INNOVATION GUIDE

City and County Issue Guide

2009

The Center For Local Innovation

CITY AND COUNTY ISSUE GUIDE
2009

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 Staff and the Center for Local Innovation offer 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 in the lefthand menu select* Spotlights *and* Policy Reports.

The John Locke Foundation Research Staff would like to thank Michael Moore and the following research interns for their contributions to this guide: Abby Alger, Katie Bethune, Clint Atkins, and Shelley Gonzalez.

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On the cover: The Chowan County Courthouse in Edenton. Photo courtesy of the Chowan County Tourism Development Authority and Edenton-Chowan Chamber of Commerce.

New Transfer and Sales Taxes

Recommendation

Counties and municipalities should prove their case for new taxes.

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 water and sewer, solid waste removal, recycling, or electric power.

As part of the legislative deal that swaps 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 that most counties already have.

Fifty-seven counties have sought one or both tax increases since 2007. Those counties that put just one measure on the ballot have invariably chosen whichever increase had the higher projected revenue, even though the land-transfer tax increase has yet to win in 24 attempts. Voters rejected a sales tax increase 35 times and approved an increase just eight times. Voters rejected a land-transfer tax increase 22 times. Seven times voters have said no to both proposed increases.

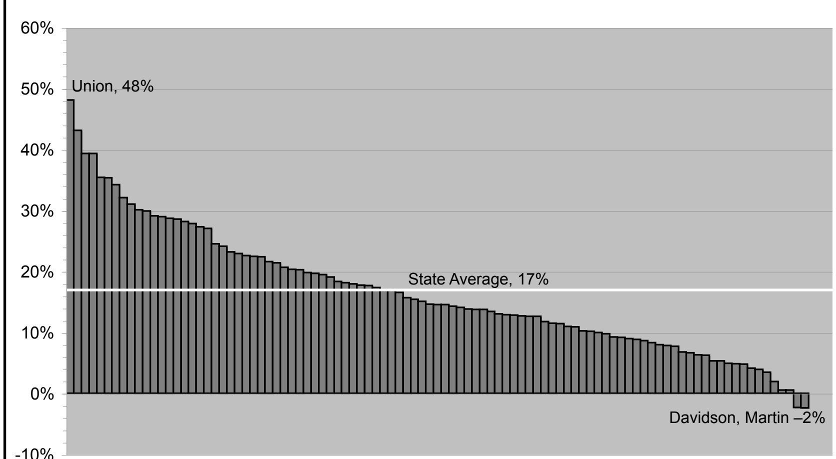
Some local officials argue that growth does not pay for itself and therefore new taxes are to compensate. These same counties, however, often provide economic incentives to attract businesses to the area, effectively ensuring that new revenue will not keep pace with spending demands. For example, the 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.

Making the question of growth paying for itself more difficult to sustain, 22 municipalities have had revenues from taxes, fees, permits, and services grow five percent faster than population and inflation between fiscal year (FY) 2002 and FY 2007. Nine have increased per-capita inflation-adjusted revenue from these sources by at least 20 percent over the same period.

Nine of every ten counties, including 53 of the 57 counties that have sought new taxes, have also had revenues from taxes, fees, permits, and services grow five percent faster than population and inflation between fiscal year (FY) 2002 and FY 2007.

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. Char-

County Real Per-Capita Revenue Growth, FY 2002 to FY 2007*



Source: State Treasurer's Office (98 of 100 counties; the counties of Graham and Scotland failed to report revenue information for FY 2007).
** I.e., revenues in excess of population growth and inflation.*

lotte 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.

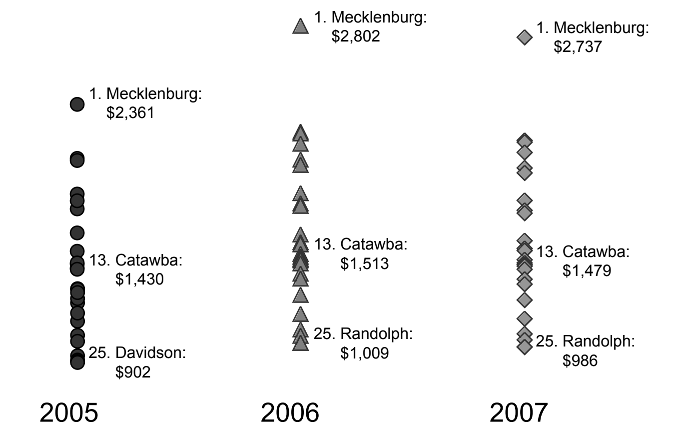
Local government cost each person $1,633 in fiscal year 2007. That figure represents five percent of per-capita personal income. For a family of four, the cost of local government is $6,532.

Local governments must earn the trust of taxpayers. Spending on municipal golf courses, economic incentive packages, convention centers, and other non-essential services have 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, one county and fifteen municipalities get less than half of their income from property and sales taxes. Eight other municipalities get no property or sales tax revenue. Many of these fees are for inspections of new buildings, water connections, or other items that could avoid the "impact fee" label and the need for legislative approval.

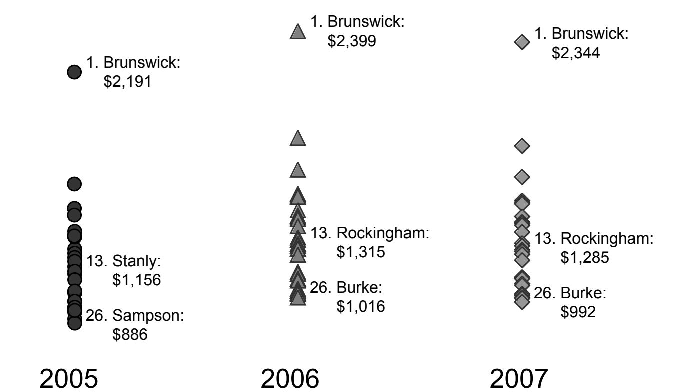
Among the high-fee cities is Holly Springs, which collects $6.9 million from property taxes, $2.5 million from sales taxes, but $8.4 million from "Other Permits." Bladen County collects $21 million from "Other sales and services."

Combined Local Per-Capita Tax Burdens: 25 Largest Counties
(Population greater than 100,000)



Source: Michael Lowrey, "By The Numbers: What Government Costs in North Carolina Cities and Counties FY 2007," Center for Local Innovation (CLI) *Innovation Guide,* John Locke Foundation, February 2009, *www.johnlocke.org/policy_reports/display_story.html?id=194.*

Combined Local Per-Capita Tax Burdens: 26 Mid-Size Counties
(Population between 50,000 and 100,000)



Source: Michael Lowrey, "By The Numbers: What Government Costs in North Carolina Cities and Counties FY 2007," Center for Local Innovation (CLI) *Innovation Guide,* John Locke Foundation, February 2009, *www.johnlocke.org/policy_reports/display_story.html?id=194.*

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Retiree Health Benefits

Recommendation

Local governments should reduce the liability for future retiree health costs with alternative insurance products and prefunding future obligations.

Background

The Government Accounting Standards Board (GASB) has been around for 23 years with a goal of making government financial information more useful and usable. In 2004 it issued a statement (GASB 45) on accounting and reporting of non-pension benefits for retirees.

GASB 45 offers guidance for state and local governments to report their liability for these other post-employment benefits (OPEB), the largest of which for most governments is health care. All governments must report their liabilities starting in fiscal year (FY) 2009.

The state and most local governments pay these costs from the General Fund each year. A few local governments have created reserve accounts, with others considering such a move. A reserve account has three benefits. First, it puts the question of health care benefits for retirees in the proper fiscal perspective. Second, it ensures money is available to meet future needs. Third, it reduces the amount that needs to be reported.

