

TRANSFORMING LOCAL GOVERNMENT – PRIVATELY*

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I am here to talk about a major change in American society. It involves, among other things, the character of American housing, property rights, and local government. I will be summarizing some of the main themes of my recent book, *Private Neighborhoods and the Transformation of Local Government* (Urban Institute Press, July 2005).

I don't think "transformation" is too strong a term. It is literally true. Basically, local government in the United States at the micro level is being decentralized to a neighborhood scale and is being privatized at the same time. This is the result of the rise since the 1960s of the private community association or, as I call it in my book, the "private neighborhood association."

Just to be clear, I should define what I mean. There are three main kinds of neighborhood associations – homeowners associations, condominiums, and cooperatives. When you move into a neighborhood governed by one of these associations, you are required to agree as a condition of purchase to the private terms of governance.

These include the power to levy "assessments" – you could call it private taxation. Neighborhood associations assert comprehensive regulatory controls over property within their boundaries. The association can control the color you paint your house, where you can plant a bush, whether you can build a fence, how soon you have to mow your lawn, and so forth. This authority is all laid out in the "CC&Rs" – the Covenants, Conditions, and Restrictions."

The neighborhood association will also usually provide certain common services. These frequently include garbage collection, street lighting, snow removal and road maintenance. Many associations also provide private security patrols. About 10 to 20 percent of associations maintain a gate – the so-called "gated communities." The associations mow the lawns, trim the trees, and otherwise maintain the common areas belonging to everyone collectively.

Associations frequently provide and regulate the use of common recreational facilities such as swimming pools, golf courses, and tennis courts. Many of them now provide parks and other open spaces for people to go for a walk, jog on a trail, do some bird watching, and so forth. Basically, if a service mainly affects a single neighborhood, and there are no major economies of scale, it is increasingly being provided by a neighborhood association. The means of provision is often a contract with a private party that may serve a number of different neighborhoods.

This all amounts to the rise of neighborhood government in the United States. Americans may want less government at the national level but at the neighborhood level they seem today to want more. The delivery of services and the regulation of land are now being undertaken by neighborhoods, where before the unit of government would have been larger, often much larger. A neighborhood association

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can be as small as a single building and as large as a city of 50,000. But the typical size is around 200 to 300 housing units with a population of perhaps 500 to 1,000.

This does not mean that there is no need for local government in the public sector. The rise of private neighborhood associations is leaving local government to focus on things with a wider territorial scope such as sewers, water, air pollution, and arterial highways. The basic units of local government are also becoming much larger, often a core city or a powerful county government.

Just how important, how widespread are these neighborhood associations? For people in the Northeast and Midwest, the answer may be hard to believe. In other parts of the country, neighborhood associations are becoming the main instrument of micro-level local government. In these areas, almost every new major development is now being governed by a neighborhood association. I am talking especially about states such as Florida, Texas, Arizona, Nevada, and California. In California at present, 60 percent of all new housing is being build in a neighborhood association.

Because home buyers have to agree as an initial condition of purchase, you can really only have private neighborhood government where it is created as part of the development process. In parts of the United States built before 1960, neighborhood associations are therefore less common. The first condominium in the United States did not even exist – there was no legal provision for condominiums – until 1962. It was built in Salt Lake City.

But since the 1960s, neighborhood associations have taken off. Half the new housing built in the entire United States between 1980 and 2000 was in a neighborhood association. In 1970, about 1 percent of Americans lived in a neighborhood association. Today, about 18 percent do. That amounts to about 55 million people. They live in 275,000 neighborhood associations. More than 1.25 million Americans serve on the board of directors of a neighborhood association. And these numbers are rising very rapidly.

In the 1960s and 1970s, there was a neighborhood movement that advocated shifting many government responsibilities to the neighborhood level. The leading advocates in this movement were talking about the public sector. But it never really happened. There was too much institutional resistance to such a basic change. Instead, and to most people's surprise, we had a private neighborhood movement. It has been a much wider and more powerful movement than probably anyone anticipated.

And, as I argue, it is transforming the whole structure of local government in the United States. If you look at the Boston area around here, you see the metropolitan governance pattern of most of the Northeast and Midwest. It is an older city surrounded by large numbers of suburban municipalities. The suburban governments are typically on the small side, compared with the older cities. Almost half the municipalities in the United States are less than 1,000 people. Admittedly, these tiny municipalities have only 2 percent of all Americans who live under a municipal form of government -- 174 million people.

