Development Impact Fees as
Planning Tools and Revenue Generators

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Introduction

In recent years many communities have been faced with significant population growth. Local officials in these communities often confront overcrowding schools, deteriorating infrastructure, and dwindling revenues as a result of the strain caused by this new growth. "The use of traditional revenue sources (such as property taxes) to pay for the infrastructure necessitated by growth has caused concern that new development is not paying its own way" (Singell and Lillydahl, 1990, p. 82). Three significant events in American history spurred the changes necessary for the revolt against the traditional ways of paying for new development: (1) inflation of the 1970s substantially increased housing values leading to increased property taxes; (2) federal retrenchment of the 1980s and 1990s led to more financial responsibility at the lower government levels; and (3) a general tax revolt against real property taxes occurred over the past couple of decades. These three events forced "…local jurisdictions to look elsewhere to fund the ever increasing demands to constituents" (Nicolas and Juergensmeyer, 2006, p. 4). This perception of inequity in cost burden has led to calls from communities for a greater contribution towards infrastructure development from the developers.

One proposed method for capturing more of the cost of growth from developers is through the use of development impact fees—more commonly simply called impact fees. Florida is credited with *inventing* impact fees in their current form when Broward County assessed the first impact fee in the country in 1977 (Evans-Cowley, 2006). Although the use of impact fees is not a new phenomenon, in recent years they are gaining wider acceptance and usage. Some sources estimate impact fee usage at over 60 percent for all cities over 25,000 people (Duncan and Associates, 2007). This practice guide is intended to offer a resource for local officials and interested citizens who want to understand how impact fees can work as a planning tool and a revenue generator while understanding some of the criticism associated with the use of these fees. To do this, this practice guide first outlines a brief history of impact fees; then discusses some of the benefits and costs associated with impact fees—including a few examples of the use of impact fees; and finally concludes with some implications and lessons for the U.S. Environmental Protection Agency's (EPA) Region 4 states. This practice guide is not intended to advocate for or criticize impact fees; rather it is simply presented as an easy-to-read collection of information and facts offered to local officials considering the use of impact fees.

Development Impact Fees

Historically, the infrastructure needs of new growth were paid for by existing residents and property owners through some combination of sales, income, and property taxes. This relationship was generally accepted by citizens and policymakers as the growth was viewed as beneficial to the entire community. However, as discussed briefly above, this perception has shifted in many communities to one of it not being the local government's responsibility to pay for new growth with the existing population's tax dollars (Singell and Lillydahl, 1990).

In many communities, growth can create a swift and significant impact on the ability of the local government to adequately finance services and maintain infrastructure that it is required to provide. For example, in Dade County, Florida, public school enrollment jumped 40 percent between the years 1984 and 1995, while at the same time state and federal funding for education decreased. As a result of this increased demand and decreased overhead financial support, the responsibility for absorbing the costs associated with this growth rested primarily with the local school district (Maliza and Norton, 1997). With citizens increasingly growing more reluctant to accept tax increases, such enormous growth can create a dilemma for local officials. This is the case of Dade County, whose local government is faced with the question of how to pay for its share of the increased service required by the state constitution. As Americans remain reluctant to pay increased taxes, it is apparent that a different methodology for raising revenue is necessary for many cash-strapped local governments in areas of strong population growth.

As previously stated, when populations increase the demand for public services increases as well. This causes many local governments to be faced with difficulties in raising the necessary funds to expand and to improve the infrastructure required to support that new growth. As a result of this difficulty, many governments have turned to the developers to help fund some of the costs associated with population growth, the so-called *growth paying for growth* philosophy. "In recent years developers have been asked to contribute toward the infrastructure necessitated by growth, and there has been an increase in the use of special assessment districts, negotiated developer contributions, user connection charges, and impact fees" (Singell et al, 1990, p. 83). Although other methods exist and have certainly been used to raise revenue for new growth, this practice guide is only concerned with impact fees.

