Regionalist Paper No. 12

Revenue Sharing as a Component of Regionalism
What are the Issues?

Regionalists are convinced that metropolitan-level strategic planning and decision-making are essential. Broad, visionary and comprehensive planning must be at the core of metropolitan economic development, socioeconomic management, and region-wide investment planning in order to prevent haphazard development with all of its adverse consequences. These regionalists develop theories, organizational wiring diagrams, leadership models, and hosts of persuasive arguments proving in their minds that economies of scale and higher levels of public services will result. This enthusiasm then runs into an institutional fact-of-life reality—money. By definition, regionalism is, and certainly requires, inter-jurisdictional cooperation. At the same time, in virtually every state, and in whatever manner is possible, these same jurisdictions must plan and provide for their own citizens. For them, "the buck stops here"; they must compete for revenues. Populations and their needs grow, and these municipalities will go to the mat in order to build up their tax base capacity. In short, "competition trumps cooperation", a short term thought process that often results in bad decisions or in activities that mortgage the future. This institutional conflict—"must cooperate to advance" versus "must compete to survive"—has stymied regionalism, despite its legitimate virtues, probably more than any other factor. For Americans on the other hand, competition is considered to be, most often, a healthy thing. Regionalists may need to merge their enthusiasm and models with existing institutional realities into some kind of "New Regionalism"[1]. Truly, this is an important issue. Building on the "state or local revenue sharing" techniques in practice today and moving into the emerging, modern day realm of "metropolitan revenue sharing" formulas may break the log jam or at least serve as an element of the solution.

As context for this paper, we will view "revenue sharing" in three different categories: state, local, and metropolitan levels of revenue sharing. Different forms of revenue sharing exist in each of these three categories. As a public policy, this subject is complex, often controversial, and always requires dedicated and thorough analysis and sound judgment.

[1] Richard Eggleston in the Wisconsin Alliance of Cities e-newsletter, August 27, 2002, quoting Old Dominion University professor, Roger Richman used the term "New Regionalism" to portray the marriage of regional management and regional funding. Other public administration researchers have also used this term.

“State level revenue sharing” is nothing new. For over a hundred years, states have shared (redistributed) revenues back to their cities, counties, and towns, and in recent years, sometimes back to regional organizations or projects. Such state level revenue sharing has always supported a set of public policies—to ensure viable court house operations, for example, in the older days; to support public education throughout the state, the most prevalent purpose for state revenue sharing today; and to support road building and many other basic community needs.

Revenue sharing has evolved considerably during the last fifty years. Let us note right away that state revenue sharing programs continue to be substantial and the most important form of revenue sharing today. State public policy initiatives have expanded. The number of services or functions for which state aid is available has grown, using earmarked fractions of sales taxes or allocations from the general fund to support crime prevention, aid for the homeless, transportation, higher education and much else. Beyond assuring that the basics are covered, the long standing and well known state revenue sharing process has served as a very practical tool for policy makers, with ever changing programs and recipients, sometimes expanding and sometimes contracting.

In addition to being provided to cities, counties, and towns, this state revenue sharing process can also be provided to regions or metropolitan areas. This relatively new process does occur, but since there are no regional governments, it always requires some special statutory act or other mechanism to ensure a sufficient legal basis and to get it started. In Virginia, the 1996 Regional Competitive Act enables state revenues to go directly to duly-established “regional partnerships”, as defined by the Act, for the purpose of enhancing a region’s economic competitiveness. As another example, the state transportation program allocates, using established formulas, state revenues to its regional transportation districts, but, so far, and at best, there are only a few other examples where state revenues are shared directly with regional bodies. Given the broad recognition that regions have become the primary unit of economic development and cultural cohesion, regardless of jurisdictional boundaries, one would expect that this process of “state revenue sharing directly to regional entities” will dramatically increase. Let us hope so.

“Local level revenue sharing” is the second and a newer category of revenue sharing that has emerged over the last forty years in a variety of forms. As a matter of general law for broad applications, or sometimes statutorily for specific purposes or municipalities, states have authorized neighboring jurisdictions to execute local “shared services-shared revenue” type agreements. Several examples of this bilateral or multi-lateral process in Virginia are described below. They foster cooperation; they limit what might otherwise be fratricidal competition.

