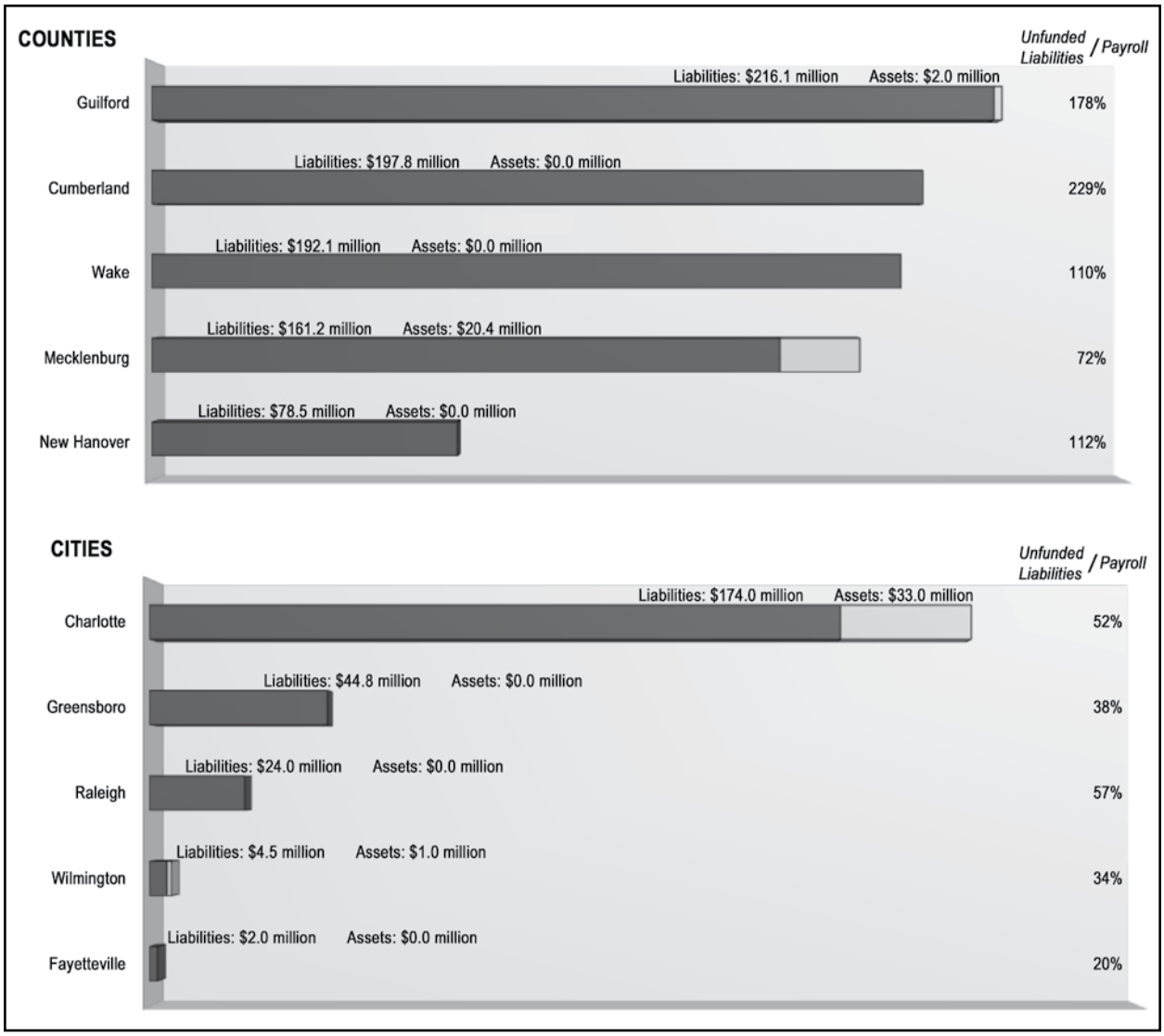
Graham County stopped providing health insurance for anybody not vested as of December 2, 2006. The county has no active employees covered by the plan and is down to just $5,460 in liabilities.

Guilford County, which reports an unfunded liability 78 percent larger than the county payroll, moved all employees hired after July 1, 2009, into a defined contribution health care plan. County commissioners also set aside $2 million to pay for the health benefits of existing employees.

Unfunded pension and health care promises:

- hurt local governments' ability to provide services to residents as funding demands rise over time
- mean local government employees could receive less than their expected compensation
- put citizens in jeopardy of higher taxes to pay for local government employee pensions and health care.

County and City Governments' Liabilities and Assets for Retired Employee Health Insurance Benefits



Analyst: Joseph Coletti
Director of Health and Fiscal Policy Studies
919-828-3876 • jcoletti@johnlocke.org

Recommendations

Local governments should put all debt to a referendum vote concurrent with a general election or primary election.

Governments should report the full financing costs and expected repayment plan for any debt before a vote.

Budgets and financial reports should include a full accounting of debt, including the diverted revenue streams to pay higher-cost "limited-obligation" revenue bonds and tax-increment financing (TIF) bonds.

Background

Local governments throughout North Carolina have used a number of methods to borrow money without asking for the approval of voters and taxpayers. Bond votes for schools, libraries, and other projects often pass, but elected officials and government managers claim to prefer other methods as a way to reduce risk and taxpayer exposure, or to take advantage of a short-term dip in construction or finance costs. Those claims rarely deliver as promised.

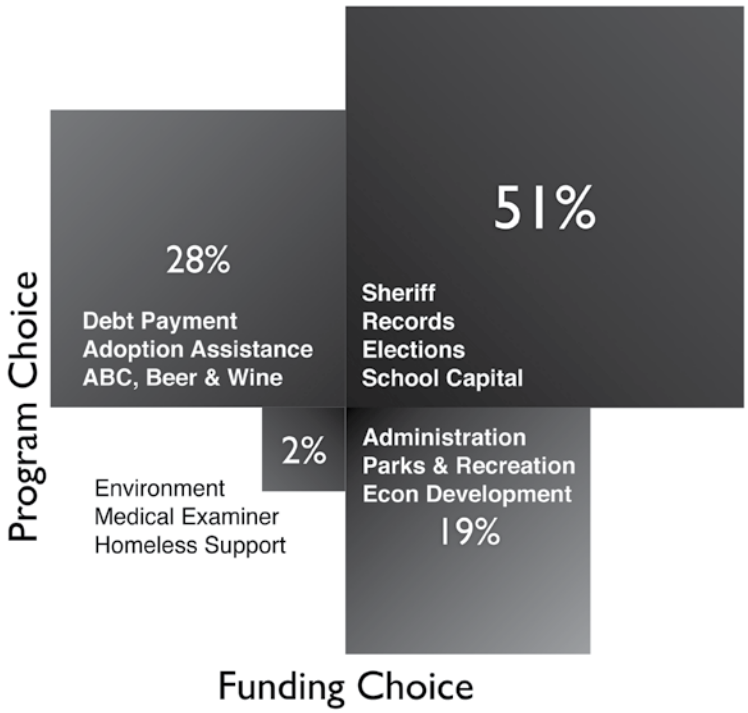
North Carolina voters in 2004 approved Amendment One, which allowed local governments to issue debt for capital projects paid from the new tax revenues collected in special districts tied to the projects. This form of debt is usually called tax increment financing (TIF), but Amendment One proponents often called it simply Project Development Financing or, euphemistically, Self-Financing Bonds. Nearly every other state uses TIFs with mixed results.

Those bonds have proven less popular than expected, and just two projects in North Carolina have actually relied on tax increment financing – a $12.8 million package in 2006 for downtown redevelopment in Woodfin, Buncombe County and a $21.5 million package in 2007 for the Randy Parton (now Roanoke Rapids) Theatre and Carolina Crossroads entertainment district in Roanoke Rapids, Halifax County. In 2007, Kannapolis and Cabarrus County proposed to use TIFs to finance $67 million in projects related to the North Carolina Research Campus, but they eventually relied on a combination of federally subsidized Build America Bonds and reclassified the TIFs as revenue bonds to finance $30 million in capital projects and economic incentives.

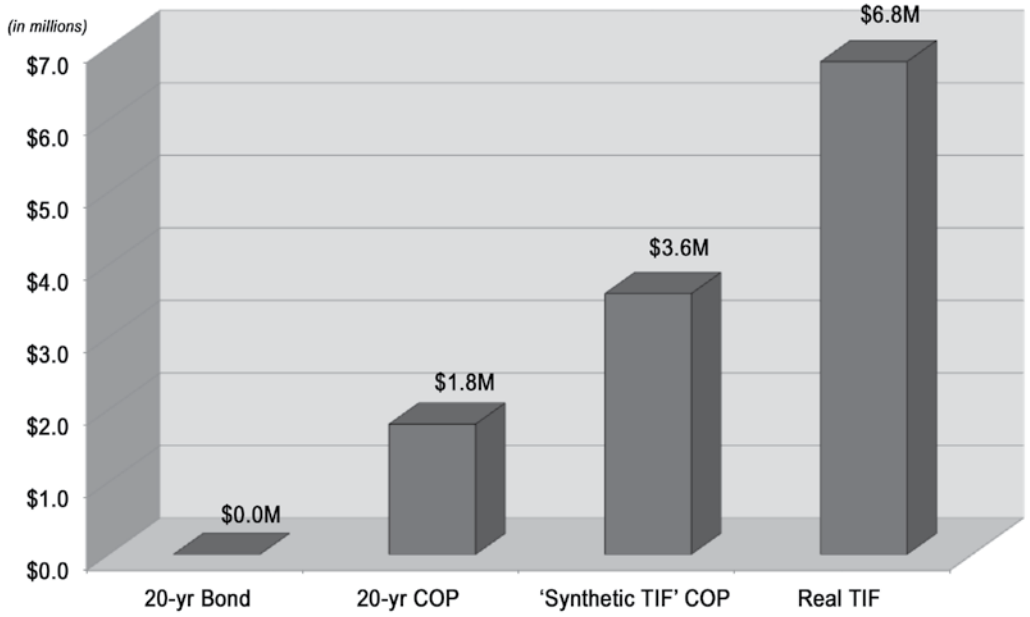
Certificates of participation and other installment plans also come with promises to protect taxpayers, but the town of Salisbury pledged its town hall and fire stations as collateral to finance a fiber-optic broadband network. No bank is likely to take possession of these properties for resale, which means taxpayers would still be responsible for the town's leasing back those facilities.

Lenders charge higher fees and interest for debt that does not have an explicit pledge of general taxes. Those costs could have added as much as $6.8 million more in present-value terms compared with other forms of debt

Grid Showing Counties' Program and Funding Choices



Present-Value Cost of Non–Voter Approved Debt Over Traditional Bonds (in $Millions)



for the original $67 million project proposal in Cabarrus County.

In other words, it can cost local governments up to 10 percent more to borrow money without asking.

The money used to pay the debt service is not available for other needed services, even in the revenue district itself. For example, if a TIF district needs upgrades to the road, water, or sewer systems, those are new costs that would not have occurred if the land remained in its prior state. Whatever new tax revenue is dedicated to debt service is not available for other projects such as those. Taxpayers are just as exposed to the costs.

Key Points

Any form of debt, including certificates of participation, revenue bonds, Build America Bonds, and tax-increment financing ultimately pledges the taxing authority of the issuing government.

Per-capita debt service payments have risen in counties from $113 in 2005 to $157 in 2010 and in municipalities from $180 in 2005 to $223 in 2010. A family of four spent an average $348 more per year on debt payments for local government in fiscal year 2010 than in fiscal year 2005. In some jurisdictions, that amount may not include diverted revenue used to pay debt.

Analyst: Joseph Coletti
Director of Health and Fiscal Policy Studies
919-828-3876 • jcoletti@johnlocke.org

Recommendations

1. **Put contracts and detailed spending information online.** Local governments should look at *NCOpenBook.gov* and Wake County's WATCH website to provide transaction-level detail updated daily with spending and revenue for all of state government. Each local government should provide easy access to its transaction information on every page of its website.

2. **Use XML and structured formats for data transparency.** Just putting information online is not enough if it is difficult to analyze and use the data. Open data standards make it easier to compare information in context.

3. **Develop meaningful outcome measures for government agencies and hold them accountable for their results.**

Background

Local governments need to build accountability and transparency into their budgeting and management processes, just as they have with meeting agendas, video, and social media. Many of the tools to achieve that goal also help government employees succeed in their jobs.

Many local governments are posting agendas, audio, and video from commission meetings. They are adding crime maps, documents related to zoning, and building permit requests. Governments and individual elected officials are on Facebook, and more of them are using Twitter to share news. These are all positive steps to more open dialogue and greater involvement of citizens.

Citizens need solid information of how government works and what they get for their tax dollars if they are to be truly engaged. Local governments should help citizens to understand how they pay for services. They also need to measure and report results, then make decisions that hold managers and programs accountable for those results.

As budgets have become increasingly complex, citizens are less able to monitor how their taxes are spent. Government managers also need better information to use the taxes with which they are entrusted in the most effective way.

What is available online now is of limited value. Documents must be downloaded and citizens must often re-enter data to make use of the information. A good rule to remember is that **PDF is not a data format**. With Google documents and other online tools, governments have fewer roadblocks to making more information more readily available for citizens and employees.

To understand local government spending, an elected official or citizen must consult a number of documents, go through hundreds of virtual or real pages, add numbers together, and sometimes extrapolate from the past. Even when local governments are given a standard format for data entry, such as for the State Treasurer's Annual Financial Information Reports, the data that go into the report differ from locality to locality and even within the same county or town over time.