As Rosenberg (2002) points out, "The term impact fee has been broadly defined to include any monetary charges imposed by local government on new development to recoup or offset a proportionate share of public capital costs required to accommodate such development…"(p. 649). Impact fees are usually found in the form of one-time fees charged to the developers or to new residents to help raise revenue for capital projects or improvements such as schools, libraries, roads, water and sewer systems, and other services that would be used by the new residents (Carrion and Libby, 2001). Forms of impact fees, known as *exactions*, have been around since the 1920s when cities first used them as alternative revenue resources for infrastructure development (Kolo and Dicker, 1993). However, impact fees as currently used differ in important ways from the old traditionally-used exactions. 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 development or just plain cash up front. … Impact fees, on the other hand, are direct mitigation tools" (Davies, 2000, p. 1). "The general purpose of impact fees is to shift the burden of financing new infrastructure from the community at large to owners of developable land, developers, or buyers of new homes on the grounds that they not only impose a burden of higher costs but also they reap the benefits of growth" (Singell et al, 1990, p. 83). Impact fees are also known as benefit assessments, user fees, or connection charges.

Impact fees have important differences from the government's traditional way of raising revenue (taxes). Taxes are a forced contribution made by most, if not all, regardless if the taxpayers use the services the taxes are paying for. Conversely, fees are paid in exchange for a specific use or benefit. In the case of impact fees, these fees are paid in exchange for the allowance to build and develop in a certain area or city. The key difference is that impact fees are voluntary—if a developer doesn't want to pay, he/she can simply go elsewhere and avoid the fee.

Impact fees are a sensitive issue to many because of their effect on the distribution of infrastructure costs. In fact "[c]onventional wisdom among some private interests and public officials is that impact fees constrain local economic development, serving as a de facto 'tax' on capital, stifling investment, and driving job growth to other fee-free jurisdictions" (Nelson and Moody, 2003, p. vi). Regardless of this debate, the problems created by growth in some communities still provide a contradiction left for policy makers to resolve. Impact fees are one proposed *solution* to raising revenue to handle costs associated with growth in a community. Carrion and Libby (2001) point out contradictions facing communities in experiencing new growth, "…previous residents can refuse to raise taxes needed for new facilities serving new people, or if the costs are charged to new users, previous residents can enjoy the benefits from the construction of new public facilities without paying for them" (p. 2).

Although still a contentious issue in some areas, courts, state legislatures, and local governments have generally upheld the use of impact fees as a revenue raising tool. (For further information on the legality of impact fees see Evans-Cowley, 2006.) Both advantages and disadvantages have been discussed in reference to the use of impact fees. The following sections outline the usual associated benefits and perceived and potential costs of the use of impact fees.

Impact Fees as a Tool

Revenue Benefits

For a local government entity struggling to pay for infrastructure necessitated by new growth, impact fees can certainly work to alleviate some of the fiscal burden associated with the expansion of growth-related infrastructure and services. The most obvious benefit of impact fees is the revenue-raising capability. Rather than relying heavily on property taxes, which may already be high and/or capped by the state government, a local government is able to diversify its revenue stream through this alternative source. Often these impact fees are more popular with elected officials who find the general population discontent with the perceived inequity associated with paying the costs for new development. Furthermore, impact fees are imposed upon future voters—not current ones—something of interest to many policymakers looking at reelection prospects.

In addition to the general diversification of revenue sources, the fee-imposing entity is able to receive the revenue associated with impact fees in one lump sum, as opposed to

waiting over an extended period of time, which is the case with many of the standard taxes collected at the local level. This, in effect, enables a more concurrent or synchronized development of infrastructure. Thus, the funds to pay for the infrastructure are readily available when the development is required and installed, instead of financing the cost over time with debt-servicing costs associated with the usual forms of revenue.

Going even further, it is important to recognize that in some financially unstable communities, the revenue required to support new development may not even be available—even if the community desperately needs that development. The use of impact fees enables the development to proceed even when the local government cannot pay for the necessary infrastructure. The impact fees earmark funds for the required infrastructure of the new development, ensuring that infrastructure is able to be built and be available. It is generally undisputed that impact fees offer an alternative to the more common taxes to raise revenue. "Impact fees are a viable means, beyond traditional exactions, to finance the variety of service needs created by growth" (Kolo and Dicker, 1993, p. 200).