The story behind "local revenue sharing" in Virginia helps us to understand its merits: Throughout the United States, the former traditional means by which urban municipalities increased tax base in order to serve their growing populations was by annexation of the empty or sparsely occupied land of adjacent counties. As the rural areas became more populous, and as urban social burdens and more expensive infrastructure drove up city tax rates, outlying jurisdictions increasingly resisted forced takeover. Annexation as a process of expanding metropolitan areas declined sharply[2], nationwide, during the late years of the 20th Century. By 1990 the Commonwealth of Virginia also acceded to the wishes of suburban and rural voters by instituting a moratorium on the annexation rights of the cities.

Today, even if the Commonwealth lifted the ban on annexation, many Hampton Roads cities would be unable to use it: They are landlocked by adjacent cities and can never expand their boundaries unless their residents vote to consolidate. As an alternative to annexation or consolidation, compensation for the mutual costs and benefits that arise across local government boundaries can be negotiated in the form of revenue sharing agreements.

What is local revenue sharing? Ted McCormack of the Virginia Department of Housing and Community Development (DHCD), in his research into the subject, defines it as "A sharing of revenues between jurisdictions which involves the transfer [from one to the other] of some portion of a locality's revenue receipts, with the individual political subdivisions retaining full autonomy over tax rates applied within their jurisdictions." He goes on to say that "revenue sharing programs have been employed throughout the nation to offset some perceived inequitable consequences [arising] from the nature and pattern of development and to address problems caused by local reliance on the property tax."

In Virginia[3], several factors come into play in any effort to negotiate a revenue sharing arrangement among localities.

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[2] See Regionalist Paper No. 8, *Regionalism As Advanced Elsewhere: The Sppectrum of Regional Structures that has arise in North America: What are Our Options?* for a discussion of the historic trend of building communities or regionalism.

[3] John S. West and Carter Glass IV, *Revenue Sharing: An Important Economic Development Tool for Virginia Localities*, Virginia Lawyer magazine, the official publication of the Virginia State Bar, April 2000, describes the genesis and effects, somewhat limited, of local revenue sharing programs throughout Virginia

First is the fact that Virginia is a Dillon Rule[4] state. The Dillon rule limits what local governments can do without approval from the General Assembly. Therefore, before a shared revenue area can be created it must be authorized by State law.

The second factor is that Virginia's structure of separately independent cities and counties discourages communities[5] from cooperating since each has its own way of operating its government and sets its own tax rates.

Third, revenue sharing agreements must be reviewed both by the Virginia Commission on Local Government[6] and by a special court before they may be implemented. These requirements sound formidable, but they are designed mainly to prevent coercion. Where the two communities see potential mutual benefit and agree to the arrangement, state authorities seldom stand in the way.

Why would communities be interested in shared revenue? One reason would be that one community has something that the other needs. For example, one community may need sewer and water from an adjacent jurisdiction to attract a new industry, and the other community will benefit from that industry too. A shared revenue agreement would allow shorter and less costly sewer and water runs to be extended from one community into the locality that needs it, predicated on the two communities sharing in the costs of the extensions and also sharing in the taxes generated.

Another important and frequent example would be a community that may have the land needed to build a major regional facility such as a large industrial park, a convention center, an arts pavilion, a sports complex, or a recreational park but lacks the funds to execute the project by itself. Often, these possibilities could have considerable positive regional impact. Adjacent jurisdictions interested in the outcome of these ventures might therefore be invited to assist with the construction costs and then share in the revenues generated as well. There are many examples of a variety of shared revenue agreements throughout the country.

In the Hampton Roads region, there is only one city that is actively involved with other communities in shared revenue programs. The City of Franklin has two shared revenue agreements, one with Southampton County and one with Isle of Wight County. The nature of these agreements is instructive.

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[4] See Regionalist Paper No. 14, *Regionalism: Does the Dillon Rule Help or Hinder Metropolitan Progress?*
[5] On the other hand, prominent public administration practitioners, including Myron Orfield, argue that the separate state-city structure is advantageous to overall regional economic development.
[6] The Commission on Local Government is a Division of the Virginia Department of Housing and Community Development (DHCD)

A 1984 attempt by Franklin to annex portions of Isle of Wight County and Southampton County led to their first shared revenue agreement. Southampton County agreed to let Franklin annex 4.7 square miles of territory in two phases over 25 years. In exchange, Franklin agreed to pay to the county, annually in perpetuity, one-half of its net tax revenue and one-half of the net revenue from the city's owned electric utility company. The agreement allows the city to calculate net revenue by deducting all operational and local capital funds "allocable to those governmental services provided" in the area.

