

# Comments on the Equity, Efficiency, Incidence and Politics of Impact Fee Methodologies

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*Development impact fee systems are a controversial topic among developers and planners. This article proposes that the use of locationally-sensitive impact fee methodologies can have positive effects on the cost of development and the price of the final product. The authors caution local officials against jumping on the "development fee bandwagon," and using fees to raise new revenues rather than as a regulatory measure to meet growth needs.*

Development impact fee systems provoke heated debate among proponents and opponents concerning the equity of cost-shifting, the incidence of who ultimately bears such costs, and the effectiveness or efficiency of marginal cost techniques in the provision of new infrastructure.

The recent publication of *Paying for Growth: Using Development Fees to Finance Infrastructure* by the Urban Land Institute, may cause opponents of impact fee systems to voice renewed justification for their positions, based upon the report's summary conclusions. But before every builder, developer and realtor heeds the clarion call of the report to rush to the steps of his statehouse in order to seek statutory prohibitions to impact fees, it would be well to remember the sad state of affairs surrounding the current infrastructure financing crisis. The continued rejection of local infrastructure bond tax initiatives; moratoriums; uncertainty, extortion and regulatory delay; and decreasing federal and state assistance are the very reasons that "surrogates" for infrastructure adequacy, in the form of fair share development fees, were originally conceived.

The authors of this article were among the first to caution against the perils and pitfalls of badly conceived development fee systems and poorly constructed impact assessment methodologies. Such systems can exhibit most of the serious defects and consequences alleged in the ULI report. However, properly conceived and designed methodologies may just as well have neutral to positive effects on the equity, incidence, efficiency and politics of impact fee systems.

## The Trend Toward Cost-shifting

Simultaneously faced with deteriorating existing infrastructure and growth-generated requirements for expanded facilities, local governments have begun to focus upon development fees as promising alternatives to increased

local taxes. As a result, the local development community has become the target of an array of new impact-oriented, cost-shifting techniques employed to permit each new development project to pay its "fair share" of new infrastructure demands. The early efforts to implement development impact fee concepts focused upon issues of legal defensibility. As a result of the pioneering efforts and litigative experiences of a variety of leading edge communities and practitioners, the converging base of judicial standards and tests upholding police power development fees has been established.

Having discovered the general formula for legal acceptance, far too many communities are leaping on the development fee bandwagon with only a minimal understanding of the operative effect and implication inherent in the mechanics of the endless variety of impact assessment and fee apportionment methodologies. The politics of preparation and public hearing related to a proposed new system are generally highly debated and controversial. The eventually adopted ordinance represents an uncomfortable compromise among political expediences, methodological tinkering, urgent facility needs, and the perceived underlying urge to reform the way infrastructure was formerly locally financed.

The attendant public debate invariably centers on assertions by proponents that growth should pay its own way, that new development should pay its fair share of new costs, and that the new system will foster the growth management objectives of more efficient provision and utilization of facilities. Opponents counter-argue constitutional and statutory taxation and taking issues, intergenerational inequities, rising costs of development, housing unaffordability, and anti-business, non-competitive economic disadvantages which will result from such new fees.

There is no end to the availability of literature and advice concerning the judicial standards supporting the

new development exaction and fee systems now proliferating. However, until recently, very little serious research has been, or could have been, undertaken to provide a common basis of empirical evidence concerning the operative effects of marginal cost impact fee methodologies, because of their lack of longevity. Now a number of published surveys, case studies and similar research efforts are beginning to appear.

The ULI report has made a major contribution to a common framework for analysis by both proponents and opponents of the operative effects of impact fee methodologies. Based upon its summary conclusions, the report cannot be characterized as a level or neutral playing field for analysis, but more as the first significant effort to attempt to develop design standards for the location and construction of the ballpark. Tom Snyder, Mike Stegman and the ULI are to be commended for their significant efforts.

#### Equitable and Efficient by Whose Standard?

Traditionally, infrastructure at the local government level has largely been financed through the property tax on land and improvement values. From an equity standpoint, this means individual taxpayers bear financial responsibility for infrastructure according to their "ability to pay," not on the basis of use or impact, which is the "benefit" principle of equity. The benefit principle is similar to the private competitive market principles where individuals must pay specifically for the goods or services they consume. Development fees represent a political policy shift to the benefit principle, requiring new development to pay its "fair share" of new infrastructure: requirements on a proportional *impact* basis rather than on a *value* basis.