For most governments, retiree health benefits are not yet a problem. Government payrolls have grown more in recent years than previously; those newer employees may not get counted in actuarial studies of existing liabilities because they do not qualify for the retirement benefit, but they show up in studies of future years. The size of the cohort of baby-boomer employees who will become eligible could have a significant effect on government finances.

As of December 31, 2007, the state had an unfunded accrued liability of $28.6 billion, which was 133 percent of General Fund spending in FY 2008. Unchecked, this liability will grow to $50 billion in 2016. Liabilities among the state's local governments, though nowhere near as large as the state's liability, range up to 70 percent of General Fund spending in Charlotte and 51 percent in Guilford County. On the other end, Cary has a liability equal to just 15 percent, and Buncombe County's liability is 8 percent of FY 2008 spending.

Planning for retiree health costs

Investors want to know. Although GASB has no authority to force governments to act on its statements, bond investors and rating agencies such as Standard and Poor's may consider a government that does not follow GASB rules a greater risk, though there is no indication yet that it would lead to a rating downgrade.

Glen Bowen of Milliman Consultants and Actuaries stated in a September 2004 Milliman *PERiScope* publication about the importance of GASB 45 that

> *If a sponsor's financial statements are used to assist in borrowing or are otherwise subject to scrutiny, the standard may have a significant*

Unfunded Liabilities of Select Local NC Governments

Cities	*Unfunded Liability (millions of dollars)*	*Percent of FY08 General Fund*
Cary	$57.8	15.2%
Charlotte	$326.2	69.9%
Durham	$137.0	67.3%
Greensboro	$44.8	18.5%
Raleigh	$106.0	35.9%
Counties	*Unfunded Liability (millions of dollars)*	*Percent of FY08 General Fund*
Buncombe	$19.8	8.1%
Durham	$150.0	22.3%
Forsyth	$49.8	12.9%
Guilford	$280.0	51.0%
Mecklenburg	$142.0	10.4%
Orange	$84.5	49.1%
Wake	$109.0	11.8%

impact. Ultimately, though, long-term plan costs are determined by plan provisions, not accounting treatments.

Town of Cary's Liability as of Jan. 1, 2006
(in millions of dollars)

	Without Trust 4%	*With Trust 7%*
Accrued Liability	$57.8	$44.3
Annual Required Contribution (ARC)*		
Annual Amount	$5.3	$2.2
Past Service	$2.0	$1.4
Total ARC	**$7.3**	**$3.6**

** The term "annual required contribution" is a technical term used by actuaries; no contribution is required.*

Regardless of what one thinks of GASB or its specific recommendations, the costs are real. If a county or municipal government does not report its liability, it must still find a way to convey its trustworthiness to investors.

Positive action will be rewarded. If a government creates a reserve fund for its OPEB obligations, it would reassure investors. This in turn could shave points from the government's cost of borrowing. Creating a reserve fund also allows a government to discount its future obligations, making them less expensive today, meaning its liability shrinks overnight.

Ways to lower the burden

A government can create a **reserve account**, as did Winston-Salem, which has the immediate benefit of prefunding some of the future obligations the government will face. As the example from Cary shows, creating a trust or reserve account also reduces the government liability by discouting it at a faster rate. That would, in turn, reduce the amount the government must set aside in future years. The difference in total liability may not appear large, but it can cut the annual contribution by half.

Depending on the vesting requirements now in place, a government can lengthen the **time of service** needed to qualify for benefits. This approach does not address the potential liability for existing employees who do not yet qualify for retirement health benefits, but it can make the upper limit of the liability a little easier to determine.

A government can also offer different plan options, such as high-deductible insurance policies with **health savings accounts (HSAs)** that allow employees to build assets and save for their own future medical needs. These accounts, like defined contribution pensions, lower the future liability for the government and make the employee more aware of his preparedness for retirement.

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Tax Increment Financing

Recommendation

Local governments should report the full costs and consequences of development incentives through tax-increment financing (TIFs).

Background

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.

Premium Over General Obligation Bond

Instrument	*Present value (millions of dollars)*	*All-In TIC (basis points)*
TIF	$6.8	55
Synthetic TIF	$3.6	39
20-year COP	$1.8	19
20-year GO Bond	—	0

Source: Cabarrus County estimates for $67 million capital

Tax increment-financed bonds (TIFs) have three disadvantages for taxpayers. These disadvantages, however, are what make TIFs extremely valuable to some government officials.

First, like certificates of participation (COPs), TIFs do not require voter approval. Once the town council or county commission determines how much to borrow and what to do with the proceeds, it just needs the approval of the Local Government Commission.

Second, TIFs divert tax revenue before it reaches the General Fund, so the fiscal effect is hidden, and the TIF's role as a subsidy is left begging.

Third, the lack of voter approval and transparency, combined with the transfer of risk to lenders, make TIFs far more expensive than other forms of debt.

Tax increment financing is the newest option for local governments. New incremental tax revenue in a district provides the revenue for a TIF, instead of the value of a specific asset such as a stadium or office building as in a certificate of participation. For example, incremental property taxes from new development expected to locate in the Carolina Crossroads entertainment district near the Roanoke Rapids Theatre (formerly known as the Randy Parton Theatre) were expected to pay off the debt incurred to build and operate the Theatre. The original plan for the Theatre was an example of a capital project that is itself a private enterprise intended to anchor other investments.

Local governments must also take care that feasibility study assumptions match actual circumstances. The Parton Theatre feasibility study started from an assumption of 200,000 square feet of retail space and 400 new hotel rooms being operational before the theater's construction, neither of which were met.

Because incremental tax revenues pay the TIF debt, instead of general revenues as in a COP or general obligation bond, TIFs do not affect a government's credit rating. This feature also makes repayment less certain, however, so lenders charge higher fees and interest, making TIFs the most expensive way for governments to borrow money – up to $6.8 million more in present-value terms compared with other forms of debt for a $67 million project in Cabarrus County.

Even these high costs for government financing are very low compared with what it would cost a private-sector borrower to finance the same project. So government financing is an inherent subsidy for the developer who might otherwise take on debt himself. This aspect is of particular concern when the only question is the scale of a project rather than its initial undertaking.

Advocates say TIFs do not impose a burden on taxpayers. In reality, they have no cost in the same way that withholding taxes from your paycheck has no cost. The money used to pay the debt service is not available for other needed services, even in the TIF district itself. For example, if the 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, which are higher than with other forms of debt.

Citizens have proven willing to take on additional debt to subsidize projects that make sense to them, as they have shown in passing bonds and higher taxes for schools, roads, open space, and light rail. A local government confident of the merits of a potential TIF project could offer the same subsidy at less cost by instead issuing a general obligation bond or certificates of participation and dedicating the proceeds to the project.

For all these reasons, local governments should be honest about why they want a TIF.

Features of Debt Instruments

General Obligation Bonds (GO Bonds)

- Lowest cost, straightforward accounting
- Voter approval needed
- Clearly paid from the General Fund
- Repayment schedule not tied to revenues

Certificates of Participation (COPs)

- Higher cost than GO bonds
- Do not require voter approval
- Can be structured so repayment depends on revenue availability
- Clearly paid from General Fund
- Assets provide collateral

Tax Increment Financing (TIFs)

- Do not require voter approval
- Payment is linked to new tax revenues — not General Fund
- Not counted as debt by some
- Highest cost
- Hidden obligation
- Rely on growth for repayment

Why an honest accounting of TIFs is needed

The following points are adapted from Joseph Coletti's *Spotlight* report, "Debt is Debt: Taxpayers on hook for TIFs despite rhetoric." For more information, consult the report, which is available online at *www.johnlocke.org/spotlights/display_story.html?id=187*:

- Tax increment financing hides the diversion of funds from government services that is inherent in borrowing.
- TIFs still put taxpayers at risk for repayment and are more expensive than general obligation bonds or certificates of participation.
- Just as lenders and borrowers underestimated some of the risks from subprime mortgages, there is great potential for negative surprises with TIFs.
- Higher tax revenues from TIF districts will go to debt repayment, not government services.
- Local taxpayers could also pay directly because their governments are unlikely to default on the debt even if revenue falls short.
- Governments can borrow in other ways and use the savings as a cash subsidy or incentive for target projects.