Unlike Southampton County's annexation agreement, Isle of Wight did not lose any territory to Franklin. Rather, Franklin agreed to waive any attempt in the future to annex an area of 6.37 square miles in the county that included major industries such as Union Camp (now International Paper), Franklin Equipment and a number of retail establishments. In compensation, the County agreed to pay the City between 17% and 23% of that 6.37 square mile area's annual tax collections in perpetuity. The percentage fluctuates yearly within those limits in accordance with a formula based on objective measures of the relative fiscal condition of the two jurisdictions.

The other shared revenue agreement between Franklin and Southampton County was established in 1996. The industrial corridor covered by the previous agreement enjoyed extensive new commercial development, and it was expanding west from Franklin into the county. The county has a corridor over a mile in area for future industrial and commercial development adjacent to General Thomas Boulevard and the CSX Railroad, and it was also looking at developing a 400 acre industrial park. However, the county's nearest utilities were over 4 miles away whereas the city's utilities could easily be extended west into the development site. The city and county therefore signed a formal agreement stating that if the city would extend its utilities west into the county along General Thomas Boulevard, Southampton County would share with the city 30% of the tax revenue generated by any business or industry that connected to the utilities. Before the agreement was signed, additional areas in the county adjacent to Franklin were included in the shared revenue area. As part of the agreement, Franklin agreed to never annex those areas.

Other communities in Virginia with revenue sharing agreements include Charlottesville with Albemarle County, Bedford with Bedford County, Radford with Montgomery County, and Lexington with Rockbridge County, to name a few.

Outside of Hampton Roads, there are five regions in Virginia that have revenue sharing agreements specifically for industrial development. In those regions a prime industrial site was selected and adjacent communities invested to develop the industrial park and shared in the revenue. All of these agreements have occurred in the past five years. Most of these agreements are in South Central Virginia.

Given the practical impossibility of annexation as a means for any one city in Hampton Roads to improve its tax base, revenue sharing offers new opportunities for adjacent localities or for the region to participate collectively in selected economic development opportunities. The existence of a variety of such agreements both in Virginia and throughout the United States offers the precedent for using the technique more widely in Hampton Roads when and if our local governments find themselves in circumstances where the sharing will generate a mutual benefit.

If Hampton Roads ever has the opportunity to attract an NFL expansion team, the building of the requisite stadium—a huge undertaking requiring a minimum of sixty thousand seats, too costly for any one locality—would lend itself to the use of a revenue sharing agreement. All would share not only in the revenues proportionate to their share in the investment but also in the pride of having a Hampton Roads football team[7].

"Local revenue sharing" allows neighboring governments to work together on major projects rather than each developing its own facility and competing with one another for the business. An imaginative use of the technique might also be applied to solve other regional needs, such as affordable housing or special health facilities. It would not address all of our regional development concerns, but it is a State-supported and viable process that could offer alternatives to inter-local fiscal disparities and a means of lessening inter-jurisdictional contention.

There is a second variation of local revenue sharing that is referred to as "shared funding". While not revenue sharing in its strictest sense, local "shared funding" for public services needs to be mentioned. The state-established regional authorities and districts that exist in Hampton Roads[8] are important examples of regional cooperation where funding (money) has been addressed. Here, the cost of operations may be primarily funded through user fees, but the participating municipalities also contribute fair-share funding, that may be based on per capita or other formulaic contributions (per

[7] Regional revenue sharing for stadiums is not uncommon and is always a headline issue. These cases and their supporting legislation need to be studied; they do contribute to regional economic development and to regional reputation, two noble goals. These cases generally do not contemplate or address other equally important regional issues such as transportation, socioeconomic, environmental, workforce development, land use planning and others.

