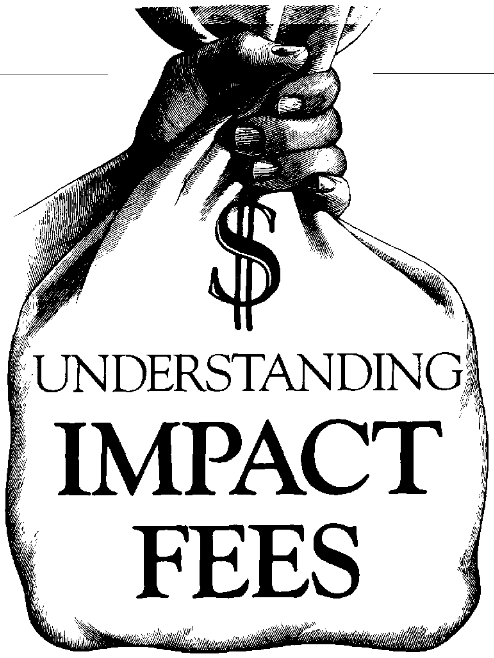

When you pay these substantial fees, know where the money goes and when you should object

Impact fees have become a significant cost of doing business for builders and developers throughout the nation.

To help builders understand the issues involved, the National Association of Home Builders recently published the *Impact Fee Manual.* The following information is adapted, with NAHB's permission, from the *Manual.*

What are Impact Fees?

Impact fees can be levied on various types of development, including subdivision, commercial, and industrial projects. Unlike subdivision exactions (where a developer is required to dedicate land to public use or contribute to the purchase of land by localities), impact fees can be used to fund the construction of offsite facilities.

Typically, fees are:

- levied on an "up-front" basis, usually at the time of building permit issuance;
- calculated by a specific formula, such as the number of bedrooms, the square footage of a building, or a flat fee per unit or building lot;
- prescribed by a local ordinance; and
- dedicated to a specific public use, such as roads, sewerage, or recreational facilities.

Impact fees range from several hundred dollars to thousands of dollars per home or building. They raise such fundamental social questions as: Who *really* pays? How is the fee calculated? Where does the money go? How and where is it spent ? Who *really* benefits from the new or expanded public facilities? What is the impact on housing costs? How is business generation or expansion affected? What are a community's financing alternatives? Is new development being required to pay its *fair* share, or something more?

Why Do We Have Impact Fees?

Impact fees were initiated in the 1970's in Florida and California—areas facing high growth and restrictive tax systems. Similar conditions, and cutbacks in federal aid, have led to a proliferation of impact fees nationwide. The continuing suburbanization of the nation's population and the rapid rate of new household formation mean that local government is often pressed to extend services to new and larger areas.

Taxpayers have grown unwilling to assume the cost of providing services to new residential development through property taxes that secure general obligation debt.

One consequence of the popularly termed "taxpayer revolt" is the emergence of local government policy that deems residential development acceptable only if it can "pay its own way."

Are Impact Fees Legal

In analyzing the legalities of fees, it is important to know the laws of your particular state, but some general principles apply.

The validity of impact fees often depends on whether they are classified as "fees" or "taxes."

A regulatory fee often needs only broad legislative delegation, but a tax requires express statutory authorization. An impact "fee" that is really a tax will be struck down if the legislature has not authorized a local tax on development.

Since the purpose of a regulatory fee is to finance a specific municipal service or capital expenditure, the fee amount should be reasonably equivalent to the actual cost. If the charge unreasonably exceeds that amount, or is used for unrelated purposes, it may very well be characterized as a tax.

In addition, constitutional questions may be raised, based on three clauses of the state and federal constitutions: the equal protection clause, the due process clause, and the taking (or just compensation) clause.

In general, impact fees are subject to legal challenge unless they are authorized by state law, and applied in a nondiscriminatory, nonarbitrary, reasonable manner.

What are the Economic Repercussions of Impact Fees?

An impact fee raises some revenue for infrastructure. But this must be balanced against how much it compromises housing affordability and growth.

While developers and builders actually pay impact fees, they are unlikely to take them out of profits. Therefore, unless the fees work their way back to lower land prices, the fee is really paid by the home buyer.