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Economic Development Policy

Recommendation

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 or tax increases such as the land-transfer and sales tax hikes currently being considered in many counties.

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 certain businesses for special subsidies while burdening citizens and other local businesses with the cost of those subsidies.

The problem with business subsidies is that they harm existing business and other taxpayers.

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, land conveyances, and low-interest loans.

According to *The Incentives Game: North Carolina Economic Development Incentives,* a June 2007 study by the North Carolina Institute for Constitutional Law, local governments in the state have shelled out more than $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 amounts that are less than a million dollars.

Analysis

While subsidies may benefit the targeted business and entice it to locate its operations within the county, they also harm existing business 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 the subsidy. 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, driving up labor costs for all businesses that are employing similarly skilled labor. So the 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.

The effect of these 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.

In addition, growth requires many communities to make additional investments in reservoirs and other new sources of water, paid for through bonds, which will have to be paid back with future property and sales taxes. Many corporate welfare schemes enacted by lo-

Per-Capita Business Subsidies (Incentives) by County, Highest to Lowest (2004-2006)

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

calities simply allow the new, subsidized businesses to be free riders — again, adding to the tax burden on the rest of the community.

A better way

There is an alternative. Counties should pursue a policy of sustained economic growth that makes the possibility of investment attractive to all businesses, not just those favored by local politicians or planners. This policy would seek to keep property and 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 in economic development is to provide for sound and reliable infrastructure services, which includes effective police and fire departments, efficient trash collection, a road system 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 to favor some at the expense of others.

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Competitive Sourcing

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. Competitive sourcing is not the same as privatization. Instead, a city or county defines a service or a function and takes 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.

Chicago, led by Mayor Richard Daley, privatized more than 40 services, saving $175 million from 1995 to 2005.

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 Nov. 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 has 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.

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.

Other examples

Johns Creek, Georgia, followed the model of Sandy Springs, when it became an incorporated town of 65,000 residents in December 2006. It also contracted with CH2M Hill OMI in the months before its "opening." CH2M Hill OMI was responsible for the design and implementation of all future town functions, except public safety. It accomplished those tasks in fewer than 90 days, which allowed Johns Creek to have just five public employees. The US Conference of Mayors recognized the success of the arrangement with its Public/Private Partnership Award in January 2008.

Weston, Florida, has only nine public employees on its payroll for a city of more than 61,000 residents. Responsibility for the rest of Weston's governmental services has been contracted to private companies. This includes the city's departments of police and fire, 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."

Phoenix, Arizona, began to accept competitive bids for government services in 1979. Since then, the city has boasted savings of greater than $41.8 million. Phoenix uses competitive sourcing to deliver a variety of government functions, which 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. The rest are performed by government employees.

Indianapolis, under the direction of Mayor Stephen Goldsmith from 1992 to 1999, started to accept bids from private companies to compete with existing city agencies to perform more than 80 government services. These services included the sewer system, trash collection, meter ticketing, the Indianapolis Water Company, and — until 2006 — the Indianapolis International Airport. These competitive sourcing measures resulted in significant savings: under Goldsmith, the total was approximately $400 million. Of that $400 million, $15 million came from privatizing trash collection and $68 million from privatizing the sewer plant. The $68 million in savings represented a 44 percent reduction in costs from when the city had managed the sewer.

Baltimore began competitive sourcing when the city faced a major budget crisis in 2001. In response to its financial woes, Baltimore closed its public libraries and fire stations, but it needed to reduce its costs even further. Since it began competitive sourcing, Baltimore has posted annual savings that exceed $8 million—and these savings came from just eight programs being put up for bid to the private sector.

Chicago, led by Mayor Richard Daley, privatized more than 40 services. Savings from privatization efforts from 1995 to 2005 totaled $175 million. That does not include the city's lease of the Chicago Skyway for $1.83 billion in 2005 and its sale of municipal parking lots to Morgan Stanley for $563 million in 2006. (Morgan Stanley will also rebuild the aging garage infrastructure—a $65 million deal.) Chicago continues to be a leader in competitive sourcing. Currently, it plans to lease its Midway Airport.

Philadelphia, under former mayor Ed Rendell in the 1990s, privatized 49 government services. By fall 1993, this and other cost-cutting measures enabled him to eliminate a major structural deficit from when he entered office in 1992 — without raising taxes. Outsourced services ran from golf courses to prison services to cleaning City Hall. Some reductions were drastic: privatizing one nursing home cut cost by 54 percent ($27 million). Rendell saved $275 million for Philadelphia.

The principles of competition, specialization, and bulk buying are often forgotten when it comes to providing city services.

New York City, using similar tactics, saved $6.2 billion during Mayor Rudy Giuliani's tenure. The city entered performance-based contracts with private companies to provide services including homeless shelters, water-meter readings, and placing welfare applicants into jobs. It also found private organizations willing to take on city services that suffered mediocre performance. For example, management of the famous Central Park was turned over to the Central Park Conservancy, a group of private citizens, whose efforts produced four times the fundraising and much better upkeep for the park.

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Education

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.

Local governments in N.C. averaged $900 million per year spent on school facilities — nearly 80 percent of all public school capital expenditures in the state.

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 lawfully 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 and corporate income tax revenue to counties for their school capital needs. North Carolina's local governments spend an average of $750 million every year on school facilities, which represents nearly 82 percent of all public school capital expenditures in the state.

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.

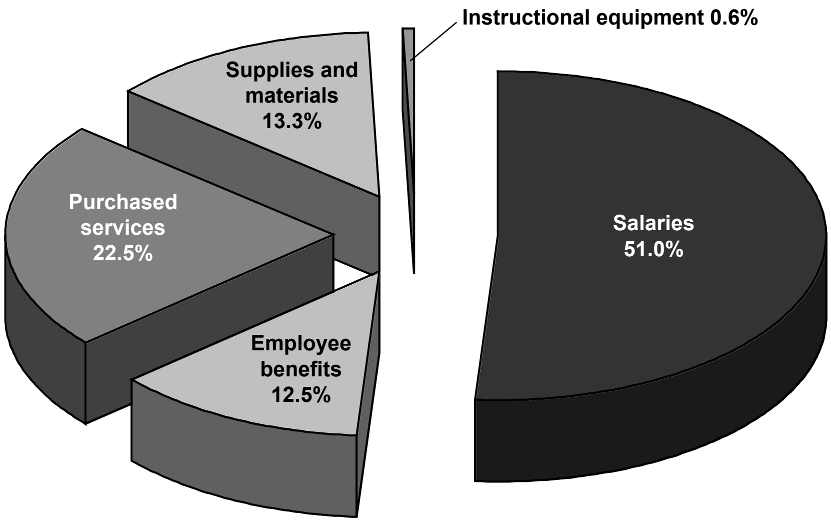
Principle No. 1. *Local governments should closely monitor county appropriations to school districts and measure the effectiveness of the funding.*

For the 2007-08 school year, local governments in North Carolina allocated nearly $2.9 billion — or an average of $2,075 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 No. 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 $1.85 billion on salary and benefits for school personnel, accounting for approximately 63 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, to reward the efforts of successful teachers and administrators. Local funds should also be used to attract highly qualified science,

School Expenditures from Local Funding, 2007-08



Source: N.C. Department of Public Instruction, Financial and Business Services, "2006-07 Selected Financial Data," November 2007, www.ncpublicschools.org/fbs/resources/data.

mathematics, and special-education teachers to low-performing schools.