[8] See Regionalist Paper No. 3, *Understanding the Regional Organizations in Hampton Roads Today: Contemporary Regionalism and Where we Stand in the Process.*

mile of sewer line, per gallon of clean water, per some measure of public need, and many more). This shared funding variant of local revenue sharing, whether involving a few or many communities in a metropolitan area always contributes to regional cooperation and regional governance and should be encouraged.

Regional or **"metropolitan level revenue sharing"** represents the third and the newest form of revenue sharing. This concept has gained noteworthy traction around the country. Over the next fifty years or so, and depending on individual regional interests, this concept could become one of the important tools used by state and local policy makers who constantly search for improved government efficiencies and effectiveness.

In addition to the myriad objectives of the previously discussed and ongoing revenue sharing programs, this time, metropolitan revenue sharing presumes and requires a regional perspective. Here, local revenues are collected, placed into a regional pool, and then shared. By its very nature, metropolitan revenue sharing presumes state acknowledgement of regional needs and interests, for state support and approval will certainly be required, and it presumes that local leaders, likewise, see the imperatives of, and have agreed to, some level of regional cooperation, for they will become the contributors.

Somewhat complex in language, but not in principal, we must exercise care in defining and using terms in any discussion of metropolitan revenue sharing, for it may really be tax revenue sharing, or tax-base revenue sharing, or tax-base-growth revenue sharing, or economic growth sharing, or any combination of the foregoing.

The Twin Cities Metropolitan Commission (Twin Cities Metro)[9] has the most mature program of metropolitan revenue sharing in the United States which was started in 1975. Other variations of this metropolitan effort have also been developed and are operating in Rochester, NY; Hackensack Meadows, NJ; Dayton, OH, and elsewhere, all with their respective merits and lessons learned.

In short, tax revenues are collected by all participating communities and a pre-designated fraction of these revenues are redistributed by an approved formula back to these communities or some fraction may also be used for regional projects. The grand

[9] Dreier, Peter, John Mollenkopf and Todd Swanstrom. *Place Matters – Metropolitics for the 21st Century*, Lawrence, Kansas: University of Kansas Press, 2nd edition, revised, 2005. p. for a discussion of the Twin Cities Metro program, its ups and downs; and Orfield, Myron, *American Metro-Politics: The New Suburban Reality,* Washington, D.C.: The Brookings Institution Press, 2002 that includes much depth on the Twin Cities structure of government; and the Twin Cities Metro website: www.metrocouncil.org

questions are what tax revenues are involved (where does the money come from), and how are they used (who gets the money).

Including Minneapolis-St. Paul, seven counties and their several included cities and towns make up the Twin Cities Metro region. Here, the revenues collected are identified as "new, non-residential, tax-base-growth revenues". Programmatically, this means that a pre-designated fraction of the tax-base proceeds from commercial and industrial new business starts is subject to being placed into the regional pool of funds. As for sources of this revenue, programs in other metropolitan areas vary and could include new residential construction; or it could include existing as well as new businesses[10], or existing and new residences; or they could further limit the types of commercial startups involved; or they could go beyond tax-base revenue and include, or have only, local sales tax revenue streams, or any combination of the foregoing. From whatever the defined source of revenues may be, the pre-designated fraction that goes to the regional pool also varies—for Twin Cities Metro, that fraction is 40 %, the remainder retained by the respective host community. On the output side, re-allocation formulas vary widely. Basically, they are designed to support regional public policies[11]. The redistribution formulas are based heavily on population, but also on the basis of tax base per capita capacity (communities with low tax bases receive more), or on the basis of city type (complex cities receive more than less complex townships), or on the basis of need (designed to stem fiscal disparities whose presence would otherwise deter prospective new businesses anywhere in the region)[12]; or on other parameters.

In theory, the basic objectives[13] of metropolitan revenue sharing are (1) to reduce competition among communities for properties to add to their tax bases; (2) to create a fairer distribution of tax benefits, providing a majority return to the community hosting and supporting the new business, but also a fractional return to all other communities inevitably impacted with traffic congestion or other costs; (3) to reduce disparities in tax-base per capita among communities within the same region so as to provide more

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[10] Code of Virginia, Article §15.2-1301, Voluntary economic growth-sharing agreements (1996) already permits local tax-base revenue sharing, defined as "growth revenue sharing", meaning that it applies only to tax-base growth after some date certain, the same as in Minneapolis-St. Paul. Although the Virginia context here did not arise with regionalism in mind, the more controversial aspect of non-state-involved, regional tax-base sharing has been addressed.

