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Policy Update: Impact Fees

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Introduction

Development impact fees can help Washington's cities and counties pay the financial costs of growth. Local governments in the state are authorized to collect four categories of impact fees to offset the cost of building new facilities to accommodate urban growth. However, few of the state's municipalities have adopted any impact fees. Those cities that have impact fees, typically charge only about half of the full cost associated with development.

A recent study by the Columbia Policy Institute shows that the cost of residential development to Washington's taxpayers is almost \$3 billion annually.¹ This is equivalent to about \$500 per person per year. These costs are contributing to the State's infrastructure funding crisis and may result in either higher taxes or declining public facilities and services (more congested roads and overcrowded schools).

How are these costs currently being funded? Can the costs be allocated in a more equitable manner through impact fees? How can use of impact fees be expanded and improved? What is the legal basis for impact fees? These are the main questions addressed in this *Policy Update*.

Who Pays for Growth?

Most growth-related infrastructure costs are paid through broad-based revenue sources such as property taxes and sales taxes. This means that everyone pays to build the facilities that new development requires – roads, schools, sewer and water lines, fire and police stations, parks, and libraries. Older neighborhoods end up subsidizing newer ones, as the cost for new public facilities is distributed across the entire community of taxpayers.

Where growth rates are slow, the costs for new facilities may be a minor concern. However, in faster-growing communities, growth-related costs can become a substantial burden to local taxpayers. Some communities will need to build a new school, fire station or library every year to accommodate growth. The cumulative expense of these costly facilities creates

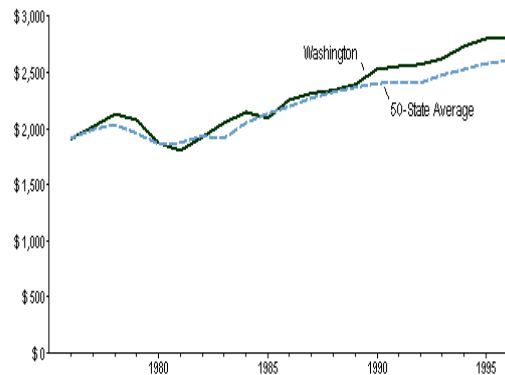
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resentment among taxpayers who receive little benefit from the expenditures.

The tax burden has been steadily increasing in Washington (on a per-capita basis), while the level of some public services is actually declining (see *Figures 1* and *2*). This situation contributes to the “anti-tax” and “anti-government” sentiment that has been widespread in the fast-growing western states. The current approach to funding growth-related infrastructure costs is exacerbating this anti-tax sentiment by maintaining a disparity between those who pay and those who benefit. The use of impact fees enables some of the capital facility costs associated with new development to be allocated directly to that development, and thereby providing tax relief.

Figure 1: Per-Capita Taxes Paid in Washington Have Been Increasing.

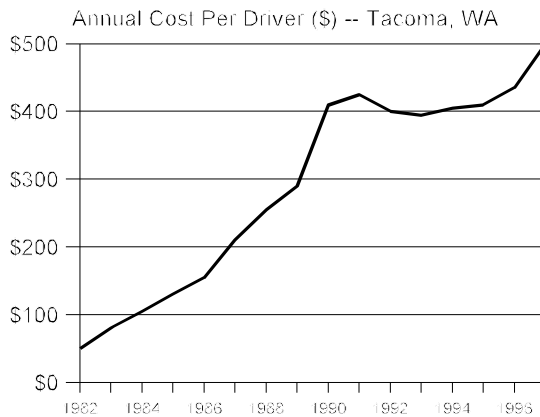
Washington State and Local Taxes Per Capita
(Inflation-Adjusted to 1996 Dollars)



Source: State of Washington Office of Financial Management (http://www.ofm.wa.gov/trends/gr99_5-04.htm)

Figure 2: Declining Public Services are Reflected in Increasing Traffic Congestion Levels.

