Impact Fees - The Non-Renewable Resource

by Susan Stroud Davies

Pay and You Go

Not to be confused with exactions, impact fees are charges imposed on new development, residential and otherwise, for the purpose of generating additional revenues in order to offset local government's capital improvement expenditures. Subdivision exactions are generally; "payment in lieu" programs that generate donated land for a school facility in the new community, major road improvements adjacent to the new subdivision or can be just plain cash up front. Local governments have long been in the business of extracting fees and taxes for a multitude of "onsite" capital projects: water and sewer hook-ups; pumping stations; subdivision streets, curbs and sidewalks; storm water management facilities; open space and forest conservation, to name a few. Impact fees on the other hand are direct mitigation tools, which while onerous in nature, have been generally more swallow-able by the homebuilding industry. Around since the '70s, invented in Florida and tweaked in California, impact fees have become part of the cost of doing business everywhere including Maryland.

In Maryland, impact fees are levied on a county-by-county basis. However, impact fee taxing authority, must first be granted by the Maryland General Assembly. Until recently, generally low fee levels, legal protections ("essential nexus" and "rough proportionality"), and the adequate public facility relief gained by paying them, has suppressed any major groundswell of opposition in the homebuilding community. Monies generated by impact fees must be spent directly on those infrastructure improvements necessitated by new growth; and that the fees can't be greater than development's fair share of the cost of the improvements. Taken at face value, impact fees are, for the most part, a reasonable and relatively inexpensive add-on to the cost of doing business in some jurisdictions.

The Honeymoon Is Over

Counties throughout the state, most of which instituted impact fees in the mid to late '80's are currently pressing for huge increases and broadening the scope of applicability. Local governments are now regularly pressing the "essential nexus" and "rough proportionality" envelope, baiting litigation from the industry According to noted economist Paul S. Tischler - *Anyone who has developed in the last 10 to 15 years knows that the popularity of impact fees as a local government revenue source has skyrocketed. The three major reasons for the proliferation of fees are state and local limitations on tax hikes; federal, state and local mandates against increasing costs without a concomitant increase in accompanying revenues; and, perhaps most importantly, the great reluctance of elected officials to raise taxes. Impact fees are especially appealing because they are passed onto future (absentee) voters.*[1]

The collective memory of new homebuyers is short lived. Many of the same home owners who paid local impact fees as part of the purchase price of their new home are now advocates for higher fees, citing overcrowded schools and roads. In some jurisdictions, impact fees are perceived as growth deterrents, while many elected officials see impact fees as a relatively painless form of taxation.

What used to go solely to increase school capacity and provide minor road improvements has become a revenue enhancement program for countywide recreation facilities, police and fire service, libraries, expansion of central water treatment plants and the funding source for major highway upgrades. Besides the rule bending, fees have risen commensurately from an average $3,000 per single-family dwelling unit to a whopping $11,000 in some instances. Homebuilders and developers in Anne Arundel County are currently fighting a major increase in impact fees. Frederick, Calvert and Saint Mary's counties are engaging in fee hikes as well.

Who Pays?

The fee levels currently being sought in a number of jurisdictions are reaching a non-absorption point. Nominally regarded as a tax on development by government, impact fees are in fact computed in the price of a new home. True, developers and builders pay impact fees at either subdivision or building permit stage depending on the jurisdiction. However, like any other tax or fee associated with the production of a product will be to varying degrees passed along to the consumer. Just as the cost of materials, labor, regulatory impacts and excise taxes go into the price or producing a new automobile, impact fees get shifted forward to new homebuyers. This is manifested in higher prices, smaller homes, less amenities and possibly smaller lots.