Principle No. 3. *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 $643 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.

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 performance.

Thus, 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. This data would provide measurable goals that form the basis of a sound budget process that ultimately determines whether school districts spend local tax dollars wisely.

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Fresh Water and Wastewater Services

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. Between 1998 and 2001, cities that contracted fresh water and wastewater services to private firms chose, when those contracts came up for renewal, to keep their water systems in the private sector 91 percent of the time (see chart).

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.

A city whose public water system is inefficient faces few consequences. An inefficient *private* supplier to a city, however, risks losing its contract.

Citizens also have experienced serious contamination of fresh water from government wastewater systems. For example, Wilmington was forced to close swimming and fishing areas when 4 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.

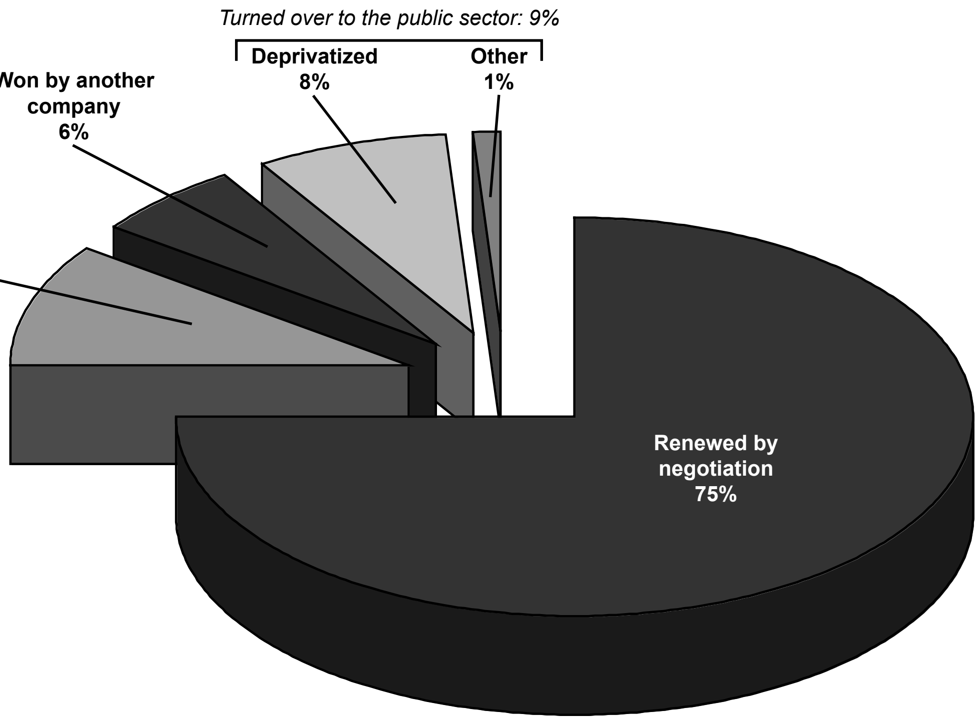
With public water operations, citizens have fewer guarantees of those criteria. A city whose public water system is inefficient faces few consequences. A private supplier that is inefficient or endangers water quality, however, risks losing its contract to a competitor. For this reason, citizens benefit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

Outcome of Water and Wastewater Privatization Contract Renewals, 1998-2001
(498 contracts up for renewal)



Source: Geoffrey F. Segal and Adrian T. Moore, "Frequently Asked Questions About Water/Wastewater Privatization," The Reason Foundation, Policy Brief *26, Sept. 2003, p. 8,* www.reason.org/files/db5c3e3e5365eb334855d7d818ef53d9.pdf.

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.

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.

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Parks and Recreation

Recommendation

Cities and counties should restructure their parks and recreation departments so they do not include services already offered by the private sector or those that serve only a small minority of residents. Local governments should also implement user fees to recover the costs of services that benefit only specialized groups.

Background

The role of the city and county parks and recreation (P&R) departments is to provide citizens with sports, exercise, and outdoor activities. Many P&R departments, however, have expanded beyond these traditional boundaries, providing uncommon services that benefit only a handful of citizens. P&R departments also provide many services and facilities already offered by the private sector. Not only is government provision of those services an unnecessary cost to taxpayers, but also it imposes the significant obstacle of government competition upon the for-profit and nonprofit organizations already providing those services. With the wide variety of activities and services now offered by many North Carolina cities and counties, local P&R departments have also lost focus.

In order to ensure the best use of taxpayer dollars, local P&R departments should invest in projects that benefit the greatest number of people. They should also avoid services that can be found in the private sector. Finally, local P&R departments should charge service fees for those facilities used by only a handful of people in the community to ensure that those who benefit from the facilities are also the ones who finance them.

General principles

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

Principle No. 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 swimming pools, golf courses, gyms, and other athletic services. Those facilities are sources of income for many North Carolinians. When P&R departments operate similar facilities, they threaten the business of these citizens — as government departments, they have an unfair advantage over private-sector services. Unlike their private competitors, they have access to tax dollars to shelter them from risk and 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 No. 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 the cost of them. User fees should be charged that would cover 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 funds to offer services that are beneficial to the entire community.

Principle No. 3. *Cities and counties should divest themselves of services that are used by a small minority of the population or the upper economic segment of the community.*

When local governments use taxpayer funds to

Recent Annual Losses
By City-Owned Golf Courses

City	Average loss per year	Average taxpayer subsidy per round	Years studied	Where to find more information
Burlington	$170,853	$5.03	2003-06	JLF *Spotlight* report on Burlington's municipal golf course: www.johnlocke.org/spotlights/display_story.html?id=168
Gastonia	$254,829	$6.37	2002-06	JLF *Spotlight* report on Gastonia's municipal golf course: www.johnlocke.org/spotlights/display_story.html?id=184
Goldsboro	$454,503	$14.20	2001-06	JLF *Spotlight* report on Goldsboro's municipal golf course: www.johnlocke.org/spotlights/display_story.html?id=183
Lexington	$188,383	$6.27	2000-06	JLF *Spotlight* report on Lexington's municipal golf course: www.johnlocke.org/spotlights/display_story.html?id=163
Mooresville	$87,918	$1.75	2001-05	JLF *Spotlight* report on Mooresville's municipal golf course: www.johnlocke.org/spotlights/display_story.html?id=149
Sanford	$210,918	$8.43	2000-05	JLF *Spotlight* report on Sanford's municipal golf course: www.johnlocke.org/spotlights/display_story.html?id=144
Thomasville	$608,286	$20.27	2000-05	JLF *Spotlight* report on Thomasville's municipal golf course: www.johnlocke.org/spotlights/display_story.html?id=152
Wilson	$210,454	$4.67	2002-06	JLF *Spotlight* report on Wilson's municipal golf course: www.johnlocke.org/spotlights/display_story.html?id=167

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 lower- and middle-income people. 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.

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Land Use and Zoning

Recommendation

Elected officials in cities and counties should reform current land-use and zoning regulations to minimize detailed regulatory control and maximize market trends.

Background

Zoning to control land use originated in Germany in the late 1800s and was adopted and expanded upon by many parts of the U.S. in the 1920s. Complaints about sprawl and other current land-use patterns can be traced to already existing zoning regulations, which strictly separated residential, commercial, and industrial uses of land. That being the case, planners who turn to even more use of zoning to solve those problems are likely only to make the problems even worse. Planners should instead consider comprehensive reform of city and county land-use regulations.