But these neighborhood-scale municipalities are the extreme that reflects a widespread phenomenon. As shown in the table below, the Chicago metropolitan area has 569 general-purpose local governments (excluding school and other special-purpose local districts) in the public sector. The Detroit area has 335; St. Louis has 314; and Cleveland has 243. Of course, it is not true everywhere. The Buffalo metropolitan area has only 65 general-purpose local governments. That is partly because the Buffalo area has only 1.2 million people. And it never had any booming

suburban development in the twentieth century. So its population is mostly fitted into a local governing structure inherited from the 19th and early 20th centuries.

But with some exceptions, the older parts of the United States fit a common pattern. In the suburbs, there are hundreds of public-sector municipalities – and including townships in some states – which provide the micro services. If not exactly at neighborhood scale, many of these governments have only a few neighborhoods. In the central city, there is a large consolidated government encompassing at least a few hundred thousand people.

TABLE – TOTAL LOCAL GOVERNMENTS (COUNTY, MUNICIPAL, TOWN OR TOWNSHIP), BY METROPOLITAN AREA

<u>Older Metropolitan Areas</u>	<u>Number of Local Governments</u>
Buffalo (1.2 million population)	65
Chicago (9.2 million)	569
Cincinnati (2.0 million)	233
Cleveland (2.9 million)	243
Detroit (5.5 million)	335
Milwaukee (1.7 million)	113
Minneapolis (3.0 million)	318
Philadelphia (5.1 million)	442
Pittsburgh (2.4 million)	418
St. Louis (2.6 million)	314
 <u>Newer Metropolitan Areas</u>	
Austin (1.2 million)	49
Las Vegas (1.6 million)	13
Orlando (1.6 million)	40
Miami (3.9 million)	62
Raleigh-Durham (1.2 million)	30
Phoenix (3.3 million)	34
San Diego (2.8 million)	19
Tampa (2.4 million)	39

Source: 2002 Census of Governments

New, consider what is happening in newly developing parts of the United States. These are mostly in the South and West. Take an area that is almost brand new since the 1960s. Nevada is our fastest growing state. Las Vegas with its 1.6 million people has a grand total of 13 local governments in the public sector. The whole metropolitan area has 3 county governments and 10 municipalities. There are only 19 municipalities in the entire state of Nevada, along with the 16 counties.

Does this mean that Nevada residents have a special taste for large government, and don't want small governments. Of course, the answer is just the opposite. Nevadans have a strong desire for small government at the neighborhood scale. It is just that they are getting this government privately. And it is not showing up in the official statistics. The Census of Governments, for example, does not

recognize private neighborhood associations as a form of government that it counts in its surveys.

Nevada is filled with many hundreds of neighborhood associations. They are playing the role that small local governments in the public sector play around Boston and most of the rest of the Northeast and Midwest. Nevada is the extreme but you find similar patterns in other rapidly developing areas of the South and West.

Look at Florida. The Orlando metropolitan area has 1.6 million people and a total of 40 general purpose local governments. The Tampa area has 2.4 million people and 39 local governments. Compare this to Cincinnati, whose metropolitan area has 2.0 million people and 233 local governments. If we shift to Arizona, it is almost like Nevada. There are only 87 municipal governments in the entire state of Arizona. The Phoenix metropolitan area has 32.

Compare that with Minnesota, which has a population similar to Arizona, both around 5 million. The state of Minnesota has 854 municipalities. It also has 1,793 towns and townships, which are frequently the functional equivalent of a municipality. Compared with the 34 general-purpose local governments in Phoenix (including 2 county governments), the Minneapolis metropolitan area has 318.

Now consider southern California. San Diego has boomed since World War II. The whole San Diego metropolitan area, with its 2.8 million people, has a grand total of 19 general-purpose local governments. In Pennsylvania, the Pittsburgh area has 2.4 million people but all of 418 local governments.

So this is some statistical evidence. Of course, there are a few exceptions. New Orleans is an older city and its whole metropolitan area has only 25 local governments. But New Orleans has a French history and in legal and other respects it is an exceptional place.