By raising the fixed development costs, impact fees have an effect on housing affordability. The normal mark-up process means that other costs, profit, and sales price will likewise rise. The chart shows how a $3,000 impact fee might raise the price of a new home from $80,000 to $84,131.

In addition to larger mortgage and closing costs, the higher purchase price could be expected to lead to at least modest increases in insurance and property taxes. Taking all these factors into account, NAHB estimates that a $3,000 impact fee would cause a typical home buyer to pay an equivalent of $5,500 'more to buy an $80,000 house.

It is important to keep in mind that impact fees also are charged to multifamily and nonresidential development. Therefore, rents for new apartments or office or retail space would rise as impact fees are passed through.

New real estate does not exist in a vacuum. When impact fees raise the prices of new homes, the prices of existing homes will soon begin to rise as well, as consumers avail themselves of cheaper shelter.

Does Growth Pay for Its Own Infrastructure Needs?

Development increases the revenues collected under various local taxes. Some of this revenue will be spent on infrastructure. In addition, greater population (or sales and employment) may bring more state tax dollars to the locality. Evaluating whether growth "pays its own way" must take into account all of these additional revenues. Presumably, if future revenues cover the new infrastructure costs, then there is really no basis for an impact fee, although there may be a need to issue additional bonds.

Are Impact Fees Fair?

There are two major fairness issues: the disproportionate burden on lower income households, and the "double taxation" of new residents.

Since impact fees raise the prices of new *and* existing homes, owners of existing homes enjoy a windfall gain, while all prospective buyers in the area face higher housing costs. This can make impact fees politically attractive to existing homeowners. But current residents who are renters, who generally have lower incomes, do not receive a windfall. They will simply pay higher rents and find home ownership further out of reach.

"Double taxation" becomes an issue because at least some of the infrastructure that existing residents use will be paid for by new residents out of their property taxes. If new development has to pay fully for new infrastructure, then it is "double taxation" if it also pays for existing infrastructure.

In determining the fairness of an impact fee, the following elements should be considered:

- The fee should never exceed the net cost to the locality of new facilities attributable to new development.
- Impact fees are for infrastructure for new development. Localities should not use them to remedy deficiencies in existing infrastructure due to past development.
- Localities should not charge new development more than once for the same infrastructure. Dedications of developer-built infrastructure and property taxes are methods used to pay for infrastructure. The impact fees a developer is charged should be reduced by the amounts already paid.

How Fees Are Calculated

The methods that localities use to set impact fees vary from place to place and across different types of impact fees.

Generally, each type of development pays for the extra infrastructure capacity in proportion to how much it is expected to use the infrastructure. For example, retail stores will pay a relatively large share of road construction costs through impact fees, but will not pay school impact fees.

Effect of Impact Fee on Sales Price of $80,000 New Home

Fixed Development Costs	Cost With No Impact Fee	Cost With $3,000 Impact Fee
Land	$ 7,500	$ 7,500
Subdivision costs	7,000	7,000
Building permits, etc.	6,000	6,000
Construction supervision	1,400	1,400
Structure	34,000	34,000
Merchandising	1,600	1,600
Warranty	600	600
	$58,100	$58,100
Impact Fee	0	$ 3,000
	$58,100	$61,100
Costs Related to Sales Price		
Construction loan fee	$ 1,000	$ 1,052
Construction loan interest	3,800	3,996
Permanent loan fee, escrow, and closing costs	4,000	4,207
Overhead	3,427	3,604
Sales commission	2,400	2,524
TOTAL	$14,627	$15,383
Total cost	$72,727	$76,483
Profit at 10%	7,273	7,648
Sales price	$80,000	$84,131

Note: If the impact fee is imposed at closing (i.e., occupancy) instead of time of permit issuance. the developer would not need to carry the impact fee as a usual development cost, as in the above example. In that case, the home buyer could purchase the home as before for $80,000, plus pay the $3,000 on top of it, or finance it along with the house. totalling $83,000, and thereby saving the carrying costs.

Credits are computed to reflect the payments that new development will make to finance infrastructure through the existing tax system. Unless these credits are subtracted from the infrastructure costs, new development may be paying twice for at least some of the infrastructure.

