

Land Development

THE NATIONAL ASSOCIATION OF HOME BUILDERS

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This article is from the National Association of Home Builders quarterly magazine, *Land Development*. TischlerBise is a fiscal, economic, and planning consulting firm specializing in fiscal impact analysis, impact fees and revenue strategies. Our other major services are market feasibility studies, economic development analysis, capital improvement programming, and growth policy planning.

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Our private sector impact fee clients include: Home Builders Associations; Private Developers; and others.

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IMPACT FEES— UNDERSTAND THEM OR BE SORRY

by Paul S. Tischler

Anyone who has developed land 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 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 usually passed onto future (absentee) voters. Therefore, it

Development impact fees are growing increasingly attractive to local governments. Developers need to understand impact fees if they are to spot illegal uses and improper calculation of the fees.

is imperative that developers understand fees or risk becoming the victim of either their illegal use or the improper calculation of fee amounts. This article provides some examples of illegal fees, discusses caveats pertaining to the calculation and use of impact fees, and offers a set of recommendations for ensuring the equitable application of fees.

Illegal Impact Fees

Hundreds of today's impact fees are probably illegal; yet, for two major reasons, the fees remain largely unchallenged. First, the fee amounts are noticeably small and thus are not particularly burdensome. Second, developers and builders are fearful of delaying development by bringing a legal challenge against a fee. One of the more blatant examples of an illegal fee is the fee for public art in a California jurisdiction. The impact fee, calculated only against nonresidential space, pays for art exhibited in such public spaces as museums. Rationally speaking, such a fee – if it is to be imposed at all – should

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probably be assessed against residential units. After all, it is residents who generally find the time to visit museums after work or on weekends.

Less subtle and unsupportable examples of illegal fees include the imposition of police and fire fees against housing, but not against nonresidential development. (Impact fees should not discriminate by type of land use.) Or how about the calculation of a park impact fee based on desired levels of service rather than on lower, existing levels of service? Another example pertains to school impact fees for a geographic area that will not generate the need for any increase in school facilities in the foreseeable future. Also likely to be illegal is the application of hypothetical future student generation rates, which are considerably higher than the actual rates experienced by the jurisdiction. Flaws in the methodology of calculating fees or inaccurate data assumptions can result in hundreds or, in some cases, thousands of dollars per house in unsubstantiated fees.

Monitor the Process

Increasingly, state law requires fee-imposing jurisdictions to include representatives of the private sector on fee review or liaison committees. This is certainly an important step in making sure that private as well as public sector interests are accorded the opportunity to participate in the review process. Often, however, the few private sector representatives are as overwhelmed as the other committee members by pages and pages of text, reams of data, and maybe even undecipherable tables. Consequently, the committee, including its private sector representatives, simply takes the path of least resistance and agrees to a consultant's methodology, data and technical recommendations.

Given that the actions of the committee automatically vest the fees with a measure of credibility, it is imperative that all interested parties monitor the impact fee process. If local builders defer their involvement until fee amounts are determined, they will be faced with an uphill struggle to amend the impact fee report and its recommendations – especially if the other members of the committee and the larger public have already “bought into” the methodology and its data assumptions.

Even though impact fees raise several questions regarding their technical aspects, they also point to several caveats that are particularly germane and understandable to the interested party. A few of these are discussed below.

1 Recognize that impact fees pertain only to new capital facilities that directly benefit the payer. Many observers still believe that impact fees can be used for capital facilities that benefit existing residents. In fact, impact

fees, are assessed and collected to fund only those capital facilities whose need is generated by new development. Further, expenditure based on impact fee collections must demonstrate a direct benefit to those paying the fees. Under many statutes, an existing facility is eligible for impact fee financing if it was deliberately oversized to accommodate new development.

Knowledgeable and willing homebuilders must participate in and evaluate all of the relevant information related to the impact fee determination process.

2 Be aware that the impact fees collected must be spent within a reasonable time period. A mandated or general rule-of-thumb holds that about six years is a reasonable period in which to expend fees, although 10 years may suffice. In most cases, the jurisdiction must operate on the good faith assumption that the money will be spent for a specific facility or facility type within the mandated period. The time limitations encourage or require the preparation of capital improvement plans.

3 Educate the electorate on what impact fees do and do not accomplish. As already noted, fees fund only those capital facilities necessitated by new development. Fee collections cannot be allocated to rehabilitation, retrofitting, or replacement of existing capital facilities. The greater cash cow of operating expenses, not covered by impact fees, must be explained to the electorate. Otherwise, the public will wrongly expect that impact fees can solve the full range of local fiscal problems.