The transformation of local government in the United States thus involves two main features. As I have said, it is shifting core functions of local government to an even smaller level, the level of the individual neighborhood. And, second, it is privatizing local government at this level of micro neighborhood services. Legally, most neighborhood associations are organized as non-profit private corporations. They are governed by a board of directors and in other key respects resemble a business corporation. (They are unlike a business corporation, however, in that they can tax their "stockholders.")

The rise of the neighborhood association is actually returning local government to a pattern found 200 years ago in England and the United States. Until the 19th century, a local municipality and a private business corporation had a similar legal status. Recall that a municipality is organized as an act of incorporation. Legally, this used to be on a par with incorporating a manufacturing firm. And today, neighborhood associations are once again providing local governance under a private corporate status.

This has various practical implications. Consider voting rights. Voting is allocated in neighborhood associations in proportion to property ownership. Owning a unit in a neighborhood association is like owning stock in a business corporation. If you have two units, you get two votes. If four adults share one unit, they get only one vote. If I own a unit in Massachusetts where I spend the summer, and another unit in Florida where I spend the winter, I can vote in both places. A Norwegian can also vote if he owns a unit in Florida, whether or not he is a U.S. citizen, and independent of the actual amount of time he resides there.

So the model for local government is shifting from a small sovereign unit in the public sector to collectively owned form of private property. This may make

sense because the key functions of local government include protecting and increasing the value of the private investment in a home. Home equity represents about 30 percent of the total financial wealth of Americans. So, in this sense, owning a home is like owning stock in a business – you want to see its capital value rise.

My economist colleague, William Fischel, has recently emphasized this element in his 2001 book, *The Homevoter Hypothesis*. He argues that even in the public sector municipal residents are mainly motivated to protect and increase their home property value. They vote for politicians and policies to maximize investment return. That obviously puts local government more in the category of a private and business-like enterprise. So we have been seeing a trend towards the privatization of local government even in the public sector. The private neighborhood association, one might say, carries this trend to its logical conclusion.

In my own past work, going all the way back to my 1977 book, *Zoning and Property Rights*, I have argued that local land use regulation essentially serves private purposes. Although it is nominally a public function, local zoning has in effect been privatized. It is for practical purposes a collective private property right to the common neighborhood environment. So, again, a neighborhood association makes it all explicit and official. It is the culmination of a longstanding unofficial privatization trend within the public sector as well.

A third key function of local government is to provide common services. And, again, this is a business-like activity. Many governments in the public sector contract out things like garbage collection to private firms. There is not much difference between a private golf club and a municipal course limited to municipal residents. A private neighborhood association recognizes this, and delivers the services privately from the start.

So, to summarize my argument, the differences between a small local government in the public sector and a private neighborhood association are greater in form than in substance. Private neighborhood associations allow us to consider the wider social implications of a general privatization of local government that was occurring in the United States through much of the 20th century.

There are some important consequences, however, of the newly explicit and legally recognized private status. Overall, neighborhood associations have wider freedom to innovate in matters of internal governance. There are fewer legal and constitutional constraints on a private organization, as compared with a local government in the public sector. The local government, for example, is bound by the one person/one vote rulings of the U.S. Supreme Court. A neighborhood association, by contrast, and as I mentioned above, can allocate votes according to property ownership.

Another area of difference is the application of rights such as freedom of speech and assembly. A neighborhood association can ban political signs on lawns, for example. It could deny the right to have a protest march. In general, constitutional rights that would clearly apply in a public context may not apply in a private neighborhood association.

I can offer another example of the greater flexibility of neighborhood associations from the experience of my own family. My father belongs to a neighborhood association in the Shenandoah Valley of Virginia. The association was having trouble passing an amendment to its declaration, even though this was not particularly controversial. It was simply that not enough unit owners were voting to meet the minimum vote requirement.

So the association decided to convert the referendum into a lottery. Each ballot submitted became in effect a lottery ticket. The first prize was \$300, second was \$200, and third was \$100. I heard about it because my father got the \$100 prize. Anyway, the amendment passed. It was, to my mind, a practical device to stimulate greater turnout. It was legal for a private neighborhood association but probably would have been illegal for a local government in the public sector. In America, you are not supposed to pay people to vote in public elections.

Consider another example where paying is illegal publicly, but legal privately. Let us say a new store wants to move into a neighborhood. A private neighborhood association in concept could sell entry rights. It would simply be a sale of private rights, something that happens all the time. The money might be used to compensate the nearby property owners. And the whole neighborhood might benefit from easy access to a conveniently located store.