Newspapers in some of the larger metropolitan areas (Raleigh-Durham, Charlotte, Wilmington) have begun creating their own searchable databases of government employees' salaries and pension benefits. These are helpful for citizens, but not as timely as would be possible if governments managed their own databases. Leaving it to outside groups can lead to embarrassing moments, such as Mary Easley still showing up as an employee of NC State University nearly a year after her job was eliminated.

Key Facts

- Governments at all levels have taken steps to make more information available online. They have been assisted by the press, the John Locke Foundation, and other groups.

- North Carolina has an online directory of contracts, stimulus projects, and grants.

- Wake County makes transaction information available in a useful online database (*http://www.wakegov. com/budget/watch*).

Wake County's Open-Government Web Site
(*http://www.wakegov.com/budget/watch*, screen capture)

Wake County Budget & Finance WakeGOV.com

WATCH
Wake Accountability Tax Check
Watch how your tax dollars are used.

Fiscal Year 2011 General Fund Transactions - July, 2010 through March, 2011
Show previous fiscal year

Ask a question about this information

Current Filter Criteria — Set Filter Criteria
Department: --All-- Expenditure Category: --All--
Vendor:

Department	Division	Cost Center	Expenditure Category	Expenditure Line Item	Vendor/Description	Budgeted Amount	Actual Amount
Board Of Commissioners						$459,651.82	$343,565.04
Board Of Elections						$3,009,544.14	$2,708,588.73
Budget And Management Services						$0.00	$12,155.53
Capital Lease						$0.00	$4,813.02
CCBI						$4,175,713.08	$3,073,281.17
Community Services						$25,585,052.74	$18,842,350.29
County Attorney						$1,482,483.28	$1,044,829.55
County Manager						$1,457,187.52	$1,034,662.77
Emergency Medical Services						$20,294,870.12	$15,150,044.75
Environmental Services						$7,828,118.84	$8,031,057.43
Facilities Design & Construction						$1,094,272.84	$758,813.38
Finance Department						$2,955,370.76	$1,934,527.93
Fire and Emergency Management						$1,984,957.41	$1,629,382.26
General Services Administration						$23,976,157.94	$18,150,559.40
Human Resources Department						$1,895,126.94	$1,248,578.97
Human Services Department						$226,108,592.68	$158,566,122.51
Information Services						$11,956,868.68	$8,696,761.54
Medical Examiner						$195,000.00	$106,600.00
Non Departmental						$10,834,017.62	$10,056,793.63
Public Safety Communications						$1,033,480.00	$1,013,285.98
Register Of Deeds						$2,944,046.32	$2,069,396.23
Revenue Department						$5,215,145.64	$3,946,966.16
Sheriff						$60,781,761.72	$43,983,156.38
Transfers						$209,069,000.00	$37,372,032.63
Wake County Public School System						$313,503,224.00	$235,127,418.00
Wake Technical College						$15,991,050.00	$11,993,283.00
Grand Total						**$953,830,694.09**	**$586,899,026.28**

- Newspapers across the state post salaries of state and local employees in easy-to-use databases.
- *NCTransparency.com* acts as a portal to transparency resources available online.
- The basics of transparency can be handled at little cost if the commitment exists. The town of Columbus (population 1,000) was able to put its payments online each month.
- State and local governments generally have also made their operations and processes more transparent with online meeting calendars and agendas.
- Open data standards allow better analysis of data and make it possible to combine with other online sources. Examples include *PadMapper.com* and *recovery.org*.

Analyst: Joseph Coletti
Director of Health and Fiscal Policy Studies
919-828-3876 • jcoletti@johnlocke.org

Chatham County's Open-Government Web Site
(*http://www.chathamnc.org/Index.aspx?page=1502*, screen capture)

Home | Local Information | County Government | Departments & Programs | Resident Information | Visitor Information | Business Information | Community Contacts

CHATHAM COUNTY NORTH CAROLINA

Quick Links | Search... | SEARCH

County Government

County Government 101
County Calendar
News & Updates
Board of Commissioners
Commissioner Meetings
Commissioner Resolutions & Agreements
Open Government
Monthly Checkbook Registers
County Ordinances
County Boards and Committees
County Budget
FY 2010-11 Bid Opportunities
Legal Notices
Learn More about Your County
Citizen Reports, Surveys & Newsletters
Employment Opportunities
Online Services
Site Map
Sign Up for e-Notifier

Open Government

Chatham County is in the process of adding information to the website to make government operations more transparent to the public it serves. We will be addiing more items over the next few weeks, including videos of the Board of Commissioners meetings and specific financial information.

Sign Up for E-Notices: Stay informed on county government activities and meetings by signing for email notices. You can choose from an array of choices, including upcoming Board of Commissioner meeting agendas, county news releases, department events, etc.

Sign Up for Public Input: You can sign up online to provide comments at public hearings or public input sessions. You also can submit written comments using this same form.

County Positions by Department: Shows the number of full-time equivalent county positions by department, as of the current adopted budget.

Statewide Study of County Salaries (includes Health Care Costs): Includes salaries by county of key positions and health care costs. Report from the School of Government at UNC-Chapel Hill provides 2010 data.

County Budget: Includes links to current adopted budget as well as budgets for the past few years.

Five-Year Capital Improvement Plans: Provides links to the current and most recent previous five-year capital improvement plans for the county.

County Financial Audits (includes full Annual Financial Information Report): Includes links to the most recent audits of the county. Chatham County has consistently won the top national awards for its comprehensive audit reports.

Checkbook Registers: Includes monthly checkbook register statements, effective December 2010.

Obligations for Future Retirees: Includes fiscal liability for county payments of separation allowance for future law enforcement retirees. **See pages 3-5.**

Proposed & Adopted Resolutions and Agreements: Includes copies of proposed resolutions or agreements that are up for

Recommendations

Local governments should focus on making their communities conducive to economic growth and business investment by keeping property taxes, sales taxes, and business regulations and fees low. Furthermore, they should avoid implementing new taxes such as land-transfer taxes that many counties have considered over the past several years.

They should also focus on essential government services, making sure that these services meet the needs of business. This focus would include providing reliable sources of water and transportation services that accommodate the desired lifestyles of the workforce and the needs of industry. It cannot be accomplished by targeting businesses for special subsidies while burdening local businesses and citizens with the cost of those subsidies.

Background

North Carolina's county governments divert hundreds of millions of dollars to individual businesses in an attempt to attract economic growth and job creation to their communities. These subsidies come in a variety of forms, including property tax exemptions, direct cash grants (about 42 percent of all subsidies), land conveyances, and low-interest loans.

According to *The Incentives Game: North Carolina Economic Development Incentives*, a 2007 study by the North Carolina Institute for Constitutional Law, local governments in the state have shelled out over $403 million in incentive packages in the period between 2004 and 2006. This represents 66 of the 92 counties from which NCICL was able to obtain data.

Of North Carolina's 100 counties, 26 provided no incentives during this period. By far the largest incentive package during this time came from Caldwell County in its well-publicized deal with Google, which totaled $165 million. Most grants are much smaller than that. Most of the largesse comes in smaller amounts of less than a million dollars.

Setting aside Caldwell County, which was an anomaly during this time period, subsidies ranged from a high of $140 per county resident in Forsyth County down to a low of $0.40 per resident in Harnett County.

Analysis

While subsidies may benefit the targeted business and entice it to locate its operations within the county, they harm existing businesses and other taxpayers. Such policies do not generate net benefits for a county. Instead they simply hurt some and help others.

There's no such thing as a free subsidy. When a county decides to use tax dollars to entice a new company to set up shop in a community, that money has to come from somewhere. Local businesses and their employees must pay more in taxes and other costs to support the subsidized industry. That is why such programs are referred to as corporate welfare. Since higher taxes are an added cost of doing business, these subsidies depress economic growth for those businesses not receiving subsidies. In reality, the subsidies end up being a mechanism for transferring wealth from existing businesses to the subsidized businesses and the people who work for them.

Higher taxes for the community at large are not the only way existing businesses must pay the cost of these subsidies. The subsidized entrants into the market add to the demand for workers and other resources (land, for example), driving up costs for all businesses. That means existing businesses not only have to pay for the subsidies through higher taxes but, adding insult to injury, they may also face higher production costs.

An additional effect of the subsidies is to exempt the subsidized businesses from bearing the costs of infrastructure needs that their presence generates. These include the costs of road construction, police and fire services, and construction of new schools and other public facilities. It has also become clear that many communities will have to make additional investments in reservoirs and other new sources of water. Bonds will be

Related Topics: **Smart Growth**, p. 30; **Land Use and Zoning**, p. 28; **Affordable Housing**, p. 32; **Stadiums, Water Parks, Restaurants, etc.**, p. 24; **Convention Centers**, p. 26.

Per-Capita Business Subsidies (Incentives) by County, Highest to Lowest (2004-06)

County	Subsidy Per Person	County	Subsidy Per Person	County	Subsidy Per Person	County	Subsidy Per Person
Caldwell	$2,095.45	Rockingham	$45.91	Rowan	$17.27	Person	$7.70
Forsyth	$140.02	Bladen	$45.16	Greene	$15.88	Pender	$7.62
Lenoir	$124.22	Chatham	$42.74	Wayne	$14.09	Alamance	$3.85
New Hanover	$95.48	Nash	$42.50	Randolph	$13.77	Stokes	$3.36
Richmond	$87.05	Lincoln	$40.09	Ashe	$13.71	Henderson	$3.33
Northampton	$86.41	Wake	$38.78	Guilford	$13.53	Martin	$3.29
Hoke	$73.66	McDowell	$38.24	Granville	$13.17	Columbus	$3.08
Johnston	$70.04	Cleveland	$36.34	Mitchell	$13.05	Scotland	$2.23
Halifax	$65.38	Craven	$31.58	Cumberland	$12.82	Pitt	$1.93
Iredell	$63.98	Anson	$30.08	Robeson	$12.78	Franklin	$1.73
Alleghany	$60.60	Davie	$29.12	Mecklenburg	$10.83	Carteret	$1.58
Gaston	$57.39	Lee	$27.07	Jones	$9.87	Wilkes	$1.56
Beaufort	$55.85	Transylvania	$24.21	Stanly	$9.84	Warren	$1.24
Surry	$52.43	Davidson	$22.64	Rutherford	$8.92	Moore	$1.22
Catawba	$52.08	Durham	$22.32	Union	$8.52	Yadkin	$0.53
Wilson	$50.63	Cabarrus	$21.59	Buncombe	$8.27	Harnett	$0.40
Pamlico	$49.80						

Sources: North Carolina Institute for Constitutional Law, The Incentives Game*, 2007; the U.S. Census Bureau.*

floated to pay for all this, which will have to be paid back with future property and sales taxes. Many corporate welfare schemes enacted by localities will simply allow these new, subsidized businesses to be free riders. Again, this adds to the tax burden on the rest of the community.

Economic growth, not economic development

There is an alternative. Counties should pursue a policy not of targeted economic development, but of *sustained economic growth*, making the possibility of investment attractive to all businesses. This policy would seek to keep property taxes, sales taxes, and business fees low. But beyond that, the policy should also focus on keeping land-use and other regulations to a minimum. Such regulations drive up housing and land costs, both of which make investment less attractive.

The primary role of local government is to provide for sound and reliable infrastructure services. The latter includes effective police and fire departments, efficient trash collection, a road system that is kept in good repair, a safe and instructionally effective school system, and a dependable sewer system and water supply that can accommodate economic growth.

The goal should be to create an environment that is conducive to investment and business activity, not for a politically favored few, but for all potential entrepreneurs.

Analyst: Dr. Roy Cordato
Vice President for Research and Resident Scholar
919-828-3876 • rcordato@johnlocke.org

Recommendation

Cities and counties should establish an aggressive competitive sourcing policy that includes most, if not all, governmental services.

Background

What is competitive sourcing? It is the competitive process for determining the most efficient and effective source — private or public — for performing a specific governmental function or service. The first step is to define a service or a function and take bids from private and public providers. The lowest bid wins. Whether the service stays in-house with government employees or is contracted out to a private provider, taxpayers are the victors. The competitive process ensures that the service is provided at the lowest price. As such, it provides a powerful tool for officials to cut costs while providing essential governmental services. Savings of 5 to 50 percent due to competitive sourcing have been reported, with savings in the amount of 20 to 30 percent being common.

What city and county services can be competitively sourced? When the newly incorporated town of Sandy Springs, Georgia, reviewed its options for providing city services in 2005, it compared the price and quality of services previously provided by Fulton County to a bid by the international management firm CH2M Hill OMI. There was no comparison. CH2M Hill OMI saved the city nearly 50 percent of the county costs for the same services, as reported by Steve Stanek and Leonard Gilroy for the Reason Foundation on November 1, 2006 (*www.reason.org/news/show/122369.html*).

According to Sandy Springs' first mayor, Eva Galambos,

> All the public works, all the community development, all the administrative stuff, the finance department, everything is done by CH2M Hill. The only services the city pays to its own employees are for public safety and the court to handle ordinance violations.

Sandy Springs decided to provide public safety by creating its own police and fire departments. According to Galambos, the city would have preferred to hire a private fire company, but none was available in the area.

See this Reason TV video online that explains the Sandy Springs contract city approach: *reason.tv/video/show/sandy-springs-georgia-the-city*

How does competitive sourcing save scarce tax dollars? The general public knows almost by instinct three essential and interrelated economic principles: competition, specialization, and bulk buying all save money. But these principles are often forgotten when it comes to providing city services. There is a misguided belief that city services can be provided by city agencies that don't face competition and are often not large enough to take advantage of specialization and buying in quantity.

Analyst: Dr. Michael Sanera
Director of Research and Local Government Studies
919-828-3876 • msanera@johnlocke.org

Examples of Competitive Sourcing Across the United States

Philadelphia

Privatized 49 government services under Mayor Ed Rendell in the 1990s. • Outsourced services ran from golf courses to prison services to cleaning City Hall. • Privatizing one nursing home cut costs by 54 percent ($27 million). • Efforts saved the city $275 million. • Rendell took office in '92, and privatization and other cost-cutting measures eliminated the city's major structural deficit by Fall 1993 — without raising taxes.