Zoning is actually a highly politicized process where those with power in the community often gain advantages at the expense of those who lack it.

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.

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 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 No. 1. *Modern land use must be based on simple, flexible rules.*

For example, one residential, one commercial, and one industrial zone could be established. Any broadly defined use would be permitted in those zones. Mixed use within the zones would be permitted by allowing residential in commercial zones and commercial in industrial zones.

By simplifying its land-use regulations, Anaheim, California, was able to redevelop successfully a rundown 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.

Cities and counties should also remove zoning limitations to land-use innovations such as coving and bay home developments. When developers use coving, they build homes in a pattern separate from the pattern of the streets. Coving allows for larger lot sizes without using more land. Other benefits of coving include reduced road lengths, less erosion from runoff, as well as greater privacy for homeowners.

Bay homes are another way to reduce infrastructure costs and create more open space. Bay homes are arranged so that families share the spaces outside the homes with other members of a homeowners association. Government hurdles such as specified minimum distances between home and streets often keep developers from building bay homes. Local governments that present developers with such limitations make it hard for them to use these and other innovative techniques. Removing these zoning barriers would be beneficial to many communities.

Principle No. 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 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. Only those landowners who can show they will be directly and identifiably affected should be granted "standing" to comment on land-use decisions. This reform would go a long way toward taking the politics out of zoning and land-use decisions.

Principle No. 3. *Moratoriums, impact fees, and adequate public facilities ordinances (APFOs) don't solve growth-related problems; they create them.*

Moratoriums can be devastating to the livelihoods of people whose employment is related to construction. They hurt developers, construction workers, bankers, lawyers, and people looking to sell their land. The negative consequences outweigh the proposed benefits.

Impact fees and APFOs are designed to compensate for the costs associated with increased growth. They are often unfairly applied, however, driving up the cost of housing. These fees should represent the difference between the public costs of growth (new schools, access roads, police and fire protection, solid waste disposal, water and sewer services, and utility line extensions) and the public benefits of growth (increased public revenues from construction activities and from property taxes, local sales taxes, utility excise taxes, inspection and permit fees, and motor vehicle taxes paid by new residents). Currently, impact fee and APFO studies calculate only the costs without comparing them with the benefits.

Ignoring the benefits of growth means missing the bigger picture. In 2005, N.C. State Economics Professor Michael Walden, published "Economic Impacts of Construction of Owner Occupied Residential Housing in the Triangle, North Carolina," which calculated the *total* economic impact of constructing 100 new single-family homes and 100 multi-family housing units in the Triangle. He found that, with some minor technical caveats, local city and county tax revenues outpaced the public costs by nearly $77,000 per year over a 10-year period, and the construction produced $64.7 million in new economic activity and almost 600 new jobs. As Walden noted, "from the point of view of the local public fiscal ledger, owner occupied residential construction in the Triangle 'pays for itself.'"

APFOs force developers to pay "voluntary" fees to cover public service costs — costs that are later passed on to homebuyers. Through this process, housing costs are further increased. 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. Buyers pay in the form of higher housing costs and property and sales taxes.

Instead of forcing developers to pay impact fees and APFOs, counties and cities should use marginal-cost pricing for public services. Developers should cover only the direct costs of extending infrastructure to new housing. For example, if a new housing development is located far away from the city's water and sewage lines, the developer should cover the costs associated with connecting the development to the system. This approach will save homebuyers from unnecessarily increased housing prices that result from impact fees and APFOs. It will also help prevent sprawl by making it more beneficial for developers to build closer to the city's existing facilities.

Principle No. 4. *Re-establish the rule of law.*

Too many land-use regulations allow too much discretion on the part of the planning staff, planning boards, and elected bodies. A time-consuming process and public input drive up housing costs. 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.

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Smart Growth

Recommendation

North Carolina leaders should embrace a market-friendly approach to growth to avoid the restrictive and counterproductive policies known as "Smart Growth." Leaders should favor consumer choices and prices over bureaucratic planning and guesswork. "Flex Growth" tools such as marginal-cost pricing, voluntary open-space protection, and more flexible zoning codes that allow mixed-use developments are readily available without the need for additional state legislation.

North Carolina cities that have implemented Smart Growth techniques have experienced far more housing problems than those that have not.

Background

North Carolina's 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 controls called Smart Growth, which place greater government control over development, housing, transportation, and consumer choice. 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, traffic congestion, and expensive planning penalties (artificial inflation of a home's price as a response to heavy regulation) for many homebuyers.

North Carolina cities that have implemented Smart Growth techniques have experienced far more housing problems than those that have not. Before the recent housing crisis hit, housing prices in Asheville and Wilmington, cities that have experimented with growth planning, 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. High housing prices make it harder for people to buy their own homes or upgrade to larger homes as their families grow. North Carolina cities should avoid Smart Growth policies in order to keep housing priced at fair values and promote home ownership.

The high-density housing projects supported by Smart Growth advocates also contribute to traffic congestion by adding more drivers to the streets. Rather than building more roads to accommodate the increase in demand, Smart Growth principles call for increased spending on mass transit. Those projects cost millions of dollars to construct and maintain, but few citizens use them.

Mass transit projects are too prohibitively expensive to justify even in the long run, and worse, funding for them takes away funds from much-needed road construction and improvement projects that actually alleviate congestion (see the section on Public Transit, pp. 26-27). A large portion of transportation funds come from gasoline excise taxes, which are meant to go toward road construction, but often are used instead for mass transit. 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 investing in roadway projects before they attempt to force people from cars to mass transit.

Many Smart Growth advocates attack urban sprawl by saying that it is costly for taxpayers, but the effects of sprawl are often positive. A 1999 JLF study on growth and taxes in North Carolina (*Flex Growth: A Market-Friendly Development Policy for North*

Carolina's Growing Communities by Jonathan Jordan and Michael Lowrey) disproved many Smart Growth theories. The study found that cities with newer homes have, on average, lower taxes than those with older homes. It challenged the idea popular among Smart Growth advocates that growth raises taxes through increased demand for public services.

The study also found that the tax burden decreased as the percentage of single-family homes increased, disproving the theory that it is more expensive to provide services to single-family homes.

Finally, the study refuted the Smart Growth assumption that higher densities and greater reliance on transit reduces commuting times and improves transportation access. The communities with shorter commutes and less highway congestion were also the ones criticized for having urban sprawl.

Smart Growth proponents say their policies are needed to combat the negative effects of sprawl, but sprawl can actually be beneficial to a community. In many cases, Smart Growth policies only add new, worse problems.

The Flex Growth alternative

Rather than continuing the trend toward Smart Growth, policymakers should move toward a more market-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.

The following elements of Flex Growth will allow communities to experience healthy growth without excessive government interference.

- **Pursue 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.

- **Implement 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.

- **Change zoning laws to allow for development based on consumer demand.** Mixed-use zoning should be implemented to allow developers 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 planning.

- **Protect 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.

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

- **Strengthen 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.

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Affordable Housing

Recommendation

Cities and counties should abandon burdensome and counterproductive "affordable housing" and inclusionary zoning policies. Instead, they should adopt less stringent land-use management ordinances to lower construction costs and increase housing stock.

Background

What is affordable housing? Affordable housing includes initiatives to bring "affordable" homes into a municipality. Affordability is defined by the government. It divides households into different strata based on income relative to the area median income (AMI), as defined by the U.S. Department of Housing and Urban Development. For example, moderate-income households are most often defined as those between 80 percent and 100 percent of the AMI.

Inclusionary zoning forces builders and most buyers to subsidize the 'affordable' home purchases. It amounts to a hidden welfare tax.

Affordable housing initiatives are voluntary in theory. Governments try to entice builders to construct affordable units, in exchange for which they will offer builders incentives such as increased building density or floor/area ratios.