In the public sector, you couldn't do this – at least legally and officially. Changes in zoning are not supposed to be for sale. If a public official took the money, it could even be bribery, a felony. But sale of private rights is obviously legally acceptable, as in a private neighborhood association.

Consider another example. The recent Kelo decision of the Supreme Court, involving the City of New London, Connecticut, highlighted some of the problems of land assembly. The use of eminent domain – approved by the court – is very troublesome for a number of reasons. But it remains a fact that we do need to assemble large parcels, potentially involving many ownerships, if we want coordinated land development. It is an important question how this will be accomplished.

Now, consider how the existence of a private neighborhood association might help in dealing with this issue. Depending on the declaration, it may be possible for the association to sell out everything in one transaction. The neighborhood association would vote to terminate and divide up the large windfall profits among the unit owners. It might take a vote of say 75 percent, but not 100 percent.

This would have two major advantages over eminent domain. First, the neighborhood price would be set by direct negotiations between the neighborhood association unit owners themselves and a potential developer. Second, the decision to accept or reject a developer offer would be made by the neighborhood unit owners. Under eminent domain, by contrast, the wider city acts unilaterally to make these decisions. It is understandable that neighborhood residents may be angry and upset, if they feel they have not been adequately compensated or simply do not want to move.

Of course, right now local neighborhood control would work only where there is an existing neighborhood association. But what if it were possible to create a new neighborhood association in a previously developed area, even though properties in the area are already individually owned. In fact, that is what I have proposed in several writings, including my latest book.

Basically, it would work as follows. If a group of property owners wanted to create an association, they would have to gather signatures on a petition for some minimum number. If enough owners signed, representatives of the proposed association and the local government would work out a transfer agreement. It would cover streets (some of which may be turned over to the association), transfers of service provision responsibilities, divisions of regulatory authority, and other such matters. After that, and with the wide circulation of information to the public, the property owners would vote. It might take say a vote of 80 percent of the property owners to form a new private neighborhood association.

So, if this legal mechanism existed – which would require state legislation -- the property owners in the Kelo case would have had an alternative to eminent domain. They could have formed a neighborhood association to serve as their bargaining unit. Then, it would be up to the developer to make a good enough financial offer to win neighborhood agreement on a sale of all the properties.

Even if whole neighborhoods were not sold, retroactive creation of neighborhood associations could stimulate the redevelopment of inner city and other urban neighborhoods. A neighborhood association could provide a whole new degree of security of investment in an inner-city area. It might even put up gates and control entry – an inner-city gated community. If an urban neighborhood could keep out potential criminals and drug dealers, many of them would suddenly become more attractive for redevelopment. If anyone needs gates, it is not in the suburbs but in the inner cities. Investment might even flood in.

Hence, as these remarks suggest, I see the rise of private neighborhood associations overall in a positive light. I recognize that there is often a lot of internal tension. Some unit owners even talk about members of the board of directors as power loving, little Nazis. But some of this is simply inevitable when people are living and interacting with others in close quarters.

Some families are dysfunctional. And some neighborhood associations are dysfunctional. Some families end up in fierce court fights. And the same thing happens to some neighborhood associations. But we still see the family favorably in a broader light. I would suggest that the neighborhood association should also be seen in this overall favorable perspective, despite the warts in some particular cases.

We have heard a lot recently about a declining sense of community in American life. Many older forms of association such as the labor union, the Kiwanis Club, the American Legion, and so forth are declining. But neighborhood associations are exploding across the United States. They may represent the most important newly emerging form of American community.

They are also, as I suggested earlier, a major event in the evolution of American property rights. By the end of the 19th century, the new legal form of the private business corporation had become a major factor in the economic organization of American society. The business corporation shifted ownership of industrial property from the individual firm to the collectivity of stock holders.

One hundred years later, in the last few decades of the 20th century, we saw a similar shift towards collectivization in the ownership of residential property. Instead of individually owned homes, ownership of residential property was shifted to new collective forms. In the future, the full social significance of this transition in the ownership of residential property may turn out to be as great as the rise of the business corporation in the late 19th century.

In 1905, it would have been hard to predict the full social consequences of the business corporation. I suggest that, in 2005, it is hard today to say where the private neighborhood association will take us. It is possible that it will be a main contributor to a general privatization of local government in the United States at the neighborhood level. It should be an interesting journey to watch.