4 Make certain that fees are assessed only to maintain current levels, versus future levels, of service – unless a jurisdiction has adopted a plan to address existing deficiencies and is actually implementing this plan. Some communities and their consultants tend to use a level of service that is not met elsewhere in the jurisdiction. It is illegal to extract from new development fees to pay for a higher level of service unless the jurisdiction is using other funds to bring other parts of the jurisdiction up to this same level of service.

5 Do not rely solely on the jurisdiction's assumptions; instead, obtain your own background information. Various local government departments may not be familiar with the requirements of impact fees and are therefore unlikely to understand clearly the difference between adopted and

existing levels of service, the relationship between service delivery areas and existing and new capital facilities, and several other issues. If the builders ask local jurisdictions the right questions, they should also be able to extract the needed information.

Some of the questions to ask are: What is the basis for the land use projections? How were service areas ascertained to meet the rational nexus requirements? How were levels of service and cost factors determined? How have credits for other payments been considered?

6 Analyze the capital improvement budget. Potential impact fee revenues need to be related to the capital improvement budget or capital improvement plan. That is, there should be capital projects in the plan that can legitimately use impact fees. It is important for builders to become familiar with this budget and its validity over both the short and long terms.

7 Be familiar with the likely geographic service areas in order to evaluate the rational nexus requirement. In summary, rational nexus requires a reasonable relationship between the need for the capital facility and the use of impact fees directly benefiting those paying. To show a

direct benefit to the development paying the impact fee, jurisdictions tend to describe larger service areas than may be appropriate.

8 Can a jurisdiction provide the needed capital facilities? The recommended impact fees should demonstrate some relationship to what the jurisdiction is capable of providing (i.e. Has the jurisdiction been spending much money on this category in the capital improvement budget?). Whether due to time lag, backlog of existing facilities, debt ratios, or political constraints, the effort that goes into setting an impact fee will be diminished if the jurisdiction cannot provide the needed capital facilities in a timely fashion (assuming that the impact fee does not pay 100 percent of the new cost).

9 Understand the importance of granting credits. Under the provisions of some state statutes, the future tax payments of a house or nonresidential property that are used to cover the debt service of a particular capital facility need to be credited against the impact amount on a discounted basis. Even in states that do not require granting credits, the “spirit” of impact fees is to avoid double payments.

Reality Testing

As already mentioned, impact fees are popular because elected officials perceive them as a free revenue source not paid by current constituents. As a practical matter, several of the flawed impact fee methodologies gained acceptance because the fee amount ultimately proved to be much lower than the amount discussed in the impact fee report. Of course, in some jurisdictions, lower



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- Reprint “Impact Fees – Understand Them or Be Sorry”
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fees are subject to annual increases.

It is important that the community imposing an impact fee is experiencing significant growth. If not, the jurisdiction will be unable to generate enough revenues to make the impact fee process worthwhile. Impact fees incur a set of administrative costs and, in most cases, are legally required to be segregated from the general fund by type of account, type of activity, and geographic subarea (where appropriate).

For home builders, two nontechnical points are worth noting. First, several of the homebuyers assessed impact fee payments are already residents within a given jurisdiction. In some jurisdictions, over 50 percent of purchasers are trade-up buyers and therefore have been paying for capital facilities through the property tax from the time they started residing in the community. Elected officials should be aware of this conundrum.

In some cases, those preparing the fees hide behind “sophisticated” models and use them as an excuse not to explain the methodology and the supporting data.

Second, impact fees give rise to an “intergenerational equity” issue. Many of us and almost all of our parents lived in a community where the capital facilities were paid

as part of the regular tax burden. The increasing reliance on impact fees and other exactions means that households moving into a community must now buy into the capital facilities with a one-time fee.

Steps to Take

From the outset, a private sector advisory group should be convened to participate in the impact fee review process and to ensure that private interests present their concerns as a unified front. Experience suggests that such groups allow for more rational input into the fee determination process, help avoid methodological flaws in setting the fee, and ensure the application of relevant data. All members of the advisory committee should be able to understand the data used to justify the fee. “Garbage in” will produce “garbage out” and will generally lead to unjustifiably higher impact fees.

Paul S. Tischler is a principal of TischlerBise a fiscal, economic and planning consulting firm with offices in Bethesda, Maryland, and Pasadena, California. The firm has prepared over 600 impact fees for communities around the country. None of the impact fees have been challenged. In representing the private sector, TischlerBise has succeeded in reducing impact fee amounts or, in one instance, eliminating a fee altogether.

Note: Please let us know if you would like to receive a copy of “20 Points To Know About Impact Fees”, a reprint from *Planning* magazine.

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