Environmental Benefits

In addition to the more obvious financial benefits associated with impact fees, other benefits have been linked to their use which makes this a logical and worthwhile planning tool for local governments to explore. As Coyne (2003) points out "[s]prawling development does not generate enough tax revenue to cover the costs it incurs on local municipalities to provide new infrastructure and public services" (p. 5). (See Practice Guide #14 *"Do you want utilities with that?"* for more information.) Numerous studies have associated impact fees with the possibility and potential of curbing sprawl (Mullen, 2002; Ridlington, 2003). As developers are faced with additional fees for developing green space, it is possible that they will either opt not to develop at all or will look inward at a redevelopment opportunity—both which work to counter the problem of sprawl. It has been pointed out that current revenue sources and conditions in local areas actually create an incentive for local governments to favor sprawling developments. "… [M]any local governments approve sprawling development projects out of dire need for tax revenue. Some local governments get caught in a cycle wherein they approve development projects to generate new tax revenue to pay the costs of old development" (Coyne, 2003, p. 6).

Although impact fees have been linked with curbing sprawl, the effectiveness of this tool varies from state to state. The ability of these fees to effectively counter sprawl likely rests with the state government as it is quite possible a developer can elect to build and invest elsewhere in a state or region to avoid impact fees specific to one locality, thereby eliminating this as a net benefit for the region altogether. The 'vote with your feet' concept applies very well to this issue. If one locality imposes an impact fee on a developer that the developer does not wish to pay, it is possible for that developer to simply develop in a neighboring jurisdiction to avoid that fee, potentially eliminating the sprawl curbing benefit altogether. One extreme example of this can be cited from the state of Washington. Wellington River Hollow, LLC was set to develop a 144-unit

multifamily development in King County, Washington. A school impact fee was levied against the development in the amount of $1,398 per unit plus another $65 per unit administration fee. The total impact fee was $210,672. If the project had been built elsewhere in the same district, no fee would have been imposed (Evergreen Freedom Foundation, 2001).

Certainly, a strong state-supported strategy can more effectively harness the potential benefit to curb sprawl and help direct development in certain areas to avoid developers simply avoiding certain jurisdictions. A number of previous studies have indicated that limiting sprawl with impact fees is best done in combination with the usage of growth controls, either statewide or local (Been, 2004). However, key to note here is that impact fees could be applied strategically by some communities to help curb sprawling development and better direct growth where the community desires. In this nature, impact fees can be thought of as another planning tool helping local officials plan growth strategically.

The Housing Factor

One of the most widely discussed controversies associated with the use of impact fees is the potential negative impact on housing and residential developments. Impact fees are generally calculated by determining the expected impact a development will have on a community (Evans-Cowley, 2006). Logically, a residential development will have the most impact on a community through the use of roads, fire and police protection, ambulance, utilities, and schools. Public education is generally a community's biggest expense and a development which adds students to a local school district will likely be deemed to have a higher impact on the community—therefore they will have a higher impact fee than other forms of development. Of course, this may discourage residential development even in a community which needs that type of development.

Another housing issue associated with impact fees is the presupposition that the impact fees are passed along to the consumer through higher housing costs. "… [S]tatistical analyses suggest that impact fees do indeed have a significant effect on the price of new homes and that home buyers bear the incidence of such fees" (Singell et al, 1990, p. 90). This can create a problem with affordable and multi-family housing in a community. If residential developments are inflating prices of the homes as a result of the use of impact fees in a community, then naturally the potential for affordable housing may be in jeopardy. Also, some studies have indicated that certain types of impact fees reduce the prevalence of multi-family housing developments (Evans-Cowley, 2006). Though impact fees certainly have an effect on housing in a community, the true impact on housing is still undetermined and likely varies significantly across localities.

To help offset some of the perceived negative impacts on residential developments some communities have started to use flexible or varying impact fees. For example, in King County, Washington, developers of affordable housing are completely exempt from paying impact fees. This type of exemption or flexibility helps alleviate some of the problems associated with impact fees and affordable housing. Variation and flexibility

with impact fees may be able to help a locality be strategic both in directing growth and receiving the revenue benefits from that growth. Impact fees do not have to be 'one size fits all' and can be modified to fit the specific needs and desires of a community.