New York City

Under Mayor Rudy Giuliani, entered into performance-based contracts with private companies to provide such services as homeless shelters, water-meter readings, and placing welfare applicants into jobs.• Found private organizations willing to take on underperforming city services. • For example, Central Park management was given to the Central Park Conservancy, a group of private citizens, whose efforts produced four times the fundraising and much better upkeep for the park. • These efforts saved the city $6.2 billion.

Chicago

Led by Mayor Richard Daley, privatized more than 40 services. • Savings from 1995 to 2005 totaled $175 million. • Savings do not include the city's lease of the Chicago Skyway for $1.83 billion in 2005 nor its sale of municipal parking lots to Morgan Stanley for $563 million in 2006. • Chicago now plans to lease its Midway Airport.

Baltimore

Began competitive sourcing during a major budget crisis in 2001. • Baltimore had closed its public libraries and fire stations, but still needed to reduce costs. • After competitive sourcing, Baltimore has posted annual savings that exceed $8 million. • These savings came from just eight programs being put up for bid to the private sector.

Indianapolis

From 1992 to 1999, under the direction of Mayor Stephen Goldsmith, accepted bids from private companies to compete with existing city agencies to perform more than 80 government services. • Services included sewer, trash, meter ticketing, the Indianapolis Water Company, and (until 2006) the Indianapolis International Airport. • Significant savings totaled approximately $400 million. • $15 million were saved from trash collection. • $68 million were saved from the sewer plant, a 44 percent reduction in costs.

Phoenix, Arizona

Accepted competitive bids for government services in 1979, saving over $41.8 million. • Competitively sourced functions range from billing services to emergency transportation. • Of the 65 contracts that the city government has put up for bid since 1979, 40 have been awarded to private companies, and the rest are performed by government employees.

Weston, Florida

Has only nine public employees on its payroll for a city of more than 61,000 residents. • City services contracted to private companies include police and fire depts., finance and administration, community services (parks and recreation), and planning and zoning. • Weston boasts that its competitive sourcing approach allows it to "acquire and delete the amount of service it needs at a specific time" and to avoid "maintaining burdensome overhead."

Johns Creek, Georgia

Followed the Sandy Springs model when incorporated in 2006 with 65,000 residents. • Contracted with CH2M Hill OMI before its "opening." • Made CH2M Hill OMI responsible for design and implementation of all future town functions, except public safety. • That was done in fewer than 90 days, allowing Johns Creek to need just five public employees. • Received the US Conference of Mayors' Public/Private Partnership Award in January 2008.

Recommendation

Local government appropriations to school districts should be tied to performance-based measures and innovative practices that ensure sound expenditure of local tax dollars.

Background

According to state law, local governments have two primary responsibilities related to the public school districts within their jurisdictions. First, local officials must examine all information bearing on the financial operation of the local school district to determine how much local tax revenue to appropriate to the district. Approximately 24 percent of total spending on public education in North Carolina comes from local sources.

Second, local officials must collaborate with boards of education to oversee funding, construction, renovation, and maintenance of public school facilities. County commissions have the power to acquire property on behalf of a board of education, as well as construct, equip, expand, improve, or renovate property for use by a local school system. They may also allow local boards of education to build schools on property owned in fee simple by the county. In most cases, county commissions and local boards of education accept discrete responsibilities for school facilities. School districts manage the school facilities program, while school districts rely on county commissioners to approve debt funding in the form of certificates of participation and installment purchase contracts (neither of which require voter approval) or general obligation bonds (which require voter approval).

The state also permits local governments to impose local option sales taxes, land-transfer taxes, and other supplementary taxes to pay for school facilities. In addition to taxing authority, the state provides lottery transfers and corporate income-tax revenue to counties for their school capital needs. Since 1995, North Carolina's local governments spent an average of $764 million per year on school facilities, which represented over 84 percent of all public school capital expenditures in the state.

Related Topic: **Debt**, p. 6.

General principles

While school boards control much of the educational, organizational, and financial operations of school districts, local governments can guide districts toward maintaining an efficient, responsive, and high-performing public school system.

Principle 1: *Local governments should closely monitor county appropriations to school districts and measure the effectiveness of the funding.*

For the 2009-10 school year, local governments in North Carolina allocated nearly $2.7 billion — or an average of $1,931 per pupil — in county appropriations, supplemental taxes, and other revenue sources for public schools. Given the amount of money involved, local government officials have the responsibility to monitor and hold school boards accountable for the use or misuse of local tax dollars allocated to school districts.

Principle 2: *Local governments should pay special attention to spending on school district personnel.*

Salary and benefits for school personnel represent the largest single category of expenditures by local government in North Carolina. Last year, local governments spent $1.7 billion on salary and benefits for school personnel, accounting for approximately 64 percent of their total expenditures on public education. The use of local funds for the salaries and benefits of teachers, administrators, and other personnel should be closely tied to various performance measures as well as adjusted to reflect yearly enrollment changes.

Specifically, school systems should use outcome-based measures, including test scores and value-added analyses, to reward the efforts of successful teachers and administrators. Local funds should also be used to attract highly qualified science, mathematics, and special-education teachers to low-performing schools.

Principle 3: *Local governments should ensure a transparent public school budget process.*

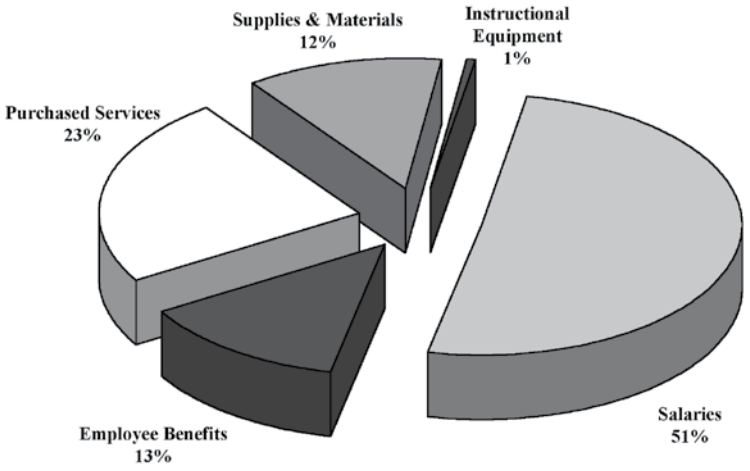
All budget reports and documents used in the public school budget process should be complete, accurate, and relatively free of jargon, acronyms, and technical language. Moreover, taxpayers should be able to access and

download all budget documents quickly and easily from a local government website.

Principle 4: *Local governments should minimize the amount of debt incurred for school capital expenses by offering incentives to school districts to use proven, cost-efficient solutions that do not burden county taxpayers and that enhance educational opportunities for students.*

Last year, local government debt service for school facilities reached $848 million, the result of debt financed to maintain costly school-construction programs. Charter schools, public/private partnerships, adaptive-reuse buildings, ninth-grade centers, satellite campuses, and virtual schools allow school districts to increase school building capacity faster and more cheaply than conventional school construction and renovation methods permit.

School Expenditures from Local Funding, 2009-10



Source: North Carolina Department of Public Instruction, "Table 22 – North Carolina Current Expense Expenditures by Source of Funds, 2009-10," *North Carolina Public Schools Statistical Profile* (online), *apps.schools.nc.gov/pls/apex/f?p=1:1:6959090718055221.*

Taking the guesswork out of the budget process

Local governments should revise the budget process to include a host of quantifiable or measurable goals and specific strategies used to achieve those goals. The state and federal governments provide several measures of student achievement, but they do not provide enough information to anyone attempting to determine whether a school district uses its local funding to increase student achievement.

As part of the budget process, local governments should require school districts to supplement state and federal data with annual studies, audits, and surveys, providing a comprehensive assessment of school district performance. These data would provide measurable goals that form the basis of a sound budget process that ultimately determines whether school districts spend local tax dollars productively.

Analyst: Dr. Terry Stoops
Director of Education Studies
919-828-3876 • tstoops@johnlocke.org

Recommendation

North Carolina city and county water and wastewater services should be contracted to private firms or converted into privately owned, government-regulated services.

Background

Privatizing water and wastewater services is not a radical idea. More than 40 percent of the nation's drinking water systems are privately owned with government regulation controlling quality and price.

Many of North Carolina communities' problems with fresh water and wastewater services could be solved by privatization. The drought of 2007 caused several communities to place strict controls, enforced with $1,000 fines, on how citizens used water. This exclusive focus on reducing demand through coercion diverted the public's attention away from government failures to price water properly (in order to manage demand voluntarily) and plan for adequate supply. But local governments often respond to political incentives and set prices well below the market rate, which inevitably leads to shortages. Private ownership creates incentives to price water based on market forces — including a temporary greater scarcity of water owing to drought — and to increase the water supply and avoid shortages.

Citizens have also experienced serious contamination of fresh water from government wastewater systems. For example, Wilmington was forced to close swimming and fishing areas when four million gallons of untreated sewage went into Hewletts Creek. Cary had similar problems when millions of gallons in raw sewage contaminated Swift Creek, causing the closure of Lake Wheeler and Lake Benson. With privatization, such problems are less frequent. Private companies facing competition for government contracts have additional incentives to act responsibly and prevent contamination.

Additional advantages of water privatization

The U.S. Clean Water Act requires cities and counties to install costly equipment to prevent water pollution. The Environmental Protection Agency suggests privatization for cities to meet this federal mandate because of the increased efficiency of private-sector firms. In many cases, areas that have chosen this path have even seen private firms surpass EPA standards.

Privatization contracts often include cost, quality, and customer service criteria that private servers must adhere to in order to maintain their contracts.

With public water operations, citizens have fewer guarantees of those criteria. A city whose public water system is inefficient faces few consequences. A private supplier that is inefficient or endangers water quality, however, risks losing its contract to a competitor. For these reasons, citizens benefit greatly from the privatization of water.

Should we trust the private sector?

Through government regulation, water safety is achieved in both publicly funded and privately owned water services. The profits of private water companies are contingent on their maintenance of high levels of safety. Many other indispensible goods, including food and medicine, are well provided through the private sector. People trust that with government oversight and private companies' incentive to maintain a positive image, those goods will be safe. Private water service is no different.

With water provided by a private firm that must adhere to strict quality regulations, water safety is preserved and can even be improved.

How do local officials maintain control and accountability of private providers?

Public officials can easily write water and wastewater contracts that specify measurable performance standards by which the officials can monitor private firms. By providing compensation only when the contract firms meet their standards, local governments are able to maintain a high level of control over the water supply. The contracts can include both safety and quality terms, as well as be flexible to a community's particular needs.

2010 Award-Winning Private Water Service Systems

City	*Award*	*Private Company*	*Reason for Award*
Schenectady, NY	U.S. Conf. of Mayors Excellence in Public/Private Partnership Award	Veolia Water North America	Wastewater management
Indianapolis, IN	Two Platinum Peak Performance Awards from National Association Of Clean Water Agencies	United Water	Wastewater plant management
Owenton, KY	EPA's Area-Wide Optimization Program and KY Energy and Environment Cabinet	Kentucky American Water	Water quality improvement
La Vergne, TN	CDC's Water Fluoridation Quality Award (2008)	Severn Trent Services	Fluoride level management
24 facilities	EPA's Director's Awards for exceeding water treatment standards	American Water	Water treatment facilities

Source: Annual Privatization Report 2010: Water and Wastewater, Leonard Gilroy, editor, Reason Foundation, March 2011.

2010 Water and Wastewater Contracts (Partial List)

City/County	*Private Company*	*Contract Years*	*Contract Amount*	*Reason for Contract*
Buffalo, NY	Veolia Water North America	10	$53 million	City's water system (operation & mgt.)
Hialeah, FL	Inima USA	20	$141.2 million	Desalinization plant (DBO*)
Pima County, AZ	CH2M Hill	20	$172 million	Water reclamation plant (DBO)*
Fulton County, GA	Veolia Water North America	5	$58 million	Operate 4 wastewater and 30 pump stations
East Providence, RI	United Water	10	DBO* ($52.5 million of upgrades)	Wastewater collection and treatment (DBO)*
Prichard, AL	Severn Trent Services	5	Not available	Operate and maintain water and wastewater plant (contract renewal)
Hollister, CA	Veolia Water North America	10	$6.88 million	Manage new wastewater plant
Clovis, CA	CH2M Hill	10	Not available	Wastewater plant

Source: Annual Privatization Report 2010: Water and Wastewater. **Design, Build, and Operate*

When a local government opts to convert its water operations to a private service, it can retain some power through regulation. If the private firm fails to adhere to the regulations, it risks being fined, losing customers, or being shut down.

For those reasons, private water systems have an incentive to follow the regulations and deliver a high-quality service at a competitive price.

Analyst: Dr. Michael Sanera
Director of Research and Local Government Studies
919-828-3876 • msanera@johnlocke.org

Recommendations

Cities and counties should restructure their parks and recreation departments to eliminate activities and services that are offered or could be offered by private businesses and those that serve only a small minority of residents. Local governments should also implement user fees to recover the full costs of services that benefit only specialized groups.

Background

Traditionally, city and county parks and recreation (P&R) departments provided the general public with parks and user-fee-supported sports leagues — soccer, softball, etc. Now, many P&R departments have expanded well beyond these boundaries. Some provide uncommon services that benefit only a handful of citizens, such as golf courses and equestrian centers. P&R departments also provide many services and facilities already offered by the private sector — full-service gyms, martial arts instruction, etc. These tax-supported P&R activities unfairly compete with private-sector providers. It is not only that they receive tax money, but also that they don't pay taxes. Thus the taxpayer cost of these subsidized activities is not just the direct tax subsidy, but also the lost taxes that would have been paid by private providers.