Cost of Traffic Congestion



Source: Data compiled from Texas Transportation Institute's 1999 *Urban Mobility Report*.
(Cost includes hours of delay and excess fuel consumption.)

Who Should Pay?

There continues to be debate about whether or not development should pay its own way. In the past, many local governments have believed that growth was desirable and beneficial. However, public sentiment towards growth is changing as more people become aware of the costs associated with land development and no longer view additional growth as contributing to their quality of life. Surveys show that most people now want growth to pay its own way and not be a continual burden to taxpayers.

In situations where a community actually benefits from new growth, it may be reasonable to subsidize this growth, to some extent, with public resources. However, the local government should be able to demonstrate clearly and objectively that actual benefits to a community will result. Taxpayer subsidies should never exceed the estimated benefits. Benefits might include achieving high priority public goals, like the provision of needed low income housing, or the revitalization or redevelopment of depressed or blighted areas.

Status of Impact Fees In Washington State

Certain impact fees were specifically authorized in Washington by the Growth Management Act (GMA) in 1990. This act authorizes the collection of impact fees by Washington cities and counties for four categories of public infrastructure:

- streets and roads
- parks, open space and recreation facilities
- school facilities
- fire protection facilities

As shown in *Table 1*, there are at least 11 main categories of public infrastructure required by urban development. The GMA allows recovery of costs for only four of these.

While local governments in Washington are authorized to charge impact fees, they are not required to do so. A recent survey by the Association of Washington Cities found that very few cities in the state make full use of impact fees.² In fact, only five of the 206 cities responding to the AWC survey had impact fees for all four of the categories of public facilities authorized by the GMA. *Table 2* shows that the

TABLE 1
Categories of Public Infrastructure
Required by New Development Compared
with Impact Fees Authorized

Infrastructure Categories*	GMA Authorized Impact Fees
transportation system	✓
school facilities	✓
fire protection facilities	✓
parks & rec. facilities	✓
sanitary sewer system	✗
storm drainage system	✗
water service facilities	✗
police facilities	✗
library facilities	✗
general gov. facilities	✗
solid waste facilities	✗

* The infrastructure associated with publicly-granted monopolies, such as electricity, natural gas, cable TV and telephone service, could also be included in this list as "quasi-public" facilities.

number of cities with *any* of the four impact fee categories is very small, ranging from 9 cities with fire protection facility fees to 30 cities with park facility fees. Twenty-one cities reported that they are recovering from 1 percent to 100 percent of cost through their impact fee(s). On average, these respondents were recovering 45% of costs.

TABLE 2
Cities Charging Impact Fees for Residential Development in Washington

GMA Impact Fee Category	Number of Cities with Fee	Percent of Cities with Fee (out of 206 survey respondents)	Fee Range for Single-Family House
Fire Protection Facilities	9	4%	\$104 - \$360
Park Facilities	30	15%	\$300 - \$3,147
School Facilities	26	13%	\$286 - \$6,131
Transportation Facilities	25	12%	\$160 - \$2,710

Source: Association of Washington Cities, *2000 Tax and User Fee Survey*. Note: In some cases, impact fees may be used by independent service districts that are not part of the city and therefore do not appear in this table.

Are New Impact Fee Policies Needed?

Given that impact fees are not being fully utilized, are there policies or programs that could improve the use and effectiveness of these fees? Here are several suggestions:

- ***Broaden Impact Fee Authorization***

If it make sense to have impact fees for four categories of public facilities, then why not for all 11 categories? At least 19 states (including Washington) have “enabling acts” that specifically authorize the use of impact fees by local governments. The benefits of enabling legislation include a consistent policy framework for impact fees and protection for the local governments against law suits brought by developers seeking to challenge the validity of local impact fees.

At least six states (AZ, CA, ME, VT, WV and RI) authorize impact fees for all 10 categories of public infrastructure. Rhode Island is the latest addition, where residents recently voted to adopt a statewide policy authorizing impact fees for all types of public facilities. Washington could likewise expand its authorization via a referral, initiative, or legislative action.