The private market theory of free competition suggests that price is the primary determinant of economic efficiency. In the public good and service finance arena, user fees, development fees and impact fees are most akin to the benefit principle of equity, while taxes on value represent the other end of the equity spectrum. Price, as represented by either taxes or fees, allocates resources most efficiently when price approaches or equals the marginal cost of producing an additional unit of infrastructure. Marginal cost pricing is said to occur naturally in the fantasyland of perfect competition. To the extent that market failures exist in the private sector or that the public sector is providing infrastructure at prices below marginal cost, infrastructure is allocated inefficiently. To the extent that the development of land imposes ability-to-pay costs on the community-at-large and the developer does not pay his proportional, fair share of such costs, there will exist

inefficient spatial location of development and inefficient allocation of the costs to various land uses.

Opponents of marginal cost approaches to infrastructure financing argue that the benefit principle of equity results in a reallocation of former costs, previously borrowed or deferred by the community-at-large through taxes, to new fees to the development project which raise the cost of development and ultimately the cost of the end product. The next extrapolation is to argue that new businesses and new residents, without voice, are being treated unfairly in relation to established ones, raising new questions of intergenerational equity and incidence of burden. Equity, efficiency and incidence issues are debated hotly within the context of competing ability-to-pay and benefit views on equity, an extension of the traditional City Hall political debates relating to "them versus us," "neighborhood versus developer," etc.

A third view of equity, the horizontal equity principle, provides a more rational framework for such issues. The principle of horizontal equity holds that people in similar situations should be treated similarly, or that they should contribute the same amount to the financing of infrastructure. This view of equity is complementary to both other views, and most appropriate to planning, development regulation and growth management considerations of a spatial, geographic dimension. This view of equity permits assessment of financing techniques to be addressed compatibly with the more traditional concerns of the planner for location, timing and sequencing of infrastructure.

Horizontal equity permits public policy to concentrate first on the political values of capital programming, adequacy of facilities and the pattern of future land use and development as they affect the utilization of current excess capacity, the problems of existing deficiencies and the planning for needed new infrastructure in terms of reality, not just theory. Both the private sector and the public sector agree that the financing of new infrastructure should encourage economic efficiency, orderly development and the optimum use of public facilities. Debate remains polarized between the pros and cons of appropriate alternative financing techniques based upon the effects of "ability-to-pay" versus "benefit" approaches.

#### Equity, Efficiency and Incidence

The horizontal equity view can serve to level the playing field for debate. The crux of most debate centers on issues of intergenerational equity. Opponents of impact fees allege that they somehow apply differently to established versus new residents or businesses. The horizontal equity view totally destroys this argument because the financing of infrastructure will fall equally upon all res-



idents or businesses, new or existing, who chose to make a common or similar locational decision. It is immaterial whether a new development has financed its on- and off-site costs via a special taxing district or an impact fee system (both constitute forms of marginal cost-shifting). Those who purchase a home in a certain development are paying as a result of their locational decision. In reality, the largest market for new housing is not new, immigrating residents, but existing residents desiring new homes. The intergenerational arguments dissolve when tested against horizontal equity.

The costs which new development may impose on a city for new infrastructure differ from location to location and vary by type of use. For development to be efficient, these costs must be considered in making either private or public capital investment decisions. All other externalities being equal, private development locating where costs are lowest is most efficient. However, private investment decisions to locate elsewhere, due to the private benefits of view, waterfront or similar amenities, reflect the incorporation of higher offsetting private benefits. To the extent that all development is required to assume its actual, locationally distinct marginal infrastructure costs, it can be considered efficient. The horizontal view of equity again reduces the efficiency test of development to the locationally sensitive price decision for the home buyer, whether new or current resident.

Achieving efficient provision and utilization of public infrastructure is believed to occur where use is equal to the marginal costs of provision and when benefits exceed costs in the provision of infrastructure. If orderly development and efficient use of public facilities are to be encouraged, we must recognize the limits of the pragmatic applicability of the various views of equity as they are assumed to operate in the pure, competitive market arena. Alternative financing techniques which shift costs further along the spectrum in the direction of more nearly equating actual marginal unit costing reinforce efficiency considerations.