In addition, P&R department activities result in a political constituency that benefits elected politicians and P&R bureaucrats. By providing a free or highly subsidized activity, the P&R department creates a special-interest group out of people interested in that activity who will lobby for its continuation and expansion, transferring the costs to taxpayers who may not benefit. For example, the losses incurred by city golf courses (see chart) are paid by the general taxpayers for the benefit of a small group of golfers, whose incomes are generally higher than the average city taxpayer's. If local P&R departments can provide yoga, kickboxing, golf courses, equestrian centers, extreme sports, cooking classes, vermicomposting (worms) classes, etc., are there any limits on what they can provide to a specialized interest group using taxpayer subsidies?

General principles

In order to serve the parks and recreational interests of the general public rather than special interests, local government officials should follow three guiding principles to keep P&R departments within proper boundaries.

Principle 1: *P&R departments should not compete with services already provided by the private sector (for-profit and nonprofit).*

Across North Carolina, many private recreational centers provide golf courses, gyms, equestrian centers, and other activities. Those private facilities are sources of income for many North Carolinians. When P&R departments operate similar facilities, they threaten the businesses of these citizens. As government departments, they have an unfair advantage over private-sector services: their access to tax dollars shelters them from risk, and they aren't burdened with the additional overhead cost of having to pay taxes on their facilities and land.

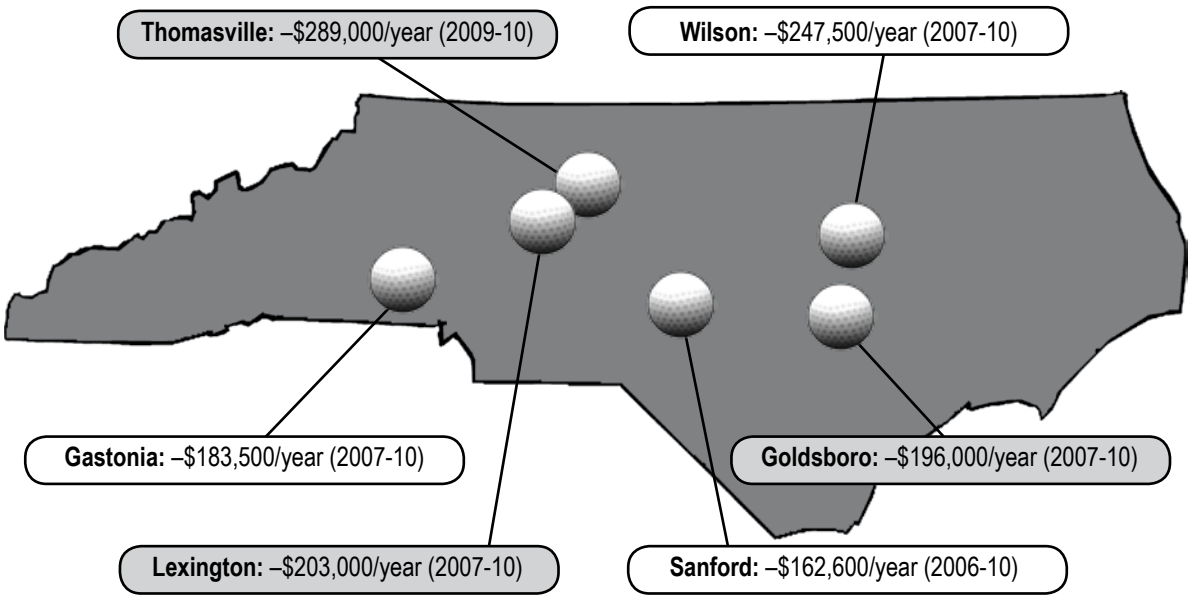
Public facilities also compete with private, nonprofit firms such as the YMCA. These organizations rely on user fees and private charitable donations to stay open and pay employees. Competition from taxpayer-funded P&R departments is harmful and unfair to them.

It is also unfair to shackle taxpaying individuals and businesses with the costs of providing superfluous facilities and services.

Principle 2: *Where services are provided for specific activities, user charges should capture the total costs of the activity.*

Community members who do not benefit from specialized P&R department services should not have to bear their costs. User fees should be set at levels that would capture all the costs, including capital costs, administration costs, maintenance costs, and the taxes that would have been charged had the service been provided by the private sector. For example, softball league user fees should cover the costs associated with a public softball complex. Local governments should implement accounting systems to ensure that these costs are fully recovered. P&R departments should use their limited

Recent Average Annual Losses By City-Owned Golf Courses



Sources: Individual cities' financial information. For earlier years, see Dr. Michael Sanera, "Sell Government Golf Courses," March 12, 2009, *www.johnlocke.org/lockerroom/lockerroom.html?id=19267*.

funds to offer services that are beneficial to the entire community.

Principle 3: *Cities and counties should divest themselves of services that are used by a small minority of the population or the upper-income segments of the community.*

When local governments use taxpayer funds to subsidize highly specialized recreational activities, they are benefiting a tiny segment of the community at the expense of the whole community. This problem has manifested itself in North Carolina most noticeably in city-owned golf courses. In general, higher-income individuals tend to use these more than others. Taxpayers should not have to fund these projects, because they do not benefit most people.

City–owned and operated golf courses also unfairly compete with private courses. The private courses pay taxes, portions of which go to subsidize their competition. In addition, many private courses are open to the public and charge green fees comparable to the subsidized rates at the city courses. P&R departments should get the most out of taxpayer funds by investing in recreational facilities and services that benefit a majority of community members without competing against other community businesses.

Analyst: Dr. Michael Sanera
Director of Research and Local Government Studies
919-828-3876 • msanera@johnlocke.org

Recommendations

Communities should recognize the changing economics of air travel and not expend resources pursuing questionable attempts to attract or keep air service.

Background

Airline economics. The economics of the airline industry has changed dramatically in recent years, with the bar being raised for communities to retain scheduled air service. This is a trend that will continue in the future, with more communities likely to lose scheduled airline service over time. In addition, it will be difficult for communities outside of Charlotte, Raleigh, and Greensboro to attract and keep additional air service.

Diffuse demand. While there is demand for air travel from many communities, it is diffuse as it involves people going to a multitude of different final destinations. Only the state's top markets generate enough travelers to fill even a single daily flight to a single destination. To address this problem, airlines operate connecting points — hubs — which allow them to bring passengers going to different locations (spokes) to a single location and change planes to their final destinations.

Hubbing airlines. Cities such as Charlotte (CLT) used to have their hubs paid for through higher fares. The hubbing airline dominated the market, while low-cost carriers offered limited competition. Now most travelers want to go to major destinations, and low-cost carriers like Southwest and jetBlue have increasingly focused on bigger markets. Charlotte has become much more competitive in the past few years. U.S. Department of Transportation data show Charlotte flyers paid an average 11 percent fare premium in the third quarter of 2010 — while still high, it is nowhere near the 38 percent higher prices at CLT eight years ago.

Higher cost per average seat mile. The aircraft that are used to serve smaller communities have a higher cost per average seat mile (CASM) than the larger jets commonly flown out of Charlotte and Raleigh-Durham (RDU). To compensate for the higher CASM, airlines must charge a higher price to serve smaller communities. Unsurprisingly, many travelers bypass their local airport and drive to Charlotte or Raleigh to take advantage of the lower fares and greater variety of flights.

In a March 21, 2007, article in the Washington Daily News, Jim Turcotte, general manager of the Pitt-Greenville Airport, estimated that 75 percent of the city's air passengers drive to RDU rather than using Greenville's five flights a day to US Airways' Charlotte hub.

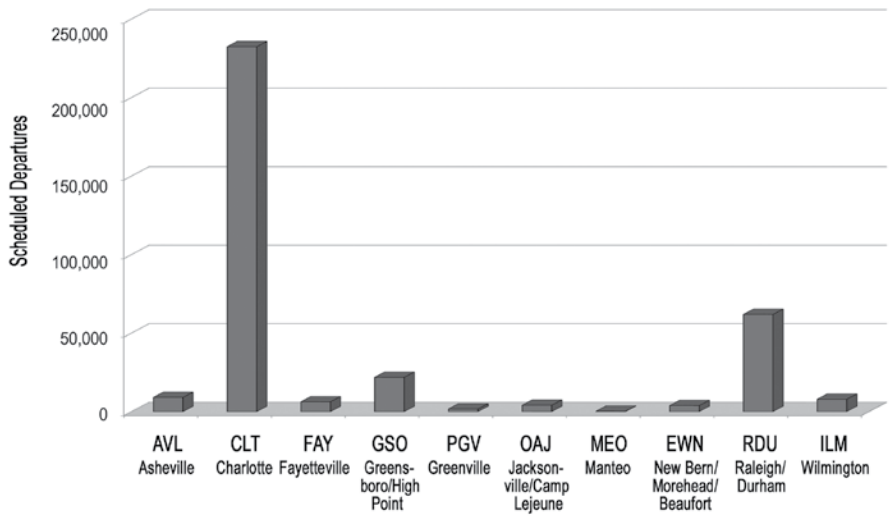
"We're selling convenience," Turcotte said. But at the higher prices, most customers are not buying.

Complicating matters is that the type of aircraft traditionally used to serve smaller communities, the 19-seat turboprop, is simply no longer cost-effective and has largely been withdrawn from service in the U.S. Communities such as Hickory, Kinston, Moore County (Southern Pines), Rocky Mount, and Winston-Salem that can't generate enough passengers to support 37- to 50-seat aircraft have simply lost all service. Likewise, non-stop service between cities such as Raleigh-Asheville, Raleigh-Norfolk, and Raleigh-Charleston, S.C., that had relied upon 19-seat turboprops has also disappeared.

Consolidation means fewer hubs. The recent Delta/Northwest and United/Continental mergers are expected to bring about fewer but larger hubs. Most of the surviving hubs, with Charlotte as a notable exception, will also be located in the nation's largest cities. Unfortunately, many of these hub sites, such as Dallas, Houston, and Chicago, are located a considerable distance from North Carolina. Sheer distance will create a challenge to communities outside of Charlotte, Raleigh, and Greensboro to attract and retain service to these cities. The 50-seat regional jets that are used to provide service to such secondary destinations are relatively inefficient when operated on routes beyond 500 or 600 miles, a situation made all the worse by high fuel prices. Service that exists today may be discontinued if fuel prices remain high. This is especially true for service that began in the past year or two.

Larger planes. In the medium term, the bar for air service will rise again. The smallest airliners now in common usage, those seating 50 or fewer passengers,

Scheduled Departures from NC Airports (March 2010-February 2011)



Source: Research and Innovative Technology Administration, Bureau of Transportation Statitiscs, http://www.transtats.bts.gov/airports.asp

have largely gone out of production in the last few years. Airlines are beginning to replace their existing fleets of 37- to 50-seaters with planes that carry 66 or more passengers. High fuel prices will accelerate this trend.

Flights offered at limited times and for few destinations are not tools for economic development. An exception to the traditional hub-and-spoke model is provided by airlines like Allegiant Air, which offers a flight a few days a week — and sometimes only seasonally at that — to popular vacation destinations like Orlando and Tampa Bay from secondary markets including Greensboro and Wilmington. Allegiant's success is prompting several new entrants, each of which is aiming at somewhat different niche vacation destinations. While such flights are a welcome development for leisure travelers, they offer essentially no opportunity for connections to other cities. As such, these flights offer nothing for business travelers and cannot be considered tools for economic development.

New entrants have a tough time. The airline industry has traditionally been unkind to new entrants, and offering government incentives to startups doesn't change that equation. Among the recent startups to fail was Skybus Airlines. Despite that airline's having been in business for all of five months and operating five planes at the time, Piedmont Triad International Airport (PTI), regional economic development groups, and the state still offered Skybus up to $57 million in October 2007 to establish its second focus city at PTI. The airline's PTI operations ramped up in January 2008 and hit 18 flights a day in March — but by early April, the carrier had shut down, even after spending millions of dollars in taxpayer money on advertising.

Fewer private pilots. Despite increases in population and income, the number of private pilots nationally continues to decrease. In 1980, there were 827,000 active pilots. In 2009, there were less than 600,000. High fuel prices and the still-weak economy are likely to lead to further reductions in the number of pilots. Though each airport's situation is different and must be evaluated individually, the continuing decline in general aviation makes government attempts to cater to private pilots a problematic strategy going forward, especially given the potentially high cost and large land area required for infrastructure improvements.

Analyst: Michael Lowrey
Economic Policy Analyst
mlowrey@infionline.net

Recommendation

The actual transportation needs of citizens should dictate what modes of transportation are used in a public transit system. This seemingly obvious recommendation frequently gets lost in discussions about public transit.

Background

Transit systems in North Carolina have become less about providing transportation and more about shaping communities to fit the vision of planners. Transportation policy is too important for much-needed resources to be expended in a manner that has nothing to do with a community's actual transportation needs.

Related Topic: **Smart Growth**, p. 30.

Developing an effective public transit system

Transit is about providing mobility. The proper role of transit is to provide mobility for customers. As transportation expert and University of North Carolina at Charlotte professor emeritus Dr. David Hartgen argues, transit systems should not be viewed "as saviors of urban problems."

Unfortunately, transit has become less about mobility and more about centrally planned communities. Instead of transportation meeting the needs of the community, the community is changed to meet the needs of a specific mode of transportation, such as rail. Supporters of this tail-wagging-the-dog approach call it "transit-oriented development."