In the past developers and builders were not likely to bear a major portion of the impact fees because they were able to change location to where no fees existed. This has become increasingly more difficult due to the plethora of impact fees and similar development excise taxes in the region and the scarcity of developable land. Low inventory has driven up the price of raw land and finished lots. The effect of local fees and taxes on the value of raw land, which historically has made a substantial difference, is becoming less obvious. Availability has overtaken as a key factor. In most instances developers pay impact fees up front, and therefore treat them as a cost of development to be passed along. "In the short run, builders may incur lower profits if they are not able to completely pass through all of the increased development cost."[2]

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[1] Paul S. Tischler, "Impact Fees- Understand Them Or Be Sorry", reprinted NAHB Impact Fee Handbook, (Home Builder Press, 1997), p. 83.
[2] National Association of Home Builders, "Impact Fee Handbook", Chapter 3, Economic Aspects of Impact Fees, (Home Builder Press, 1997), p. 14.

Profitability isn't the only aspect of impact fees. According to the National Association of Home Builders, impact fees put upward pressure on all housing costs and warn that communities that impose them may become less competitive with surrounding communities in attracting new business as well as retainage. Businesses may find it difficult to recruit workers in an area where housing is more expensive than in competing areas

Are We Paying Our Own Way?

The answer to most keen observers is that new residential development does in fact pay for itself. A point proved recently in Howard County[3], Maryland. Howard County government engaged Tischler and Associates of Bethesda, Maryland to conduct a fiscal impact analysis on new residential construction in the county and received a quite a surprise from their consultant. Growth is good for Howard County and it pays for itself. Residential development however, has become the whipping boy of just about every economic development director in Maryland. We're the industry that takes and keeps asking for more according to many elected officials in this region. Cecil county government had a recently had an unsuccessful attempt to impose a $3,500 excise tax on all new residential units in the county. Excise taxes provide the maximum in flexibility for local governments and provide no direct benefit to developers, builders, or ultimately homebuyers, unlike impact fees, which are governed by stricter rules.

In an economic benefits model developed by the National Association of Homebuilders Economics Division, the ripple effect from the construction of 1,000 average-priced, single-family homes was extrapolated from the land development stage through build-out in a "typical" metropolitan area. Approximately $50 million in local wages were generated during the development and construction phase, and an additional $15 million in various incomes are generated in trades and services. The model also shows the generation of 1,141 full-time jobs, supporting 424 full-time non-construction jobs, producing approximately $66 million in local income (see Figure 2[4]).

Figure 2: Local Revenue Impact of Building 1,000 Single-Family Homes in An Average City: 1994

Local Revenue Source	**Development/ Construction (000)**	**Local Business Expansion (000)**	**Fully Occupied Homes (000)**
Business Property Taxes	$383	$646	$498
Residential Property Taxes	0	0	1,600
General Sales Tax	153	258	199

[3] Tischler & Associates, *Fiscal Impact of Four Scenarios*, Prepared for Howard County, Maryland (April 28, 2000).
[4] Estimated by NAHB Economic
Division from Bureau of Economic Analysis, Survey of Current Business, Jan/Feb 1996; 1987 Benchmark Input/Output Tables; and Bureau of the Census, 1991 Census of Governments CD-ROM.

Specific Sales and Excise Taxes*	86	144	111
Income Taxes	309	206	415
Licenses & Other Taxes	64	97	83
Residential Permit/Impact Fees	4,826	0	0
Sewer & Solid Waste Charges	180	145	240
Transportation Charges	102	123	134
Other Fees & Charges**	589	476	788
Local General Revenues	**6,691**	**2,097**	**4,068**

*Primarily taxes on motor fuels, tobacco products and alcoholic beverages.
** Primarily hospital room charges, school lunch sales, and fees and tuition at local higher education institutions.

What Then If Not Impact Fees?

Around since the Seventies, impact fees are still relatively new thinking in terms of infrastructure financing. A large majority of jurisdictions still rely on property tax revenues, debt financing (general obligation bonds), user charges, and other types of taxes to keep pace with need. In many respects impact fees have become a multifaceted tool for local governments. As part of their "managed growth" policies, impact fees have become an alternative for raising funds for expansion, while keeping a lid on property taxes. Coupled with zoning restrictions, to artificially affect the market, impact fees have become an excellent vehicle to dampen growth. However, most politicians realize that growth must continue at some pace in order to fund government.