Implications and Lessons

According to Duncan and Associates, in 2007, 27 states had enabling legislation for the use of impact fees. In EPA's Region 4, this includes Florida, Georgia, and South Carolina. Of further note, only eight of the 27 states with enabling legislation allow school impact fees. Of the Region 4 states with enabling legislation, only Florida allows school impact fees. In the remaining states without enabling legislation, many counties and municipalities still have the ability to impose impact fees. For example, in Tennessee, 13 counties and 15 cities have enacted impact fees based on home rule or special local ordinances or acts (Duncan and Associates, 2007).

The legality of impact fees for specific localities will vary across the states and is something individual municipalities and counties should consider on a case-by-case basis with a proper legal understanding of their home rule statutes and enabling legislation. However, impact fees have proven to be a successful alternative method for raising needed revenue to cover additional costs posed by new development.

The use of impact fees must be met with caution and a clear understanding of all the potential for unanticipated consequences and potential future problems associated with their use. Politically, impact fees may prove to be a good alternative to raising taxes on the current population, but may well drive away new development, increase the cost of housing, decrease the development of affordable housing, and provide future fiscal problems for the localities. Most impact fees are one-time levies which help pay for part, or in some cases all, of the immediate up-front infrastructure needs of a new development. These one-time fees do not cover future costs of maintenance or repair, as would be the case with raised taxes. These future costs will likely be borne by the localities—something that needs to be considered in the process of approving development and levying impact fees. Furthermore, the stage of development in which the impact fees are assessed and collected should be of concern to localities. Assessing the impact fee at the time of the issuance of the building permit can possibly create an underestimate of the true financial impact on infrastructure and services due to inflation and rising costs. In some cases years can pass from the original issuance of the permit to the completion of the construction process- further limiting the true financial benefit of impact fees.

With impact fees being a one-time charge, it is quite possible that localities are left in a position to be unable to sustain future maintenance and costs associated with that extra growth. A recent Region 4 example can be cited from Pasco, Florida. In Pasco, early in 2007, the costs of building new roads and maintaining the roads were exceeding the revenue earmarked for that purpose. The solution to this problem, as decided by the City Commissioners, came when the Pasco City Commissioners voted 5-0 to increase the transportation impact fee to $9,500 per new home built after October 1, 2007. This

increase is only levied on new homes and does not impact office or business development. The transportation impact fees make up more than half of the entire city's road budget—indicating a heavy reliance on impact fees to sustain basic construction and maintenance costs (Decamp, 2007). Furthermore, the new budget assumes a growth of 4,000 homes in Pasco over the next year, which the Commissioners themselves acknowledge may be a stretch. This heavy reliance on impact fees for operating and maintenance budgets is troubling and is contrary to the original purpose of the use of impact fees. This heavy reliance on *new* impact fees likely indicates a local government unable to meet the maintenance costs of *past* growth—something that should be considered and accounted for when impact fees are devised and new development is approved.

Florida offers other examples of the problems associated with impact fee usage as a consistent revenue tool. For example, in Zephyrhills, Florida, the city council is discussing increasing its budget to "…offset the slowed pace of building in the city… Building permit revenue and impact fees for new construction are down" (Rubenstein, 2007, p. 1). If cities and counties use impact fees to fund the capital costs associated with new building, a slow down in building starts should not logically impact the budget of a city or county. However, as is evidenced in Zephyrhills, a change in building starts is spurring a change in budget needs—implying the impact fees are being used to fund *current* costs, not *new* costs created by new development.

Overall, impact fees should not be viewed as a 'one size fits all' answer to a community's revenue needs. Rather, these impact fees should be viewed simply as one of many planning tools available to localities to direct growth and be strategic in their planning. Furthermore, impact fees do not have to be constrained to one form—exemptions, waivers, and sliding-scale impact fees can all be part of a locality's toolbox. Additionally, impact fees can also be used in concert with other planning tools (such as growth boundaries) to better direct development and growth in a way appropriate and desired for the community. Localities need to be aware of the potential unanticipated consequences of impact fees as well as the potential benefits—weighing both to come to a solution that is right for their area, laws, and needs.

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