A quote by Charlotte-Mecklenburg planning direc-

Long-Range Plan Funds by Mode of Transportation

MPO Region	*Highway*[a]	*Transit*[a]	*Other*[a]	*Total Funding*[a]	*Transit Share of Funds (percent)*	*Transit Share of Commuting (percent)*
Charlotte	$4, 699	$6,346[b]	--	$11,045	57.5%	2.6%
Raleigh	$5,726	$2,174	--	$7,900	27.5%	1.2%
Durham	$2,778	$3,104	$240	$6,122	50.7%	3.0%
Greensboro	$2,955	$743	$115	$3,813	19.5%	1.3%
Winston-Salem	$2,362	$43[d]	--	$2,362	1.8%	1.5%
Fayetteville	$2,153	$200[c]	--	$2,353[e]	8.4%	0.8%
Hickory	$1,680	$116	--	$1,796	6.5%	0.3%
Concord	$1,421	$50[c]	--	$1,471[c]	2.9%	0.4%
Asheville	$1,298[c]	$42[c]	$70[c]	$1,411[c]	3.0%	0.8%
Wilmington	$1,193	$180	$8	$1,380	13.0%	0.9%
High Point	$1,071	$9[e]	--	$1,071	0.8%	1.3%
Gastonia	$934	$95	--	$1,030	9.3%	0.3%
Goldsboro	$900	$34	$11	$945	3.6%	0.4%
Jacksonville	$682	$37	$8	$727	5.1%	0.8%
Greenville	$533	N/A	--	$533	N/A	0.8%
Burlington	$492	N/A	--	$492	N/A	0.1%
Rocky Mount	$322	$1	--	$323	0.4%	0.4%

Notes: a *In thousands of dollars*
b *Latest: $8.4 billion*
c *Estimate*
d *Through 2010*
e *Through 2014*

Source: David. T. Hartgen, Ph.D., "Traffic Congestion in North Carolina: Status, Prospects, and Solutions," John Locke Foundation *Policy Report*, March 2007, Table II.A.2: "Long-Range Plan Funds by Mode," *www.johnlocke.org/site-docs/traffic/01IntroandRecs.pdf.*

tor Debra Campbell in the June 2007 edition of *Governing* is illuminating and chilling:

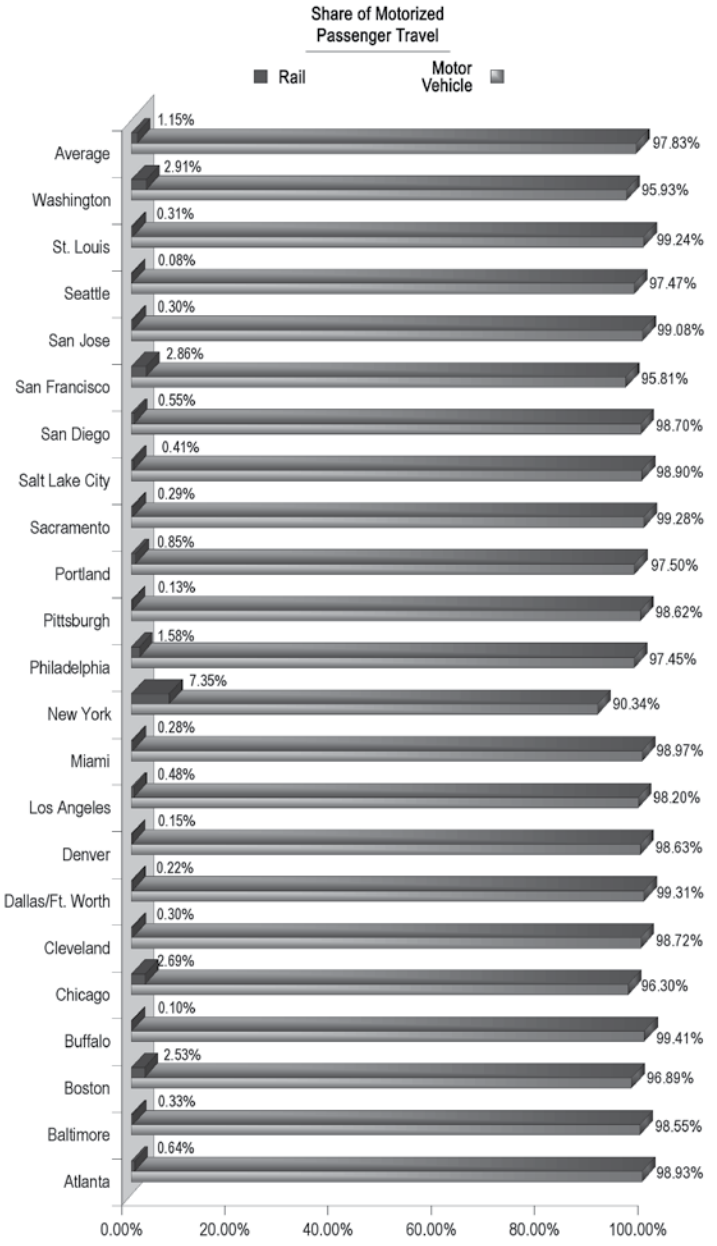
> 'We always saw transit as a means, not an end', says planning director Debra Campbell. 'The real impetus for transit was how it could help us grow in a way that was smart. This really isn't even about building a transit system. It's about place making. It's about building a community.'

Privatize when possible. The government should eliminate existing regulations that make it difficult for private modes of transit to develop, such as private shuttles.

Spend a proportional amount of money on transit. One of the most striking developments in the state's transportation policy is the disproportional share of proposed spending on transit (see the table entitled "Long-Range Plan Funds by Mode"). Spending should be commensurate with how much individuals actually use transit.

Avoid the "romance of rail." Making practical transit improvements, such as designing better bus systems, may not be as exciting as building shiny new community train sets, but rail is a poor way to meet the needs of transit riders. As the accompanying graph shows, the market share of rail even in high-density areas is remarkably low.

Who Travels How? Rail vs. Motor Vehicle Shares of All Motorized Passenger Travel *(by metropolitan area)*



Note: This chart uses data provided by the American Dream Coalition and the Thoreau Institute compiling fields from the National Transit Database. The rail share was calculated by dividing total rail passenger miles by total passenger miles for all travel methods, including rail and automobile.

Analyst: Daren Bakst, J.D., LL.M.
Director of Legal and Regulatory Studies
919-828-3876 • dbakst@johnlocke.org

Recommendation

Cities and counties should not use taxpayer funds to subsidize sports stadiums, water parks, hotels, restaurants, etc., because those activities are inherently private, not public.

Background

Many cities and counties in North Carolina have ignored the distinction between the public and private sectors by subsidizing or outright funding functions that belong to the private sector. Often, city officials pour taxpayers' money into nonessential city activities while letting essential services such as police, fire, and roads suffer.

The usual culprit behind such misplaced priorities is a quest for "economic development." City council members and county commissioners bring in highly paid consultants who tell them that, just by funding a certain new project, they will attract thousands of visitors with pockets full of dollars to prosper their community beyond their wildest dreams. Unfortunately, many elected officials forget the old adage, "if it sounds too good to be true, it probably is." One needs only to remember the thousands that Roanoke Rapids poured into the failed Randy Parton Theater to recognize the folly. Unexpected (or poorly researched) consequences, such as construction cost overruns and low attendance figures, create deficits instead of the promised profits.

Still, with the projects and their deficits usually paid by so-called visitor taxes (taxes on hotel occupancy, car rentals, and prepared meals), the spending may seem easy to justify. The taxes target visitors who cannot vote to hold elected officials accountable for their failures. The taxes also affect many residents, however, especially the prepared-meals tax. In addition, they unfairly tax many for the benefit of a few, with most of the benefits going to downtown property owners and businesses.

Recent examples

Unfortunately, communities in North Carolina are replete with examples of local governments involving themselves in the private sector on unrealized promises of civic benefits:

- ***Winston-Salem/Forsyth County's Dash baseball park***

  When Winston-Salem and Forsyth County's elected officials decided fund a baseball stadium in 2007, they were told it would cost $22.6 million. They should have known better. Construction cost overruns caused the city to cough up over $15.7 million more in loans, grants, and special financing. Since then, the total cost has grown to exceed $48.7 million.

  The owners and city officials declared the ballpark a success at the end of the initial 2010 baseball season, when they reported collecting $8.3 million in total gross revenue. That figure is meaningless, however, without comparing it with the ballpark's expenses, a number that the owners refuse to release, citing "trade secrets." In other words, city taxpayers who have financed this ballpark are being kept in the dark about their investment. Worse, city officials — seeming to cover up their complicity in their bad funding decision — are siding with the owners, not the taxpayers, in arguing that it is perfectly acceptable for the owners to keep the expense figures secret.

- ***U.S. National Whitewater Center***

  When Charlotte area city and county governments agreed to cover the losses of this $38 million center for seven years, they were told that it would make a 20 percent profit in the first year. Instead, it lost $1.7 million. For the fiscal year ending October 31, 2010, the Center reported a profit of nearly $900,000, but that was because it used a very special creative accounting system.

  What the city and county officials in the Charlotte area don't want taxpayers to notice is that the $10 million in reported revenue includes $1.7 million in taxpayer subsidies. These subsidies will continue for seven years, for a total of $12 million. When the subsidy is no longer counted as "revenue," the Center's loss for FY 2010 is nearly $900,000.

Related Topics: **Convention Centers**, p. 26; **Parks and Recreation**, p. 18.

Raleigh Leaders Spend a Mint Trying Their Hand at the Restaurant Business

In 2008, the City of Raleigh spent $1,050,000 to fund The Mint, an upscale restaurant in a city-owned building on Fayetteville Street. The city council not only required the owners to provide service in "white tablecloth metropolitan style," but also dictated the menu: "low country" cuisine. In choosing to favor The Mint, the city council ignored cries of foul from owners of other downtown restaurants and white tablecloth restaurants in other parts of the city.

The Mint signed a nine-year, eleven-month lease with the city. In its first six months rent was free. Then it was to pay about $12,000 monthly. Raleigh is an involved landlord: "substantial modifications" to The Mint's "style, service level, menu items, etc." are subject to council review.

Predictably, The Mint struggled, but just as predictably, the city council was unwilling to give up on its pet project. In April 2011, the city council restructured the lease agreement, reducing The Mint's rent by nearly $1,200 per month for three years in a deal that would supposedly recoup the loss over 10 years with higher rents toward the end of the lease agreement. Of course, the agreement assumes that The Mint lasts that long (or gets yet another bailout by the city taxpayers).

*The Mint in Raleigh (*Carolina Journal *photo).*
Newspaper clipping from The News & Observer*, April 19, 2011.*

Furthermore, the center's creative financial accounting system does not count the $26 million's worth of loans that lenders were forced to write off in 2009.

- ***Charlotte's NASCAR Hall of Fame***

When Charlotte city leaders decided to invest $200 million in the NASCAR Hall of Fame, they were told that the facility would attract 800,000 visitors annually and make a profit of $1.1 million per year. Instead, in FY 2011, the facility will attract only about 250,000 visitors and lose about $1.3 million. Somehow, Charlotte leaders have city taxpayers bailing out a multi-billion-dollar industry.

The most important lesson to be learned from this litany of failure is that city council members and county commissioners spend their own money more prudently and astutely than they spend taxpayers' money. Perhaps they would make better decisions if they were required to put up a $20,000 bond of their own money. If the project fails, the bond goes to pay part of the losses that the taxpayers must support.

Analyst: Dr. Michael Sanera
Director of Research and Local Government Studies
919-828-3876 • msanera@johnlocke.org

Recommendation

Cities and counties should not use taxpayer dollars to subsidize the never-ending losses of city-owned convention centers. They unfairly redistribute wealth from taxpayers to a small number of mostly wealthy property and business owners downtown and do little if anything to improve the overall economy.

Background

Since the late 1990s, cities were caught up in a nationwide mania of building and operating convention centers and nearby hotels, often neglecting essential services in the process. This trend produced a glut of convention center space, causing cities to use tax money to offer large discounts and subsidies to attract conventions.

City leaders often justify the spending by consultant reports that always omit information regarding other cities' experiences with construction cost overruns, huge subsidies, fewer visitors than projected, and more importantly, what economic growth would have resulted from leaving the money in the hands of taxpayers. University of Texas at San Antonio professor Haywood Sanders, the country's foremost academic expert on city convention centers, concludes that the building boom since the late 1990s has resulted in only one highly qualified "success" with the rest of the convention centers being either "embarrassments or disasters." The convention centers in Raleigh and Charlotte fit the latter description.

First come the construction cost overruns

Consultants' reports promoting convention centers habitually underestimate construction costs and overestimate the numbers of conventions and attendees. The original 2003 proposal for the Raleigh convention center was $180 million, plus a $20 million subsidy for a new headquarters hotel. By the time the center was completed in 2008, the price had risen to $221 million.

These cost overruns are consistent with the pattern of cost overruns of other convention centers and other public projects. The conclusion of the first statistically significant study of 258 public transportation projects could also apply to public convention centers:

> …[I]t is found with overwhelming statistical significance that the cost estimates used to decide whether such projects should be built are highly and systematically misleading. **Underestimation cannot be explained by error and is best explained by strategic misrepresentation, that is, lying.** The policy implications are clear: legislators, administrators, investors, media representatives, and members of the public who value honest numbers should not trust cost estimates and cost-benefit analyses produced by project promoters and their analysts (emphasis added). — Bent Flyvbjerg, Mette Skamris Holm, and Søren Buhl, "Underestimating Costs in Public Works Projects: Error or Lie?" *Journal of the American Planning Association*, Vol. 68, No. 3, Summer 2002.