[11] A very important factor, this presumes agreement has been reached for the region's public policy goals. The point of this note is the chicken-and-egg question – you cannot have one, a revenue system, without the other, an agreed to regional agenda.

[12] See Regionalist Paper No. 13, *The Social Dimension of Regionalism: Metropolitan Benefits and Cautions*, for further discussions.

equalized, but not equal, bases for financing local government services; and recognizing that all communities will benefit from any new business development, (4) to permit regional leaders to better address land-use planning across a territory, identifying and planning for power plant or transportation needs fifty years from now, for example, and much, much else. The last of these objectives may be the most important of all for the long run. In addition, the process enables (requires) local officials representing a majority of residents in the region to form a political coalition supporting regional objectives in the state legislature, even if a minority of the region's residents oppose such objectives. It moves operations and the mind beyond the voluntary or consensual only mode of decision-making, often a straight jacket on progress.

For some, however, this is an exercise in socialism; the best performing cities and counties will be net losers, subsidizing others. For others, today's net losers will be tomorrow's net winners. For them, it is an exercise in planning ahead and investing in the regional future.

The National Association of Industrial and Office Properties (representing the developers) has concluded[14] that such revenue sharing programs do not slow growth; that in the long run, tax-base sharing may improve the quality of the workforce by increasing the resources available to low tax-base communities to use for education or for other community investment; and that if the political coalition necessary to pass laws providing for these measures had been successful, then that coalition may also be strong enough to adopt other needed region-oriented policies such as workforce housing and others.

These are the important, and, yes, controversial details. The broad concept to acknowledge, however, is that this metropolitan revenue sharing process is working.

Among the leading drivers in 1971 to create the Twin Cities Metro governance structure, as well as in other metropolitan areas[15], was the issue of land use planning—the desire to stop eating up all available land especially going North with the associated sticker shock costs of providing supporting public services to both commercial and residential developments. Then in 1975, the state approved their metropolitan revenue sharing program. Among the achievements measured by observers has been the irreversible public recognition and support of a regional governance agency, much better

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[13] Drawn from the study report: *Regional Tax-Base or Revenue Sharing,* drafted by and posted on the National Association of Industrial and Office Properties' (NAOIP) website, www.naiop.org
[14] Ibid

transportation and transit planning with its attendant land use impacts, and improved land use management opportunities because of the collaboration involved in attracting and locating new commercial developments, as opposed to the beggar-thy-neighbor, and all costs competition of the past. Measurable gains, likewise, have occurred elsewhere. Challenges remain as well as they always will. Government leaders not only need structural and funding mechanisms; they will always need selfless and sound judgment to stay abreast of changing requirements.

Metropolitan revenue sharing is a regional program, using regional resources for regional purposes, because that was deemed by its participants as the best thing to do for the future health and welfare of its regional citizens. It has reduced, but not eliminated inter-local competition; promoted a visionary approach to sprawl or land use questions; reduced fiscal disparities between communities; given public credence to regional planning among political leaders; and more.

Regionalism has succeeded in Nashville, Louisville, Jacksonville, Toronto, Portland, and in several other metropolitan areas without the involvement of metropolitan revenue sharing programs. Thus, such a revenue sharing system is not an absolute pre-requisite to effective regional cooperation, regional governance, or regional citizenship. In all of its varieties; state, local, or regional; and in its sub-varieties, tax, tax-base, or tax-base-growth; revenue sharing serves as a set of tools that policy makers may draw upon. And as lessons learned from others, such tools, whether used as the core of a regionalist effort or as an element in the effort, may offer enormous value.

As noted in several other Regionalist Papers, there are no two regionalism programs or organizational structures that are alike—all depends upon the unique character, geography, and traditions of the region; and upon the awareness, interests and will of the public and their leaders as to what structure and what level of regional cooperation best fits their future.

James Bradshaw and Ray Taylor, Future of Hampton Roads, February 2006

[15] Metropolitan management efforts in Wisconsin and Oregon especially, but also elsewhere have had haphazard development and land use questions serve as one of the drivers for regional planning. Terms such as the fiscalization of land and cash box zoning added to the drama.