- *Expand Use of Impact Fees to More Cities and Counties*

Many cities and counties may not be taking advantage of impact fees because they are complex to calculate and difficult to administer. These local governments may also fear legal and political opposition by developers and their associations. State government could help overcome these problems by providing assistance to facilitate and streamline the process of creating and administering fees. Standardized fee calculation methods can be prepared and representative unit cost provided for cities and counties that lack adequate staff or resources for fee development. State-sanctioned standardized methods would also tend to be more resistant to legal challenges.

- *Allow School District to Establish Impact Fees*

Under the current state regulations, school districts cannot collect impact fees. Instead they must rely on a city or county government to collect fees on their behalf. This leads to a number of potential problems. If a school district crosses into more than one municipality, there may be discrepancies between the fees charged for the same school district. The obvious solution is to authorize school districts to set their impact fees and require the local permitting authority to assess them.

Are There Better Ways to Utilize Impact Fees?

Local governments in Washington have the flexibility to offer appropriate credits or reductions in impact fees for development that achieves certain public goals or creates a desired public benefit. Full utilization of the potential for development impact fees can send an economic message encouraging better growth patterns. Proper structuring of impact fees can create incentives for better development and reduce incentives for growth and sprawl. Here's how:

- **Reduce incentives for growth and sprawl by using impact fees to recover the full costs of development as far as politically possible.** This means creating new impact fees where none exist and modifying existing fees to represent the full value of the public facilities required to serve new development.
- **Use variable impact fees to reflect the cost differences between serving sprawling development and compact development patterns.** The traffic impacts of sprawling or outlying development will be greater than for a comparable development that is compact or located closer to the city center. Traffic impact fees should increase to reflect the greater trip lengths and increased reliance on individualized auto transit caused by sprawling development patterns. This can be measured in terms of daily vehicle miles traveled, or VMT, per capita. Water, sewer and school cost are also higher with low density, sprawling development.

- **Use variable impact fees to avoid creating penalties or disincentives for building smaller homes.** This occurs when a local government charges the same flat rate for all homes, regardless of size. For example, data shows that the occupants of larger houses tend to consume more water, and consequently produce more sewage effluent, than for smaller houses. A better fee system might be based on the square footage of the house (or the number of bathrooms or bedrooms).
- **Development impact fees can be used to create incentives for the qualities and types of development that are desirable and achieve public goals.**³ For example, fees can be reduced or waived for re-development that can utilize existing urban infrastructure. Likewise, incentives can be created for development or infill in locations where it is desirable, such as downtowns. Impact fee discounts can be used to stimulate construction of low-income housing that helps achieve adopted public goals.

Legal Issues

Development impact fees have been widely used across the country and have faced many legal challenges. Developers have challenged impact fees as unauthorized taxes, a taking of property without just compensation, and as a violation of due process. Many early challenges to impact fees, such as *Hillis Homes, Inc. v. Snohomish County*, were successful but subsequent court cases and legislation have clarified standards for legal impact fees.⁴

The U.S. Supreme Court has addressed the issue of impact fees, or development “exactions”, on two occasions. First, in *Nollan v. California Coastal Commission* the Court established the “nexus” test that mandated a close connection or “fit” between impact of the development on the public and the requirement for an exaction, or public easement, from the private land owner. The “nexus” test concerns qualitative issues regarding the similarity of the impact and the proposed remedy.

In the second case, *Dolan v. City of Tigard*, the Court addresses quantitative issues and established the “rough proportionality” test. This test requires that exactions be in rough proportion to the burden created by the new development. The Court stated that “*no precise mathematical calculation is required, but the city must make some sort of individualized determination that the required dedication is related both in nature and extent to the impact of the proposed development.*”

The standards for impact fees in Washington were established by the Growth Management Act in 1990. These standards meet, and even exceed, the standards of the “nexus” test and the “rough proportionality” test. Under the GMA, fees must: (1) be “reasonably related to the new development”; (2) “not exceed a proportionate share of the costs of the system improvements”; and (3) be used for system improvements that “reasonably benefit the new development.”