Next come the operating losses

Contrary to the public's perception, convention centers are designed from the start to operate at a loss. Raleigh officials were undisturbed by the fact that their center operated with a $3 million loss in fiscal year (FY) 2010. Likewise, Charlotte officials unapologetically acknowledged a $3.5 million operating loss in FY 2009. Taxpayers face the gross injustice of having to cover those perpetual losses for the benefit for a few businesses and property owners downtown.

Why the losses?

In real-world economics, when supply far exceeds demand, the price must go down for a market to clear. In the world of convention centers, there is such a massive oversupply of space nationally that cities must reduce prices to next to nothing or even subsidize conventions to get groups to use their space. Even before the Raleigh convention center opened its doors in September 2008, its managers gave out more than $2.3 million in discounts to attract conventions and meetings. In an eleven-month period in FY 2011, at least 14 groups will pay nothing or

Related Topics: **Stadiums, Water Parks, Restaurants, etc.**, p. 24; **Convention Centers**, p. 26.

The Raleigh Convention Center and adjoining, city-subsidized Marriott City Center (photo by Don Carrington).

one dollar for space valued at nearly $532,000.

Additionally, the Raleigh, Charlotte, and Greensboro convention centers use taxpayer-funded slush funds to offer subsidies to groups to use the centers. For example, the first six subsidies paid out by the Business Development Fund in Raleigh totaled more than $166,000. Now those funds are running out of money in Charlotte and Raleigh. A recent review of Raleigh's fund shows that the commitments from the fund will exceed revenues by 2014.

Justifying the unjustifiable

How do convention center officials justify this unending drain on taxpayer dollars? First, they argue that the money comes from visitors when they pay special taxes on hotel occupancy, car rentals, and prepared meals. Local residents, however, pay the vast majority of the prepared-meals taxes, and taxing out-of-town hotel and rental-car users is unjust because it is "taxation without representation."

Second, they argue that the conventions bring in out-of-state money to produce an economic impact far larger than the deficits, debt service payments, and subsidies paid to attract them. Raleigh's experience makes a mockery of that argument. Of the 68 conventions and meetings scheduled during FY 2009, only 15 brought in out-of-state attendees who used hotel rooms. Those organizations received, on average, a 62 percent discount on the meeting space.

Even when using an extremely generous formula, they generated only $8.1 million in economic impact. That comes nowhere near the $100 million economic impact promised by center supporters back in 2003, nor the $80 million claimed by Mayor Charles Meeker in 2008, nor even the $25 million goal listed in the city's Performance Standards for FY 2009. Nor could it come close to covering total operating losses, the debt service on the building, and the city's $20 million subsidy to the adjacent hotel, let alone the opportunity cost of tax money taken from Raleigh and Wake County residents.

In other words, a true cost accounting would likely show that the Raleigh convention center, like nearly all other public convention centers around the country, has a negative rather than a positive economic impact.

Analyst: Dr. Michael Sanera
Director of Research and Local Government Studies
919-828-3876 • msanera@johnlocke.org

Recommendation

Elected officials in cities and counties should reform current land-use and zoning regulations to minimize detailed regulatory and political control and maximize individual landowner preferences that respond to constantly changing market trends.

Background

Zoning to control land use originated in Germany in the late 1800s and was adopted in many parts of the U.S. in the 1920s. Progressives enthusiastically spearheaded the movement for adoption and expansion in the U.S. because it matched their ideology that experts should be empowered to remake society regardless of individual preferences and constitutional property-right guarantees.

Current complaints about urban sprawl, lack of mixed-use developments, and other detrimental land-use patterns can be traced to early zoning "best management practices" that strictly separated residential, commercial, and industrial uses of land. Today's planners are attempting to solve problems not by eliminating previous zoning mistakes, but by creating even more complicated and restrictive land-use regulations. (For further reading on topics addressed in this section, see entries under "Land Use and Property Rights" in the Additional Resources section, pp. 38-39.)

Planners should instead break out of their self-imposed planning dogmas and consider reforms that eliminate many current regulations and allow individuals to pursue their own plans for their private property.

Zoning myth and reality

Supporters tout zoning as an objective, professional, and efficient process that controls land uses in ways that benefit the entire community. But as anyone who has experienced it firsthand knows, the zoning process is in reality a highly politicized process where those with power in the community often gain advantages at the expense of those who lack it.

Related Topics: **Smart Growth**, p. 30; **Affordable Housing**, p. 32; **Economic Development Policy**, p. 10; **Eminent Domain**, p. 34.

The result of many of these zoning regulations is to raise the value of existing property and enrich homeowners by reducing the supply of buildable land. Zoning is a way to increase an individual's wealth by voting for restrictive policies that result in higher home and property values.

Back to basics

To reform land-use and zoning regulations in ways beneficial to the entire community, local planners should adhere to the following principles.

Principle 1: *Modern land use must be based on simple rules that allow individuals to pursue their own plans for using their land.*

By simplifying its land-use regulations, Anaheim, California, allowed entrepreneurs successfully to redevelop a run-down light industrial zone. The city added an overlay zone that allowed residential and commercial uses. The city also streamlined its permit and environmental processes to attract developers. These reforms spurred economic development of the area without the use of subsidies or economic incentives.

Unfortunately, Raleigh is going in the opposite direction. Its new land-use plan remakes the city based not on individual preferences, but on the preferences of planners and narrow special-interest groups. The city will require development based on the latest planning fads that require high-density housing with residents traveling in mass transit.

Principle 2: *Depoliticize decisions.*

Elected leaders should also move to depoliticize the zoning process by allowing only those parties directly harmed by the land-use decisions of their neighbors to comment on them. Officials should restructure the process to reflect its original goal of preventing one landowner from using his land directly to harm another's. This reform would go a long way toward taking the politics out of zoning and land-use decisions.

Principle 3: *Impact fees and adequate public facilities ordinances (APFOs) don't solve growth-related problems; they create them.*

The tax base increases dramatically when subdivisions are built on former farmland, providing a revenue windfall to local governments that often claim to need more money via impact fees and AFPOs to handle growth.

©2011, Gary Blakeley. Image from BigStockPhoto.com.

Impact fees and APFOs are intended to compensate the public for the costs associated with increased growth. But to be valid, impact studies must calculate both costs and benefits of growth. Currently, impact-fee and APFO studies calculate only the costs without comparing them to any of the increased revenues associated with growth.

In fact the JLF report "APFOs Research Fatally Flawed" found that:

> Amazingly, in all of the school APFOs studies in the state, the benefit of additional tax revenues generated by new residents buying new homes is completely ignored. Instead, studies estimate public school "mitigation" fees based only on the costs of school capital improvements needed to accommodate newcomers.

The result of impact fees and APFOs is that homebuyers are forced to pay their local governments twice for the costs the city supposedly incurs from growth. Homebuyers pay first in the form of higher housing costs due to impact fees and APFOs and second in property and sales taxes.

Principle 4: *Re-establish the rule of law.*

Many city and county land-use regulations give too much discretion to planning staff, planning boards, and elected bodies, creating a time-consuming process that drives up housing costs. In addition, this discretion provides opportunities for graft, corruption, and favoritism in making land-use decisions. For example, the JLF report "Chatham County's Land Grab" found:

> At least twenty parts of the ordinance specifically granted Chatham County Planning Department officials' powers to determine compliance with the ordinance. For example, under the ordinance: Selective thinning of [landscape] buffers would be allowed, but the planning department would decide whether the thinning violated the "intent of the buffer requirement."

Cities and counties must establish a clear set of simple, flexible written rules. Once a development meets those requirements, the approval should be automatic. By simplifying land-use and zoning regulations, local governments can avoid many of the costly negative effects of excessive government regulation, as well as allow greater freedom for developers and property owners.

Analyst: Dr. Michael Sanera
Director of Research and Local Government Studies
919-828-3876 • msanera@johnlocke.org

Recommendation

North Carolina leaders should embrace a market-friendly approach to growth that favors consumer choices and prices over the restrictive and counterproductive policies known as "Smart Growth."

Background

North Carolina's recent, rapid population growth has created challenges and opportunities for the state's cities and counties. Many local policymakers, seeing only the problems, have resorted to counterproductive land-use, housing, and transit policies called Smart Growth.

Smart Growth policies typically focus on four activities:

- Creating urban growth boundaries, which drive up housing prices beyond the reach of low- and middle-income families.
- Using zoning to restrict housing options to crowded multi-family townhouses and high-rise condos.
- Discouraging driving by limiting spending on road improvements, thus purposely creating more traffic congestion.
- Allocating gasoline taxes paid by auto users ostensibly for roads to be used increasingly to fund mass transit instead.

The results of Smart Growth have been high housing costs, increased traffic congestion, and expensive planning penalties (artificial inflation of a home's price as a response to heavy regulation) for many homebuyers.

Smart Growth prices the middle class out of the housing market

Before the recent housing crisis hit, housing prices in Asheville and Wilmington, cities that have experimented with Smart Growth policies, rose dramatically. In two cities that have stayed away from Smart Growth planning, Fayetteville and Hickory, housing prices have grown at a much slower rate, largely due to allowing supply to keep up with demand. (For further reading on topics addressed in this section, see entries under "Land Use and Property Rights" in the Additional Resources section, pp. 38-39.)

High housing prices make it harder for people to buy homes or upgrade to larger homes as their families grow. This is especially true for low- and middle-income families. North Carolina cities should avoid Smart Growth policies in order to keep housing priced at fair values and promote home ownership.

Smart Growth ignores consumer preferences for single-family housing

Polls indicate that about 80 percent of us want to live in single-family homes with a yard and want the freedom to travel around the urban area in a private auto. Smart Growth advocates ignore these preferences and design policies that severely limit consumer housing choices to crowded, high-rise, tenement-style condos and apartments. While some young, urban, single professionals may prefer this lifestyle, most families with children do not. City land-use policies should aim at facilitating a diversity of consumer choices, not favoring one lifestyle over another.

Smart Growth increases traffic congestion

The high-density housing projects required by Smart Growth land-use regulations also contribute to traffic congestion. Experience in Smart Growth–planned cities shows that high-density housing residents prefer to use their autos. Rather than building more roads to accommodate the increase in demand, Smart Growth principles call for increased spending on expensive rail transit that few people use.

To make matters worse, a large portion of transit funding comes from gasoline excise taxes, which are meant to go toward road construction. This redirection of road funding to mass transit is unfair to the drivers who are forced to pay those taxes. Local governments need to meet the current needs of their community by invest-

Related Topics: **Land Use and Zoning**, p. 28; **Affordable Housing**, p. 32; **Public Transit**, p. 22.

Flex Growth: Healthy Community Growth Without Excessive Government Interference

Pursuing neutrality by avoiding subsidies.
Local policymakers should not offer some businesses subsidies and not others. Rather than forcing the growth of certain industries, they should allow consumer demand to determine how their community will grow. With this approach, only the businesses that can profit in a city, without government aid, will remain in business.

Implementing marginal-cost pricing in growing areas.
Infrastructure costs should accurately reflect the full cost of providing services to a new development. This plan will help cities avoid double taxation of homebuyers as well as prevent sprawl by making it more cost effective to build closer to the city.

Changing zoning laws to allow for development based on consumer demand.
Mixed-use developments should be permitted but not required, in order to allow builders greater freedom for their projects. With this move, consumers will have the ability to control how their community develops. Growth will come from public demand rather than government mandates.

Protecting open space with voluntary programs rather than costly regulations.
Programs such as tax credits and land trusts make it more beneficial for developers to leave room for open space without penalizing them if they choose not to do so. This approach provides an incentive for developers to have open space while avoiding excessive government regulations.

Providing sufficient roads and highways for growing areas.
Rather than investing in mass-transit options such as light rail, which have frequently proven exceedingly costly as well as ineffective at relieving traffic congestion, local governments should improve roadway systems.

Strengthening private property rights.
By giving property owners greater freedom, local leaders will let prices reflect the most valuable use of land in a local market.

Images from BigStockPhoto.com.

ing in roadway projects that reduce traffic congestion instead of using Smart Growth policies to force people from cars to mass transit.

The Flex Growth alternative

Rather than continuing the trend toward Smart Growth, policymakers should move toward a more market- and consumer-oriented approach. JLF analysts have proposed Flex Growth as a way for leaders to face the issues involved with rapid growth while still protecting property rights and individual choice. Flex Growth policies (see above) allow communities to experience healthy growth without excessive government interference.

Analyst: Dr. Michael Sanera
Director of Research and Local Government Studies
919-828-3876 • msanera@johnlocke.org

Recommendations

Cities and counties should abandon burdensome and counterproductive "affordable housing" and inclusionary zoning policies. Instead, they should concentrate on increasing the supply of housing by adopting less stringent land-use controls.

Background

What is affordable housing? Affordable housing is an Orwellian term used by narrow special-interest groups to hide the fact that the policies they support limit the supply of housing, harming the low-income people they purport to help.

The most coercive form of affordable housing is inclusionary zoning. Once adopted by a city or county, inclusionary zoning requires builders to build and sell at below-market prices a certain percentage of the homes in a new development. If they refuse, the city will not issue a building permit, thus preventing the builder from building any homes. This seems to fit the definition of extortion: "obtaining money or some other thing of value by abuse of one's office or authority" (even though a city does it and so far it is legal).

Once the "affordable" home is sold to a qualified low-income homebuyer, the builder must guarantee that future sales of that home will also be to qualified low-income affordable buyers at the government-fixed price for a set number of years, ranging from 10 years to perpetuity. A new ordinance in Chapel Hill requires 99 years. Thus homeownership becomes a sham because the "homeowner" has only an extremely limited claim to any possible increase in equity. The system is deceitful because affordable home–buyers are not told that, in reality, the system turns them into long-term renters, not homeowners.

Related Topics: **Smart Growth**, p. 30; **Land Use and Zoning**, p. 28.