A last step often made in the calculation of impact fees is the application of an arbitrary discount to allow for a "margin of error." In reality, for political and legal reasons, impact fees are rarely set as high as the calculations indicate.

Setting Road Impact Fees

The basis of the road impact fee is a projection of road use and expansion attributable to the new development. The most sophisticated method for making this calculation is with a complex transportation planning model.

A common short-cut is to use the trip lengths and frequencies as reported. by the Institute of Traffic Engineers (ITE) to determine the need for new road capacity, without regard to the expected patterns of those trips and how those patterns affect current road infrastructure.

Once needs are determined, several adjustments must be made.

First, impact fees should not be used to remedy deficiencies in existing roads. New roads can be built to higher standards, but an impact fee should be based only on the cost to add infrastructure *at the same service standard* that the locality presently uses.

Second, developer-built roads must be netted out of the estimate of needed road additions.

Third, only trips originating or ending in the new development should provide the basis for an expansion in road capacity paid for by new development. Cars that pass entirely through a locality may create a need for infrastructure, but this is not the new development's responsibility.

Fourth, the average trip lengths should be based on travel *within* the locality.

Fifth, an adjustment must be made in the number of trips actually attributed to commercial development. For example, a person may stop at a convenience store on the way home from work, but the commute has already been counted.

After these adjustments, two kinds of credits should be netted out to arrive at road impact fees: one for the additional tax revenue generated by new development to help pay expanded road capacity; and another to acknowledge that the new development will provide tax money to upgrade roads.

Setting School Impact Fees

Since school impact fees are not paid by non-residential development, the full burden is carried by residential development.

One way to determine infrastructure needs is to do a careful projection of new residential development, taking into account the status of existing schools. Needs for new schools are then tied to new development.

The easier, but less accurate, way is to simply assume that each new housing unit will cause a certain amount of demand for new school capacity. This is usually done for each type of school.

Usually, different "pupil generation ratios" are used for different housing types—single family detached, condominiums, town houses, etc.—and perhaps even by number of bedrooms.

The national average (from the 1980 U.S. Census) for a single-family house is 0.453 elementary students, 0.165 junior high students, and 0.136 high school students.

The cost attributed to each new housing unit for each type of school is simply the construction cost of needed new schools (per student at capacity) multiplied by the appropriate pupil generation ratio. For example, if construction costs are $10,000 for each elementary student and $12,000 for each junior high or high school student, then the above ratios would yield a school construction cost per household of $8,142.

That figure would not be the impact fee, however, because at least two credits must be netted out. One is the percentage of school construction cost that can be expected to come from higher levels of government.

The other credit takes into account that the real property tax collections from new homes will help to service the bonds and pay for future refurbishing of existing schools.

Setting Water or Sewer Impact Fees

The method of calculating water and sewer impact fees is similar to that for school impact fees. Like schools—and unlike roads—sewer and water systems are "closed" systems with actual boundaries.

The locality must first decide which portions of the total infrastructure it will finance through impact fees, as the locality already would receive some revenue from hookup charges, and may also levy a special assessment on all users of the system.

Once determined, this cost is then divided by the facility's capacity. This is the cost per unit of capacity—usually expressed as dollars per unit of water supplied or waste water treated. Then, the projected use by a development is multiplied by this average cost to derive the impact fee.

For residential units, projected use depends on the number of bedrooms or bathrooms in the unit. For non-residenal development, projected use deends on the number of employees or the square footage of floor space.

Other Types of Impact Fees

Impact fees for such services and facilities as parks, fire, police, libraries, etc., generally are based on the infrastructure costs of meeting established service standards.

For example, if a fire station (with a certain number of firemen, fire trucks, etc.) serves a certain number of people, then the total cost of this fire station per person is charged to new development as the impact fee. ■

For More Information

If you would like to know more about impact fees, a good place to start is the document from which the above information was taken. The Impact Fee Manual is available for $8 from: State and Local Legislative & Regulatory Services, National Association of Home Builders, 15th and M Streets N.W., Washington, DC 20005. Call 800/368-5242 ext. 361.