A number of local governments in this region have recognized the need for balance and have accepted a partnership approach for infrastructure funding. There are a number of public/private funding alternatives commonly used around they country and in Maryland to a lesser extent: 1) Special Financing Districts, where revenues are raised in specific districts to pay for special services and capital improvements. Public borrowing power, rather than private financing is utilized, thereby taking advantage of the preferred borrowing rates local jurisdictions enjoy via the bond market; 2) Special Assessment Districts which are subsets of the community, often existing neighborhoods, generally formed to provide additional infrastructure and services through extra fees or taxes to fund road improvements, upgrade storm water management facilities, or provide other amenities; 3) Tax Increment Financing Districts or TIFs have no special fees or taxes levied on its residents. The tax increment is the difference between the total tax revenues after development and the baseline tax revenues prior to development. The tax increment, whole or in part, is diverted from the parent jurisdiction's general fund revenues and used to service revenue bonds let in order to finance infrastructure within the TIF.

The Non-Renewable Resource

Today, most jurisdictions appear to be drawn to the politically simple answer – impact fees and excise taxes. The let the other guy pay, approach. When pressed, most in the industry will tell you that impact fees, on a scale of unreasonable to less unreasonable, are the preferable route. They're simple, generally not to outrageous and have rules. You get something for your money and government has to deliver the goods. Unfortunately, as witnessed over the past few years in countless instances, the predictability of impact fees has worked its way out of the system. Infrastructure is not being delivered and adequate public facilities ordinances are cropping up all over the landscape, even though payments have been made towards new infrastructure. Impact Fee payments taken at subdivision or building permit, sit languishing in dedicated accounts awaiting matching funds. Fee levels are going up, categories are expanding; proportionality and relationship rules are out the window.

When calculating the new cost of doing business today, taking all the fees and exactions into consideration, there are still no guarantees. Recent experience has shown that. The full use of legally zoned land is not being permitted. Daily, this industry is being asked to bargain away its permitted right in order to move ahead. If we are to accept impact fees or increases to existing programs, there must be a *quid pro quo*. There must be predictability. There must be more land made available. Local governments continue to down zone, taking more and more land out of inventory through agricultural preservation and environmental easements, while answering to political pressure. On the same hand, these jurisdictions seem to regard the ever-diminishing reserve of buildable land as some kind of cash cow. Any jurisdiction, currently salivating at the prospect of solving its infrastructure shortfalls by taxing new development with impact fees or excise taxes needs a reality check. There just isn't any there, there.

Is There An Answer?

Until guarantees can be built into the process, the homebuilding industry will continue to operate at risk. Washington, D.C., land use attorney, John J. Delaney, in his article for the Washington University "Journal of Law & Policy"[5] states - *In today's world, the land use regulatory review process has become increasingly elongated and complex, with environmental permitting often overlaying the traditional review process, regulations proliferating, more reviewing agencies in the mix and more public hearings. These factors and the increasing uncertainty that accompanies them have lead to a serious problem. In many areas, there is already a crisis of confidence, which will surely deepen if nothing is done to promote more predictability in the system…Smart Growth and other worthy growth management goals will never be achieved unless there also "smart process"*. Mr. Delaney advocates for statutory reforms in vesting rules and development agreement legislation. Maryland has already authorized the use of development agreements through the legislature, however not all jurisdictions take advantage of the authority. The most notable benefit of a development agreement is the "freeze period". It is that most desired of situations, where no change in law or regulation can change the nature and scope of a project. No down zoning mid-stream, and no caving in to public pressure. A deals, a deal…

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[5] John J. Delaney, Evolving Voices in Land Use Law: A Festchrift in honor of Daniel R. Mandelker., Vesting Verities and the Development Chronology: A Gaping Disconnect? *Washington University Journal of Law & Policy,* (Volume 3, 2000)