Here is where the city bureaucracy and nonprofit land trusts come in. They are more than willing to take the responsibility for the management of the affordable housing re-sales off the hands of the builder, and in some cases they actually own the property. Thus they guarantee their jobs and budgets. Since these special interests, not the low-income residents, are the primary beneficiaries of affordable housing policies, it is no wonder that they lobby city councils and county commissioners using distorted, inaccurate, and biased information.

Letting the market provide affordable housing

Housing becomes unaffordable when supply is not allowed to keep up with demand. It is not a coincidence that the North Carolina towns that have adopted coercive affordable housing policies are also the towns that have limited housing supply with coercive restrictions on development (Davidson, Chapel Hill, Carrboro, Manteo).

Local governments should change burdensome land-use regulations. These regulations, given the ironic name "Smart Growth," include everything from establishing so-called urban growth boundaries to open-space requirements to architectural design standards.

Overhauling land-use ordinances — in particular, Smart Growth measures – would directly lower the cost of homes. By disentangling the market from excessive government regulation, it would be able to provide more homes, at lower prices, without targeting homebuilders and homebuyers with hidden welfare taxes.

Analyst: Dr. Michael Sanera
Director of Research and Local Government Studies
919-828-3876 • msanera@johnlocke.org

Features of Coercive Inclusionary Zoning Policies

Ineffective. Inclusionary zoning produces *fewer* affordable housing units, not more. After cities adopt inclusionary zoning, very few affordable homes are constructed. A study of 50 cities in the Bay Area of California showed that "After passing an [inclusionary zoning] ordinance, the average city produces fewer than 15 affordable units per year." Why is that? Because builders go elsewhere rather than succumb to the legal extortion that is inclusionary zoning.

Unaffordable. The same study found that after the adoption of inclusionary zoning, overall housing production fell and predictability housing prices increased. In the 50 cities in the study, new construction decreased by 31 percent, and individual home prices skyrocketed by $22,000 to $44,000 in median cities and by more than $100,000 in hot markets. Inclusionary zoning results in increases in all housing prices making the city even less affordable.

Inequitable. Inclusionary zoning functions as a hidden tax that transfers money from builders, landowners and homebuyers to special interests. Ironically, the beneficiaries of this tax are not low-income residents, because so few affordable homes are built, but the special interests — city bureaucrats and land trust employees — who are responsible for running the program. They gain job security and increased funding.

Deceitful. It is likely that the Attorney General would drag into court any private party who claimed to sell a house to a person when the contract was in fact a long-term lease. Because inclusionary zoning prevents "buyers" of controlled houses from selling at market values, they are in effect renting the house on a long-term lease.

Destructive. The homes that were not built due to inclusionary zoning have a value that can be measured. Another study found that in 33 cities in the Bay Area, an estimated 10,662 fewer homes were built in the seven years after inclusionary zoning was adopted. These homes have an estimated combined value of $6.5 billion. Thus inclusionary zoning essentially destroyed $6.5 billion in housing stock.

Illegal. Although North Carolina courts have yet to rule on the question, inclusionary zoning is likely illegal under current laws. Current zoning law allows cities to regulate a list of features such as building height, setback and side yard distances, population densities, etc. Control of the price is not on the list. In fact, North Carolina has a specific law prohibiting rent control. Rental units are not included in inclusionary zoning for that reason. Even so, the ordinances could still be illegal rent control because inclusionary zoning controls price, so buyers are in effect signing long-term rental leases.

Source: Benjamin Powell and Edward Stringham, *Housing Supply and Affordability: Do Affordable Housing Mandates Work?* The Reason Foundation, *Policy Study* 318, April 2004.

Recommendations

The only time government should take private property is for a *public use*, as the term is traditionally understood, when no reasonable alternatives exist. Compensation should be negotiated fairly with the intent to provide just compensation to property owners.

Background

Eminent domain refers to the government's power to seize private property without the owner's consent. The Fifth Amendment of the United States Constitution states "Nor shall private property be taken for public use, without just compensation."

The United States Supreme Court held in a case called *Kelo v. City of New London* that the government may take private property for economic development. In North Carolina, there is no express provision in the law that allows for "economic development takings," but there are state laws that can be used as an end run to achieve the same objective. In 2006, in reaction to *Kelo*, other states took significant action to protect against eminent domain abuse. In fact, eight states have already passed constitutional amendments to protect against eminent domain abuse.

Why eminent domain should be used only rarely

Eminent domain is a significant power. There really is only one way to understand the power of eminent domain, and that is by putting yourself in the role of an eminent domain victim. If the government decided to take your house, how would you feel? If the government decided to seize your business, how would that impact your life?

Major impact on victims. After the taking, many eminent domain victims find themselves unable to afford to live in the same neighborhood or area. Sometimes they are forced to move away from family and friends. There are intangible harms to losing a home that simply cannot be quantified. A business that loses its property may also lose the business goodwill it had earned in the community.

How eminent domain should be used

Make sure no alternatives exist. Before seizing private property, the government should attempt to identify alternative solutions. Eminent domain should be used only if no alternative solutions exist or if the costs of alternatives are unreasonable — and if the project is worth it.

Negotiate in good faith. The reality is that many property owners lack the knowledge or the resources to effectively negotiate a price for their property to be seized. The government also has all the leverage in any negotiation. All offers should provide just compensation from the very start of negotiations and not be an attempt to take advantage of property owners. Government officials should resolve to take this good-faith approach even if the threat of eminent domain is never mentioned.

Take property for a "public use" only. Private property should be taken only for what constitutes a proper public use. "Public use" has traditionally meant uses by the general public, the government, or a public utility or common carrier in serving its public function.

Do not take property directly or indirectly for economic development. There is a good reason why Americans have been outraged over the *Kelo* decision. It is chilling to think that government can take someone's house because officials believe a private developer could make better economic use of the property. Even if property were taken only partly for economic development, that would be inappropriate.

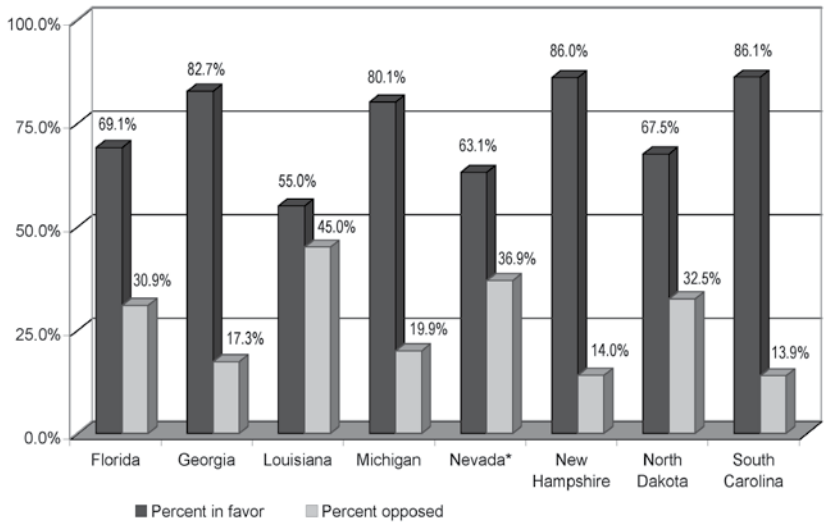
Avoid economic development takings because they actually hurt economic development. If an investor thinks that the government would seize private property in a certain area, he has no reason to buy and to improve property in that area. As stated in a January 2007 article in *The Regional Economist*, published by the Federal Reserve Bank of St. Louis: "Potential residents and businesses may avoid communities that have a record of taking private property for economic development because of a greater uncertainty about losing their property to eminent domain."

Related Topics: **Land Use and Zoning**, p. 28; **Forced Annexation**, p. 36.

Respect property rights. In many ways, public officials respecting individuals' property rights is the bottom line. Unfortunately, many cities and counties have harbored a disrespect for property rights. Past eminent domain abuse has been pervasive across the country, particularly when it comes to using "blight" laws to justify takings for economic development.

Voters Overwhelmingly Oppose Eminent Domain Abuse

States that Passed Constitutional Amendments Protecting Against Eminent Domain Abuse in 2006



* Nevada voters are required to pass new amendments in two consecutive general elections. In 2008, Nevada voters, for the second time, overwhelmingly approved the amendment by a 60.8% to 39.2% vote. Source: *Castle Coalition.*

Anaheim's model approach

In the 1980s, the city of Anaheim, California used economic development takings as a means to rejuvenate its downtown. This effort was a failure. In 2002, Anaheim again wanted to promote the economy of its downtown and focused on an area called the "Platinum Triangle." The city leadership understood that there could be economic development without the need to sacrifice the property rights of its citizens. As a result, they prohibited economic development takings.

Anaheim simplified permitting and the environmental impact report process for developers. The city reduced regulations that hindered development. For example, Anaheim generally did not dictate how much development had to be commercial or residential.

The city's new free-market plan has been an incredible success. Ironically, the city has been so successful that critics now are concerned that the Platinum Triangle's property values, which have skyrocketed, are too high for some people.

The California Chapter of the American Planning Association honored Anaheim with the Planning Implementation Award for its land-use plan. Anaheim also has received national recognition for its efforts. Stephen Greenhut, a columnist for the *Orange County Register,* wrote in *The Wall Street Journal*: "By decentralizing bureaucracies and loosening cosseted government regulation, [Anaheim] has confirmed the vitality and audacity of private enterprise. The city has made itself a laboratory for free-market thought."

Analyst: Daren Bakst, J.D., LL.M.
Director of Legal and Regulatory Studies
919-828-3876 • dbakst@johnlocke.org

Recommendations

When municipalities initiate annexations, they should be required to pay for water and sewer infrastructure and provide meaningful services to the areas they propose to annex, and residents in the affected areas should have an effective voice.

Background

Forced annexation (which is not the same as annexation) is a serious problem in North Carolina. Forced annexation is a subcategory of municipality-initiated annexations by which a municipality can unilaterally force individuals in unincorporated areas to live in the municipality. Only a handful of states are considered forced-annexation states, and North Carolina is extreme even among those states.

In other words, virtually every state in the county has rejected North Carolina's outdated system of forced annexation.

According to the 2006 North Carolina Supreme Court case of *Nolan v. City of Marvin*:

> The primary purpose of involuntary annextion, as regulated by these statutes, is to promote 'sound urban development' through the organized extension of municipal services to fringe geographical areas. These services must provide a meaningful benefit to newly annexed property owners and residents, who are now municipal taxpayers, and must also be extended in a nondiscriminatory fashion.

Under that definition, forced annexation in N.C. is not achieving its primary purpose. Forced annexation is not used for sound urban development. Municipalities are simply ignoring the areas that need services and annexing those areas that do not need services.

Key reforms to the annexation law

An effective voice. Property owners living in the proposed annexed area should have some type of effective voice in the annexation process. That could be a simple majority vote of the residents or some type of protest petition process. An incredible 67 percent of states that have annexation allow residents in the proposed annexed areas to vote.

Costs of water and sewer infrastructure. If a municipality initiates the annexation, it should be required to pay for the water and sewer infrastructure that the annexed area needs. The current law is so skewed in favor of cities that annexation victims who never even wanted city water and sewer services are given the added insult of being made to pay for the infrastructure for providing those unwanted services.

Meaningful services. Municipalities should be required to provide meaningful services to the areas they are proposing to annex. Meaningful services should be services an area truly needs — not duplicates of existing services or trivial attempts to add service (such as sending one extra police officer to an area that already has adequate police protection). Cities should be required to provide the most important services a municipality could provide — central water and sewer — if the area to be annexed needs those services.

Addressing myths of forced annexation

The "free-rider" argument holds that individuals in the county should not be allowed to vote or have any say in annexation because they enjoy city benefits without paying their fair share.

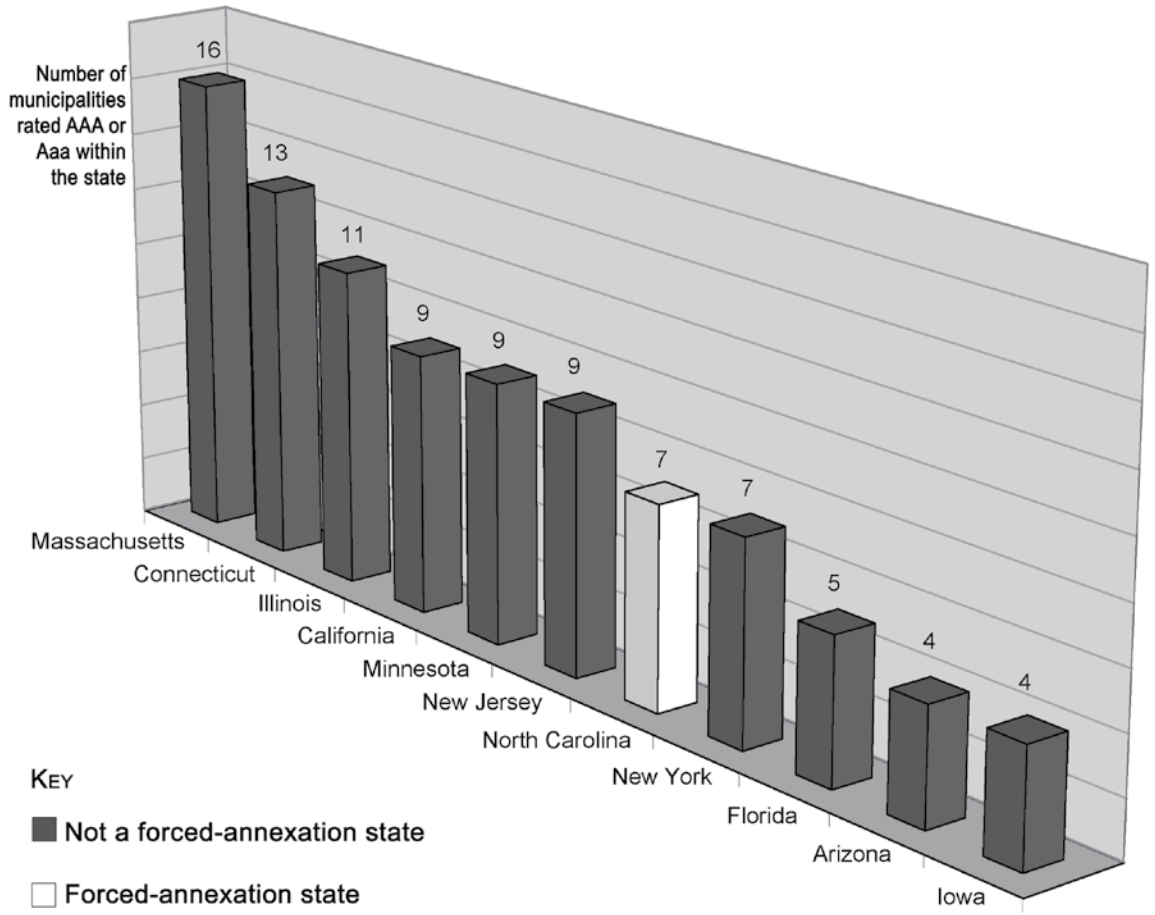
The argument examines only one side of the equation, however; it fails to take into account the incredible amount of benefits that cities receive from individuals in these areas. It is more likely that cities owe "county" residents, rather than the other way around. The free-rider argument also requires a belief that cities don't want visitors.