But governments may overstep their bounds and rig the system. Carrboro, for example, intimidates builders who do not offer 15 percent affordable housing by requiring them to meet with the Board of Aldermen for an "Affordable Housing Review Meeting."

What is inclusionary zoning? Inclusionary zoning mandates affordable housing. With inclusionary zoning, a local government requires that a percentage of new home construction be designated as affordable. Those homes are sold at a government-set price without consideration of construction cost or market value. Not only must builders sell affordable units at this arbitrary price, but they must also guarantee the home's affordability for a time period that can range from 10 years to perpetuity.

What is the effect of inclusionary zoning? Inclusionary zoning results in fewer new homes and higher prices for all homes. It is counterproductive to the goal of helping low- and middle-income families be able to afford homes.

Inclusionary zoning functions as a tax on homebuilders, making the construction of new homes more expensive and forcing builders to take on burdensome administrative costs through having to guarantee a home's affordability for a set number of years. Additionally, affordable homes are most often sold at a below-market price; therefore, each sale of an affordable home represents a significant opportunity cost. As a result, builders produce fewer homes. Some may even choose to do business in neighboring municipalities without inclusionary zoning ordinances.

Moreover, housing markets automatically produce affordable housing. As the incomes in an area rise, people buy larger, higher-priced homes, leaving behind homes that sell at affordable prices. (As affordable automobiles are often found in the used-car market, affordable housing is typically found in the "used home" market.) Inclusionary zoning, especially when coupled with restrictive land-use policies, breaks down this process.

The regulations therefore increase the cost of all homes, not just new homes. As a result, they price middle-class families out of the market: they can neither qualify to purchase government-mandated affordable homes nor buy a home at the market rate.

What are the concerns with inclusionary zoning? Inclusionary zoning is ineffective, inefficient, inequitable, and probably illegal in North Carolina.

- **Ineffective.** Inclusionary zoning produces the opposite of its intended effect: it produces less affordable housing, not more. A 2004 Reason Foundation study documented this effect in California. After the adoption of inclusionary zoning ordinances, housing production fell. Prices skyrocketed by $22,000 to $44,000 in median cities and by more than $100,000 in hot markets. Inclusionary zoning results in fewer homes sold, and they're sold at higher prices.

- **Inefficient.** Inclusionary zoning is costly. It functions as a "social welfare" tax, reducing the supply of housing while increasing costs on builders as well as buyers. Reducing burdensome land-use regulations would lower home prices more effectively and cheaply. This decrease would lower construction costs and, consequently, house prices.
- **Inequitable.** Local governments have embraced inclusionary zoning because it provides affordable homes without *government* cost. But it forces homebuilders and market-rate homebuyers to subsidize the affordable home purchases. It amounts to a hidden social welfare tax, transferring wealth from one segment of society to another.
- **Illegal.** North Carolina law has a strict ban on rent control. Rental units are not included in inclusionary zoning for that reason. Even so, the ordinances could still be illegal. Chapel Hill, in the process of formulating its own ordinance, fears becoming a "test case" to challenge the law's validity.

How can local governments provide affordable homes? Local governments should change burdensome land-use regulations. These regulations, given the ironic name "Smart Growth" (see the section on Smart Growth, p. 20), include everything from specific road setbacks to open-space requirements to architectural design standards. They significantly affect home prices: buyers essentially pay a "planning penalty," an artificial inflation of the home's price as a response to onerous regulations. A 2006 John Locke Foundation *Policy Report* found Asheville buyers' planning penalty was $13,901, and Wilmington buyers' penalty was $21,675.

Overhauling land-use management 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.

Examples

Two North Carolina cities have adopted inclusionary zoning: Davidson and Manteo. **Davidson** was the first, adopting its ordinance in 2001. It mandates that 12.5 percent of homes be affordable (although builders of less than eight units may make a cash payment to the city in lieu of actually building homes). Davidson requires those homes to be affordable for 30 years.

Manteo adopted inclusionary zoning in 2003. It requires that 20 percent of homes in developments of five units or more be affordable. Households with preapproved loans must apply for ownership of an affordable unit. The system ranks potential owners, giving top preference to residents and town employees of at least one year, who are favored over people in the four other categories, the last of which includes "general public."

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Air Service

Recommendation

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 additional air service.

Why aviation is a questionable expenditure

Diffuse demand. While there is demand for air travel from many communities, it is diffuse; 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 allows them to bring passengers going to different locations (spokes) to a single location and change planes to their final destinations.

Only the state's top markets generate enough travelers to fill even a single daily flight to a single destination.

Hubbing airlines. There was a time that communities like Charlotte (CLT) had their hub paid for through higher fares. The hubbing airline dominated the market, and there was limited competition as low-cost carriers usually only nibbled at the edges. Those days are largely over. Most travelers want to go to major destinations, and low-cost carriers like Southwest, Airtran, and jetBlue have increasingly focused on major markets. Charlotte has become much more competitive in past few years. U.S. Department of Transportation data show Charlotte flyers paying an average of a 15 percent fare premium in the third quarter of 2007 — still on the high side, but nowhere near as bad as the 38 percent higher prices at CLT of five years earlier.

Higher cost per average seat mile. The aircrafts that are used to serve smaller communities have a higher cost per average seat mile (CASM) as compared to 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.

Some passenger planes are no longer being produced. The aircraft traditionally used to serve smaller communities, the 19-seat turboprop, is no longer cost-effective in most applications and is out of production. 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, nonstop service between cities such as Raleigh-Asheville, Raleigh-Norfolk, and Raleigh-Charleston, S.C., that had relied upon 19-seat turboprops has also disappeared.

Larger planes are taking their place. 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, 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 70 or more passengers. High fuel prices will accelerate this trend.

Flights offered at limited times and for a few

destinations are not an economic development tool. An exception to the traditional hub-and-spoke model is provided by airlines like Allegiant Air, which offers flights 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. While such flights are a welcome development for leisure travelers going to high-demand spots, they offer essentially no opportunity for connections to other cities. As such, these flights offer nothing for business travelers and cannot be considered an economic development tool.

New entrants have a tough time. The airline industry has traditionally not been kind to new entrants, and offering government incentives to startups doesn't change that equation. Among the latest startups to fail was Skybus Airlines. Despite 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.

Air-taxi service is a "non-starter." The "next big thing" in air service for smaller communities is air-taxi service. In 2007, the N.C. Department of Transportation in a consortium with 11 smaller communities was awarded a federal grant to market this solution. But air-taxi service is also questionable. The highly respected aviation-consulting firm The Boyd Group declared air-taxis "Non-Starters" in a May 7, 2007, *Aviation Hot Flash*, explaining:

> *Then we have the air-taxi solution, where supposedly some entity will get a fleet of Cirrus or Eclipse or Adam aircraft, and take advantage of all that pent-up demand in underserved small communities. It's the latest mantra. It's the solution to the future.* **It's also complete hogwash**.*" (Emphasis added.)*

As if to underscore that point, both Adam Aircraft and Eclipse Aviation have subsequently filed for Chapter 7 bankruptcy (liquidation).

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. Today there are just under 600,000. Last year's spike in fuel prices and the current 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.

The continuing decline in general aviation makes government attempts to cater to private pilots a problematic strategy.

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Public Transit

Recommendation

The 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 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.