With the property tax general obligation bond, we have the least financing technique. Then comes the geographically defined special taxing district, followed by the generalized, zonal approach to impact fees. The most equitable approach, however, embraces the use of highly locationally-sensitive computerized models for assigning impact fees.

Impact fee systems that are locationally precise and sensitive most completely define the truest off-site costs of a development. Such systems reflect lower off-site costs attributable to existing unused capacity within close proximity and conversely reflect higher off-site costs attributable to seriously deficient capacity problems in close



*Transportation improvements.*

proximity. To the extent that the form of financing of such costs represents the truest marginal cost, as do impact fees versus special tax district or general obligation bonds, the impact fee supports more efficient use and provision of public facilities than other alternatives.

Efficient production and consumption of housing are most directly affected by the price of land, costs of financing and the supply of buildable sites. The optimum allocation environment is the purely competitive free market. The real world for production and consumption of housing is the local political jurisdiction. A myriad of constantly changing factors distort the type and quantity of housing that is built and consumed in a local jurisdiction. This is also true for non-residential uses.

The most obvious distortion factors relate to the rate of growth being experienced at any point in time. Both production and consumption are affected by periods of rapid growth, slow or declining growth rates, the availability of and rates for financing, inflationary pressures on labor and material costs and the effects of speculation and inflation in land costs.

Property taxes, special assessments, exactions and impact fees have the effect of increasing the cost of housing relative to other goods, thereby lowering their consumption below efficient levels. Since infrastructure must be provided from one of these alternatives, the horizontal view of equity would support a marginal cost approach as the better alternative to make up these payments for infrastructure.

There is substantial agreement that local government attitudes toward growth reflected by their regulatory systems, their support or non-support of bond financing and

their pro-growth versus no-growth orientation have played a significant role in the provision or restriction of available supplies of developed land with respect to demand. The more time-consuming the regulatory process and the more growth-restricting the community's attitude, the less available are adequate supplies of developable land. Such factors similarly distort the production and consumption of housing in terms of economic efficiency.

The effects of the factors described above, taken alone or in combination, distort production and consumption. Furthermore, they affect the price of housing by dwarfing the absolute cost of locationally-sensitive impact fees. When sound planning, linked capital programming systems, streamlined regulatory procedures and locationally-sensitive, methodologically correct impact fees systems are well integrated, they can have a neutral to positive effect upon development costs and the price of the finished product. This is particularly true when the results of such integrated growth management systems remove artificial or theretofore unresolved political constraints on the supply of developable land.

The issue of incidence of burden, or who pays, is greatly affected by the methodological approach inherent in the chosen financing technique. Stegman and Snyder imply that the only "fair" methods are continued general obligation bonds or special taxing districts spreading the costs to all according to their ability to pay. The development community would argue that charging impact fees requires such costs to be added directly to the final price

of its product, thereby raising the cost of housing to the new resident. This is similar to moving the incidence of who pays from the developer to the buyer of new homes, or forward shifting such costs.

Since property values reflect underlying economic usage, it is not unusual to find a typical single family house appraised at \$60 per square foot while an office complex is appraised at \$80 to \$120 per square foot in the same locale. The developer of commercial property therefore can argue, under the ability-to-pay principle of taxes, that he is and has been paying up to twice as much or more per square foot than residential property developers.

In fact, when contrasted with a fair share peak hour road impact fee system, using the marginal cost benefit principle, office buildings usually generate only one-third of the peak hour traffic that the equivalent square footage in single family homes generate. Only in the rarest of conditions, when the uniform market value of office property equals three times the per square foot value of residential property, can the price of infrastructure under taxes be said to be fair or equal in the marginal cost sense, relative to impact fees.

Uniform fee schedules which incorporate overgeneralized zonal service areas provide no incentive for development to occur in one location or another. Precision systems incorporating high degrees of locational sensitivity, such as the pioneering Broward County, Florida TRIPS system, represent the leading edge of fair share marginal cost impact fee practice.

Such locationally-sensitive systems have two other significant attributes. They promote efficient use of currently existing capacity by providing a more accurate assessment of impacts and incentives in the form of lower fees to developers choosing to build in locations where capacity exists. The locationally-sensitive system similarly facilitates the truest incorporation of such impact fee costs into the total land improvement cost data upon which investment decisions are made, thus permitting both short- and long-term site acquisition decisions to incorporate said fees into land acquisition price negotiations. The result is a high propensity for such fees to be capitalized or offset in the price paid for land.