The bond rating argument holds that unless North Carolina's cities have forced annexation, their bond ratings will be poor.

To demonstrate this claim, the North Carolina League of Municipalities points to the number of AAA-rated municipalities in the state. Even using this ques-

Related Topics: **Land Use and Zoning**, p. 28; **Eminent Domain**, p. 34.

Number of municipalities, by state, with at least one top bond rating
(by either Moody's or Standard & Poor's; minimum four municipalities)



tionable measure, the bond rating argument fails miserably.

Examining the states by the number of municipalities with at least one top rating from Moody's or Standard & Poor's, Massachusetts (16 municipalities) and Connecticut (13) have far more top-rated municipalities than North Carolina (seven). Neither of those states have forced annexation; in fact, neither Massachusetts nor Connecticut allows *any* annexation of unincorporated land.

Furthermore, as the above graph shows, of the 11 states that have at least four municipalities with top bond ratings, only North Carolina is a forced-annexation state.

Analyst: Daren Bakst, J.D., LL.M.
Director of Legal and Regulatory Studies
919-828-3876 • dbakst@johnlocke.org

Additional Resources

General

• "Crucial Questions: A Checklist for City Council Candidates and Citizens," John Locke Foundation *Policy Report*, Aug. 10, 2009, *johnlocke.org/research/show/policy%20reports/203*

Finances

• Dr. Roy Cordato, "Reforming the Sales Tax: Keep in Mind Liberty, Prosperity, and Sound Principles of Taxation," JLF *Spotlight* No. 394, July 12, 2010, *johnlocke.org/research/show/spotlights/245*

• Joseph Coletti, "The True Cost of State and Local Taxes: How to Understand the Business Tax Burden Study," JLF *Spotlight* No. 386, April 16, 2010, j*ohnlocke.org/research/show/spotlights/237*

• Coletti and Dr. Michael Sanera, "City and County Budget Crises: When in a hole, first stop digging," JLF *Policy Report*, March 4, 2009, *johnlocke.org/research/show/policy%20reports/195*

• Future of Retirement Study Commission Final Report, Nov. 16, 2010, *www.nctreasurer.com/NR/rdonlyres/E96ED33D-BEB0-4B07-A5D8-8A29C1030842/0/FORSCreport.pdf*

• Coletti, "Compensation Model Cannot Keep Good State Employees" JLF *Spotlight* No. 289, May 30, 2006, *johnlocke.org/research/show/spotlights/136*

• Eileen Norcross, " Getting an Accurate Picture of State Pension Liabilities" Mercatus Center, Dec. 13, 2010, *mercatus.org/publication/getting-accurate-picture-state-pension-liabilities*

• Daren Bakst and Coletti, "Common-Sense TIF Reforms: Ways to Avoid Randy Parton Theatre-Like Debacles and Other Disasters," JLF *Spotlight* No. 350, May 28, 2008, *johnlocke.org/research/show/spotlights/200*

• Coletti, "Debt Is Debt: Taxpayers on Hook for TIFs Despite Rhetoric," JLF *Spotlight* No. 337, Nov. 19, 2007, *johnlocke.org/research/show/spotlights/187*

• Coletti, "Why Transparency? Creating Trust in Government," JLF *Policy Report*, Dec. 17, 2009, *johnlocke.org/research/show/policy%20reports/206*

• Coletti, "Trust But Verify: Open Government Is Better Government," JLF *Policy Report*, Dec. 17, 2009, *johnlocke.org/research/ show/policy%20reports/205*

• Chad Adams and Coletti, "Fiscal Transparency in N.C.: Surveying State and Local Governments," JLF *Spotlight* No. 347, May 14, 2008, *johnlocke.org/research/show/spotlights/199*

• *NCTransparency.com*

Services

• Dr. Terry Stoops, "Elective Surgery: Budget deficits require elected officials to reassess course offerings," JLF *Spotlight* No. 406, Feb. 14, 2011, *www.johnlocke.org/research/show/spotlights/257*

• Stoops, "Good Classroom 'Disruption': Use the Internet to expand educational options in rural school districts," JLF *Spotlight* No. 396, Aug. 16, 2010, *www.johnlocke.org/research/show/spotlights/247*

• Stoops, "Parent-Friendly Schools, 2009: How 'parent-friendly' are school districts in North Carolina?" JLF *Spotlight* No. 381, Nov. 30, 2009, *www.johnlocke.org/research/show/spotlights/232*

• Stoops, "Crucial Questions: A Checklist for School Board Candidates and Citizens," JLF *Policy Report*, Sept. 3, 2009, *www.johnlocke.org/research/show/policy%20reports/204*

• Sanera, "Buildings Don't Teach Students: North Carolina should concentrate on what goes on inside the buildings," JLF *Spotlight* No. 311, Feb. 27, 2007, *johnlocke.org/research/show/spotlights/160*

• Sanera, "Sell Government Golf Courses," The Locker Room (JLF blog), March 12, 2009, *www.johnlocke.org/lockerroom/lockerroom.html?id=19267*

• Sanera and Clint Atkins, "The New Raleigh Convention Center: A taxpayer-funded money pit," JFL *Regional Brief* No. 58, Sept. 4, 2008, *johnlocke.org/research/show/policy%20reports/174*

• Sanera and Travis Fisher, "North Carolina Convention Centers: Important Lessons for Asheville and Wilmington," JLF *Regional Brief*, June 7, 2006, *johnlocke.org/research/show/policy%20reports/73*

• Sanera, "Solving Asheville's Civic Center Dilemma: Making Lemonade Out of a Lemon," JLF *Regional Brief*, Dec. 21, 2005,

Land Use and Property Rights

• Sanera, "APFOs Research Fatally Flawed: One-sided analysis is used to determine 'voluntary mitigation' fees," JLF *Spotlight* No. 331, Sept. 12, 2007, *johnlocke.org/research/show/spotlights/180*

• Sanera, "Raleigh's Flawed Impact Fee: Incomplete Research Means Proposal Is Broken from the Start," JLF *Spotlight* No. 284, March 30, 2006, *johnlocke.org/research/show/spotlights/131*

• Sanera, "Chatham County's Land Grab: A selfish elite is trying to take over 23,000 acres for their personal benefit," JLF *Regional Brief* No. 70, Nov. 12, 2008, *johnlocke.org/research/show/policy%20reports/190*

• Sanera, "Johnston County's 'Dumb Growth' Plan: The Growth Management Committee Fails to Understand Basic Economics," JLF *Regional Brief* No. 6, Jan. 27, 2007, *johnlocke.org/research/show/policy%20reports/79*

• Dr. Michael Sanera and Katie Bethune, "The Anaheim Solution: How N.C. Cities Can Redevelop Without Using Incentives or Eminent Domain," JLF *Spotlight* No. 341, Jan 31, 2008, *johnlocke.org/research/show/spotlights/191*

• Sanera, "Johnston County's 'Dumb Growth' Plan: The Growth Management Committee Fails to Understand Basic Economics," JLF *Regional Brief* No. 6, Jan. 27, 2007, *johnlocke.org/research/show/policy%20reports/79*

• Sanera, "Chatham County's Land Grab: A selfish elite is trying to take over 23,000 acres for their personal benefit," JLF *Regional Brief* No. 70, Nov. 12, 2008, *johnlocke.org/research/show/policy%20 reports/190*

• Sanera, "A Planners' Glossary: Understanding Raleigh's New Development Code, the Diagnostics & Approach Report," JLF *Regional Brief* No. 75, March 15, 2010, *johnlocke.org/research/show/ policy%20reports/208*

• Sanera and Joanna Grey, "Planning Penalties in North Carolina: Why Other N.C. Cities Should Not Follow Asheville and Wilmington," JLF *Policy Report*, May 25, 2006, *johnlocke.org/research/show/ policy%20reports/72*

• Sanera and Katie Bethune, "The Anaheim Solution: How N.C. Cities Can Redevelop Without Using Incentives or Eminent Domain," JLF *Spotlight* No. 341, Jan 31, 2008, *johnlocke.org/research/show/ spotlights/191*

• Christopher Goff, "Conquering Traffic Congestion in the Capital City: More Effective Solutions Than Light Rail," JLF *Regional Brief* No. 4, August 2006, *johnlocke.org/research/show/policy reports/74*

• Sanera and Abby Alger, "Un-Affordable Housing: Cities keep low- and middle-income families from home ownership," JLF *Regional Brief* No. 57, April 30, 2008, *johnlocke.org/research/show/policy reports/168*

• Bakst, "Eminent Domain in N.C.: The Case for Real Reform," JLF *Policy Report*, May 3, 2007, *johnlocke.org/research/show/policy%20 reports/85*

• Bakst, "Riding the Eminent Domain Rail: Triangle Transit Authority Is N.C.'s Case Study in Eminent Domain Abuse," JLF *Spotlight* No. 296, Sept. 22, 2006, *johnlocke.org/research/show/spotlights/143*

• Bakst, "Your Home Is Their Castle: Ten Simple Ways Government Can Abuse Eminent Domain," JLF *Spotlight* No. 288, May 24, 2006, *johnlocke.org/research/show/spotlights/135*

• Bakst, "A Model Amendment: Protecting North Carolinians' Property Rights," JLF *Spotlight* No. 275, Jan. 6, 2006, *johnlocke.org/ research/show/spotlights/122*

• Bakst, "Property Rights After Kelo: North Carolina Needs a New Constitutional Amendment," JLF *Spotlight* No. 267, Oct. 17, 2005, *johnlocke.org/research/show/spotlights/114*

• Bakst, "Meaningful Annexation Reform: Getting Through the Smoke and Mirrors," JLF *Spotlight* No. 384, March 19, 2010, *johnlocke.org/ research/show/spotlights/235*

• Bakst, "Meaningful Services and Proper Oversight: Two Common-Sense Annexation Reforms," JLF *Spotlight* No. 368, Feb. 12, 2009, *johnlocke.org/research/show/spotlights/219*

• Bakst, "Forced Annexation in N.C.: A Question-and-Answer Guide," JLF *Spotlight* No. 366, Jan. 22, 2009, *johnlocke.org/research/show/ spotlights/217*

• Bakst, "Ten Myths of the Annexation Process: The Truth Is, N.C.'s Annexation Law Lets Municipalities Run Wild," JLF *Spotlight* No. 353, June 23, 2008, *johnlocke.org/research/show/spotlights/204*

• Bakst, "Flawed and Undemocratic: Forced Annexation Is Good for Municipal Leaders, But Bad for the Public," JLF *Spotlight* No. 323, July 13, 2007, *johnlocke.org/research/show/spotlights/172*

• Bakst, "A Blueprint for Annexation Reform," JLF *Spotlight* No. 366, December 16, 2008, *johnlocke.org/research/show/spotlights/214*

About the John Locke Foundation

The John Locke Foundation is a nonprofit, nonpartisan policy institute based in Raleigh, North Carolina. Its mission is to develop and promote solutions to the state's most critical challenges. The John Locke Foundation seeks to transform state and local government through the principles of competition, innovation, personal freedom, and personal responsibility in order to strike a better balance between the public sector and private institutions of family, faith, community, and enterprise.

To pursue these goals, the John Locke Foundation operates a number of programs and services to provide information and observations to legislators, policymakers, business executives, citizen activists, civic and community leaders, and the news media. These services and programs include the Foundation's monthly newspaper, *Carolina Journal*; its daily news service, *CarolinaJournal.com*; its weekly e-newsletter, *Carolina Journal Weekly Report*; its quarterly newsletter, *The Locke Letter*; and regular events, conferences, and research reports on important topics facing state and local governments.

The Foundation is a 501(c)(3) public charity, tax-exempt education foundation and is funded solely from voluntary contributions from individuals, corporations, and charitable foundations. It was founded in 1990. For more information, visit www.JohnLocke.org.

"To prejudge other men's notions before we have looked into them is not to show their darkness but to put out our own eyes."

JOHN LOCKE (1632-1704)

Author, *Two Treatises of Government* and *Fundamental Constitutions of Carolina*

John Locke Foundation
200 West Morgan St.
Raleigh, NC 27601
V: 919-828-3876
F: 919-821-5117
www.JohnLocke.org
info@johnlocke.org