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 "tran-

Long-Range Plan Funds by Mode of Transportation

MPO Region	*Highway**	*Transit**	*Other**	*Total Funding**	*Transit Share of Funds (percent)*	*Transit Share of Commuting (percent)*
Charlotte	$4,699	$6,346†	--	$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✦	--	$2,362	1.8%	1.5%
Fayetteville	$2,153	$200*e*	--	$2,353*e*	8.4%	0.8%
Hickory	$1,680	$116	--	$1,796	6.5%	0.3%
Concord	$1,421	$50*e*	--	$1,471*e*	2.9%	0.4%
Asheville	$1,298*e*	$42*e*	$70*e*	$1,411*e*	3.0%	0.8%
Wilmington	$1,193	$180	$8	$1,380	13.0%	0.9%
High Point	$1,071	$9✤	--	$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%

* *In thousands of dollars*
e *Estimate*
✦ *Through 2010*
✤ *Through 2014*
† *Latest: $8.4 billion*

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

sit-oriented development."

A quote by Charlotte-Mecklenburg planning director Debra Campbell in the June 2007 edition of Governing is illuminating and chilling:

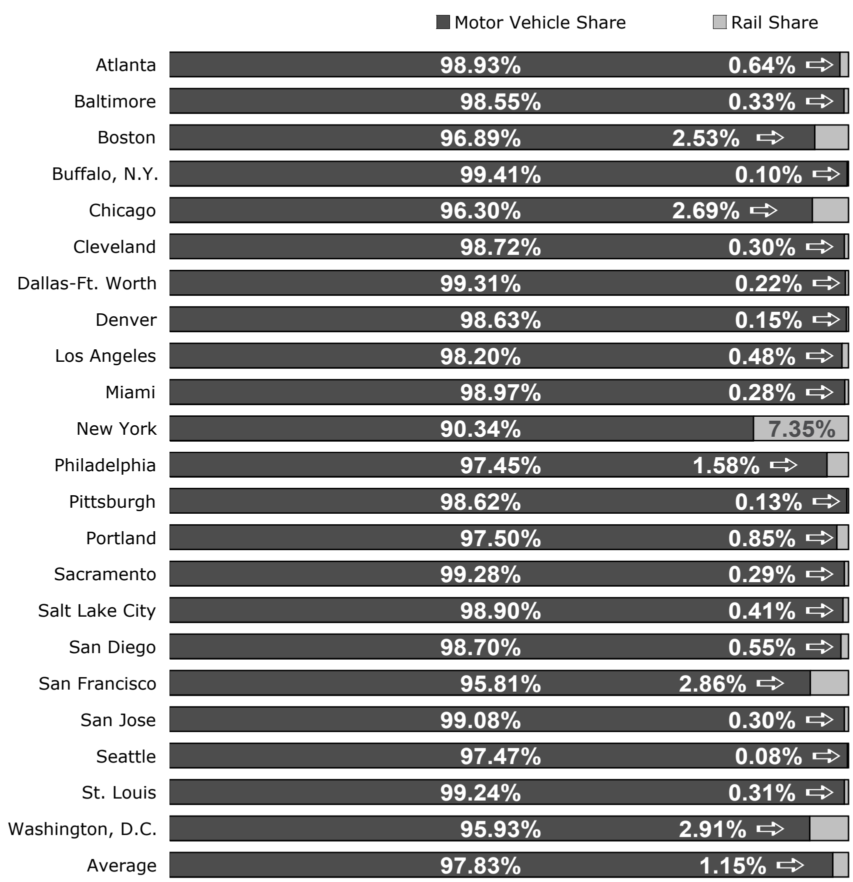
> *'We always saw transit as a means, not an end', says planning director Debra Campbell. 'The real impetus for transit was how it could help us grow in a way that was smart. This really isn't even about building a transit system. It's about place making. It's about building a community.'*

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 table above shows, the market share of rail even in high-density areas is remarkably low.

Who Travels How?
Rail vs. Motor Vehicle Share 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.

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Convention Centers, Stadiums, Water Parks, and Restaurants

Recommendation

Cities and counties should not use taxpayer funds to build convention centers, civic centers, sports stadiums, water parks, restaurants, and performing arts venues. Those are all inherently private-sector responsibilities.

Background

Recently many cities and counties in North Carolina have ignored the distinction between the public and private sectors by funding outright or subsidizing functions that belong to the private sector. In some cities, officials have poured money into nonessential activities while neglecting essential services such as police, fire, and roads.

These activities are often tied to the quest for "economic development" and justified by highly paid consultants who produce distorted and incomplete reports that always conclude that a proposed new, subsidized facility will be an economic boon.

City governments should not force taxpayers (and local, competing businesses) to subsidize private businesses, especially risky ventures.

Those studies always omit information regarding other cities' experiences with construction cost overruns, budget subsidies, fewer visitors than projected, and more importantly, what growth would have resulted from leaving the money in the hands of taxpayers.

Convention centers

For example, convention centers, especially those intended for national conferences, have been struggling for business. Before September 11, 2001, only two cities in the United States — Las Vegas and Orlando — had public convention centers that at least broke even. The rest were losing money annually for their communities. And since 2001, national attendance at *Tradeshow Week 200* events has fallen to early 1990s levels. Nevertheless, consultants still return rosy predictions that generate unwarranted confidence in a proposed center's potential for economic impact, and if heeded, would result in an immense burden on taxpayers when the structure remains empty.

Charlotte and Asheville have made disastrous convention center decisions. Asheville's civic center had a predicted debt of $400,000 in 2006; in past years (2000, 2002, 2004), its debt passed $1 million. It lost sports teams in 2006, but the City Council continued to funnel it money. In 2007, the Council approved a six-year, $3.6 million capital improvement plan.

Charlotte's $148 million facility should have had 751,000 attendees annually. Instead, it has had yearly deficits because it can attract big conventions only by using deep discounts and large subsidies. Its best booking in 2007 was the Shriners convention (25,000 visitors) — but the Shriners were given a discount and a $50,000 subsidy from the Charlotte Regional Visitors Authority, which markets the center, to underwrite costs. Nevertheless, the center was due for $2 million improvements in fiscal year 2008.

Since visitor spending is convention centers' only economic benefit, cities enact "visitor taxes" on rental cars, prepared food, and hotels. But those taxes hurt residents and local businesses who also pay them (e.g., eating out or renting a car), and it also hurts local businesses since taxes decrease tourism.

The private sector could fulfill any convention center task — without taxpayer money. The Koury Center in Greensboro is one example. It successfully competes with subsidized city convention centers while making a profit and paying taxes that, among other things, are used to support its competition.

Restaurants

In Winston-Salem, the city spent more than $600,000 in federal grant money in loans to 10 restaurants along its "Restaurant Row." Loans from the city may cover up to 37.5 percent of project cost, with a maximum of $150,000 allocated to each restaurant. The median loan is $82,000. Interest rates are low (3 to 5 percent); repayment, deferred two years. Despite those advantages, two restaurants have already closed, defaulting on more than $176,000.

Raleigh spent $1,050,000 to fund The Mint, a “white tablecloth” restaurant in a city-owned building on Fayetteville Street. Of that, $800,000 converted the space from a bank to a restaurant; the remaining $250,000 matched the leaseholder’s contributions on a $1-to-$2 ratio (every $2 the leaseholder spent the city matched with $1). 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.

City governments should not invest in private businesses, especially risky ventures (restaurants fail 60 percent of the time after three years). With public dollars used, taxpayers — including owners of competing restaurants — are the ones forced to subsidize these ventures. Furthermore, it distorts the market: winners and losers are picked based on the City Council preferences — not consumer opinion.

Entertainment

Winston-Salem and Forsyth County will invest in a $22.6 million baseball stadium as part of a greater project to expand residential and commercial construction. With interest, the cost of the stadium will be $38 million. Officials plan to recoup the expense from ticket surcharges, land taxes, and sale of its current stadium. But the experience of other cities shows that such a plan rarely succeeds.