### The Politics of Impact Fees

Impact fees find their legal base under the police power and as such are extensions of traditional planning and regulatory activities. They are integral components of policy decisions relating to the provision of adequate facilities and services, not unlike other regulatory minimum requirements found in traditional subdivision and zoning ordinances. There is a growing tendency, however,



*Growth impacts.*



of many local governments to view impact fees as a panacea for instant new revenues resulting in a distortion of the motives that should exist for their adoption. The raising of revenue becomes the objective, not the regulatory requirement that development provide adequate facilities both on- and off-site in a marginal cost, fair share manner.

Far too many planners and elected officials view impact fees as new sources of discretionary revenues. In fact, the rash of poorly conceived, overgeneralized, minimally locationally-sensitive methodologies sweeping the country promotes the revenue versus regulatory view of impact fees. The operative effect of these poor methodologies is to force the development community, through the police power ploy, to pay fees into local trust funds in order that local governments can expend such funds in a manner meeting the flimsiest benefit test and remain legal. The ULI report attempts to point out that among the shortcomings of impact fees is their loss of expenditure discretion. In reality, the benefit-expenditure test of impact fees is the paramount safeguard that the development community should be demanding from their fee payments.

It should come as no surprise that the proposed adoption of an impact fee ordinance should raise concerns on the part of the development community. Stegman and Snyder have articulated the abusive effects of poorly conceived, non-locationally sensitive impact fee methodologies. On top of ever-changing ordinance requirements and increasing processing delays, the development community understandably reacts to oppose impact fees as adding to its problems. On the other hand, the general taxpayer, particularly in high growth environments, feels compelled to reject ever-burgeoning taxes to subsidize new development and is supportive of any technique which purports to shift the costs to the developers or users of new development projects, regardless of the operative effect of the chosen methodology.

The more a chosen impact fee methodology looks and operates like a tax, the greater the likelihood that it will exhibit all of the serious consequences and defects alleged by Stegman and Snyder. The effects of such methodologies are incompatible with all three views of equity, and magnify the distortionary impacts upon goals of equity, efficiency and incidence. The more a chosen impact fee methodology seeks to emulate California's "impact taxes," the greater the likelihood that such fees will fall short of fair share, marginal cost objectives and benefit-expenditure tests.

#### Facility Type Methodologies

The concept of horizontal equity provides decision-makers with the most effective forum for consideration

of infrastructure financing alternatives. Private market decisions and public facility costs share one common attribute which distinguishes one project from another, and which impacts successful market and financing decisions . . . location, location, location! To the extent that chosen methodologies can, within state-of-the-art professional and technical competence, isolate fair share, proportional impacts of site specific or locationally common impacts upon specific infrastructure capacities, it should be incumbent upon government to do so for all police power regulatory development fee systems. In so doing, the operative distinction between a tax and a fee are made apparent, and the best approximation of proportional impacts and fair share assessments can be achieved.

Fairness and equity in application among "development projects," large and small, is best demonstrated to potential payers of development fees when their "fair share" is clearly distinguished by their locational investment decision in relationship to adequate facilities. Private market development decisions are based upon the total estimate of acquisitions, development, and improvement costs, which vary among locations.

Development fees are in reality surrogates for the same project's off-site infrastructure costs and should vary in precisely the same manner to assure minimal methodological distortion of cost effects on development and housing. Facility type methodologies should express the proportionate relationships among location, facility service area, minimum accepted standards for facilities adequacy and costs for utilization or expansion of existing or needed capacity.

Facility type methodologies, to the extent possible, should reflect clearly articulated public facility and service standards and locational determinants in coordination with the community comprehensive plan. These standards should constitute the minimum level of service adequacy declared as public policy. Only with such declaration of measurable standards can existing excess capacity or deficiency be properly determined and further needs projected.

The ultimate political reality of properly conceived, locationally-sensitive fair share impact methodology is a new degree of regulatory certainty. Such systems serve to limit the developer's liability in comparison to the selective and arbitrary employment of negotiated exactions and extortionary practices which fall almost exclusively on the medium to large scale developer. □

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