Cabarrus County approved a five-year, $2.6 million incentive package to attract Great Wolf Resort, a hotel water park, to Concord. Concord added $1.5 million in five years of tax breaks. The resort is a 409-room hotel and water park — for hotel guests only. Neighboring towns are frustrated by the pressure on water supply. The complex will use 70,000 to 90,000 gallons of water per day; if the land were developed residentially, water use would be about 39,000 gallons per day in 111 homes.

Predicted to have 20 percent profits in its first year, Charlotte’s $38 million U.S. National Whitewater Center posted a $1.7 million loss.

Charlotte is home to the $38 million U.S. National Whitewater Center, which consists of a man-made river, trails, lodge, and rock-climbing center. Area governments guaranteed the center’s loans and promised to cover some losses in the first seven years of operation. Mecklenburg County pledged $7 million ($1 million annual limit); Charlotte, $2 million; other Mecklenburg and Gaston County governments, $3 million.

Predicted to have 20 percent profits in its first year, the center posted a $1.7 million *loss*; it covered operating costs, not debt service.

City council members and county commissioners should not use taxpayer funds to fund projects in the private sector. They have no expertise as venture capitalists, and they don’t bear the financial risks of their choices. It is no surprise that the vast majority of these projects fail, leaving the taxpayers holding the bag.

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Eminent Domain

Recommendation

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?

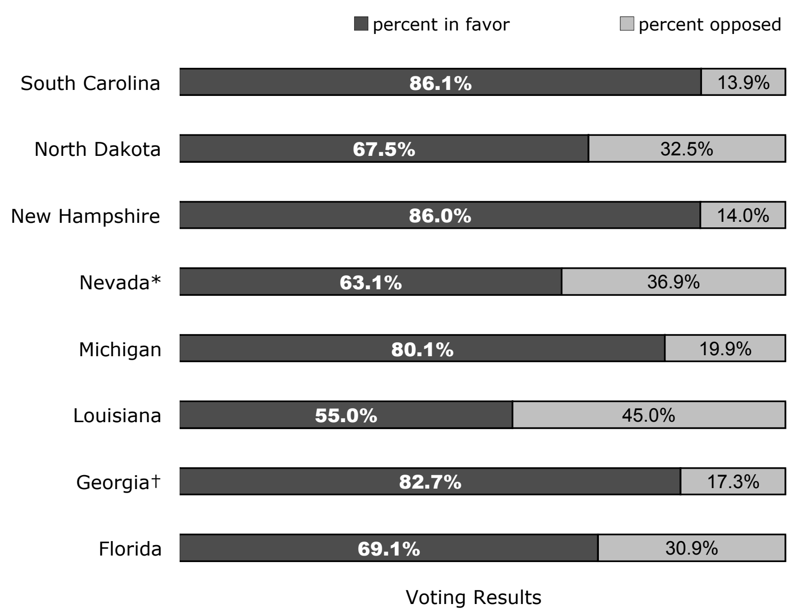
Major impact on victims. After the taking, many eminent domain victims find themselves unable to afford to live in the same neighborhood or area. Sometimes they are forced to move away from family and friends. There are intangible harms to losing a home that simply cannot be quantified. A business that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

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.

†These results were based on 98 percent of precints reporting.

Source: *Castle Coalition*

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."

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.

A model approach: Anaheim, California

In the 1980s, Anaheim 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.

If an investor thinks the government will seize private property in a certain area, he has no reason to buy and improve property in that area.

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 from 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."

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Forced Annexation

Recommendation

When municipalities initiate annexations, they should be required to provide meaningful services to the areas they propose to annex, counties should have oversight over municipalities, and residents in the affected areas should have a vote.

Background

Forced annexation (which is not the same as annexation) is a serious problem in North Carolina. Forced annexation is simply 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

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.

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.

County oversight. Under current annexation law, municipalities can basically do whatever they want when it comes to forced annexation. The process needs a neutral, third-party oversight body with the ability to ensure that a proposed annexation meets clear guidelines. Counties make the most sense because they represent the interests of municipalities as well as the affected property owners. They also are in a position to know the best interests of the overall community.

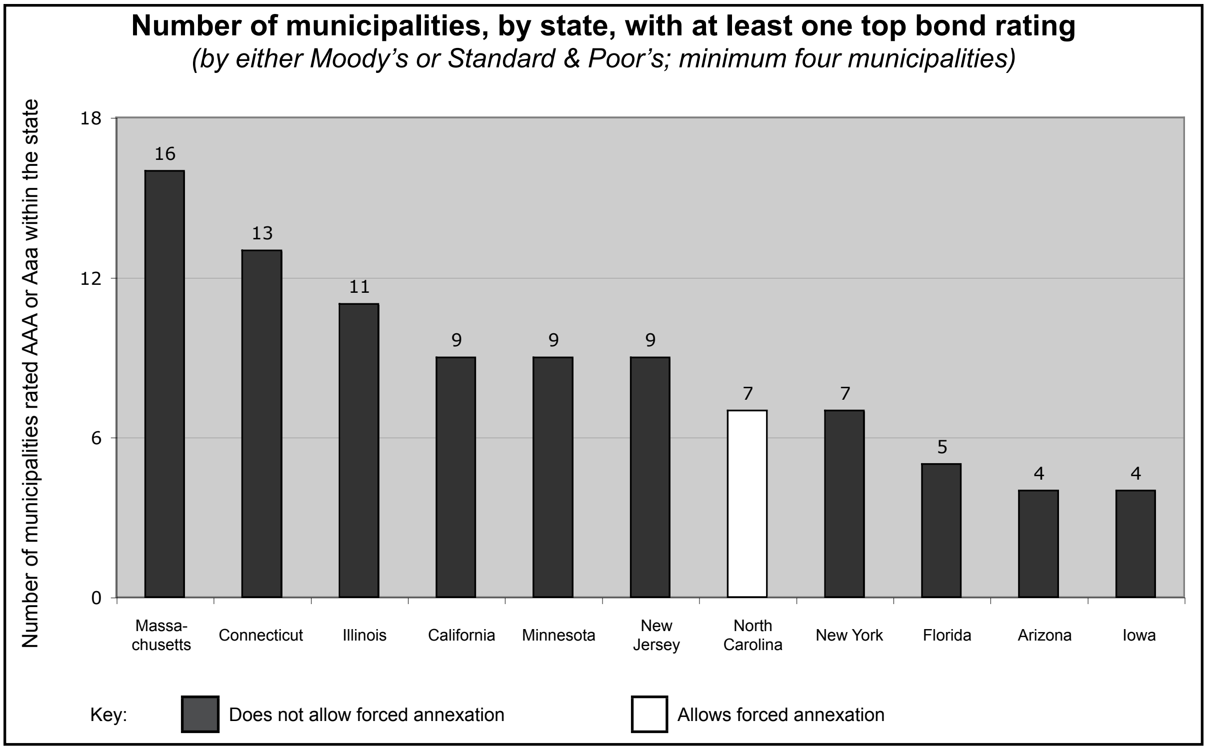
Votes. Residents living in the proposed annexed area should have a simple majority vote over the proposal. An incredible 67 percent of states that have annexation allow residents in the proposed annexed areas to vote.

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 to their cities.

The bond rating argument holds that unless



N.C. 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 questionable measure, the bond rating argument fails miserably.

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

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About The Center for Local Innovation

Created in 1999, The Center for Local Innovation is a special project of the John Locke Foundation. Through conferences, workshops, newsletters, and research papers, called *Innovation Guides*, CLI engages local government leaders in discussions about critical issues facing North Carolina's municipalities and counties, such as privatization, fiscal restraint, and growth management. Its Steering Committee includes elected city and county officials from across the state. For more information, visit the CLI web site at www.LocalInnovation.org.

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.

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"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)

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