The fees authorized by the GMA may only be used for building roads, schools, parks, open space, recreation facilities, and fire stations [RCW 82.02.090 (7)].⁵ Cities can ensure that fees meet the “rough proportionality” test by using fee calculation formulas that include factors such as the cost of new improvements, the standard level of service (LOS), the increase in population, and the cost of existing public facilities. Impact fees that use such formulas have been upheld in recent cases. In *Trimen Development Co. v. King County* an impact fee to pay for parks and recreation was upheld by the Washington Supreme Court. The fees were based on a detailed park study that included zoning, projected population, and assessed value of nearby land.

The GMA-authorized impact fees help to implement Planning Goal #12: Public facilities and services (RCW 36.70A.020). The intent of the fees is described in the enabling legislation (RCW 82.02.050(1)) as:

- (a) To ensure that adequate facilities are available to serve new growth and development;
- (b) To promote orderly growth and development by establishing standards by which counties, cities, and towns may require, by ordinance, that new growth and development pay a proportionate share of the cost of new facilities needed to serve new growth and development; and
- (c) To ensure that impact fees are imposed through established procedures and criteria so that specific developments do not pay arbitrary fees or duplicative fees for the same impact.

Other Potential Development Impact Fees in Washington

In addition to the GMA authorized impact fees, there are two other potential fees that could be applied to development impacts in Washington. The State Environmental Policy Act (SEPA), enacted 1983 (RCW Chapter 43.21C), gives local governments the authority to mitigate impacts for “... actions having a probable significant, adverse environmental impact.” This mitigation may involve charges or fees. Water and sewer districts may also charge connection fees which recover the costs of existing and planned facilities under RCW 57.08.005(10).

FAQs About Impact Fees

- *How do Impact Fees Affect the Cost of Housing?*

Impact fees are a mechanism for allocating some of the costs of infrastructure necessary to serve new development to the development itself. Thus, they do not create any new costs, nor do they increase the total cost of producing housing. Instead, they act to shift payment of these costs from the general taxpayer to the developer and new home buyer. While the new home buyer may end up paying more, existing homeowners will pay less, as their property taxes and other taxes are reduced accordingly.

“What is the effect of impact fees on affordable housing?”

Although impact fees do not alter total costs, they do affect the distribution of costs, or who pays for the facilities. Each community will need to make a policy decision about whether the cost of new infrastructure is charged directly to the new users or spread, via higher taxes, across the community.”

Quoted source: Municipal Research & Services Center of Washington, Web Site FAQs

Most studies show that some of the cost of an impact fee will be passed on to the new home buyer, while some will be paid by the developer and/or landowner. However, most of the studies considering the effect of impact fees on housing prices are overly simplistic. Some look only at the added fee, without including the general tax relief that results from assessing these fees. Some look only at the effect on new houses, while ignoring the effect on existing housing. Other studies look at all development charges together, lumping impact fees with building permits, plan reviews and other development fees.

- ***How do Impact Fees Affect Local Taxes and Service Levels?***

The principal basis for using impact fees is to provide an equitable funding mechanism for the new infrastructure required by new development. Thus, the fees provide tax relief by shifting the burden of funding new infrastructure off the general taxpayer. The fees also help ensure that adequate funding exists for maintaining service levels for public facilities. When there is more growth, there are more fees generated to pay for it. Because impact fees are collected at the time development occurs, the funds can be used to provide the infrastructure that development requires.

- ***Are Impact Fees Market-Oriented or Regulation-Oriented?***

A market economy depends on accurate price information to guide both the consumption and production of a commodity. Where hidden subsidies act to lower a commodity's price below its full value, consumption and production will be artificially stimulated. In this way the market is distorted and fails to operate efficiently.

Impact fees are not a tax, they are a fee for services provided by the local government. The fees help to reflect the full cost of land development. When impact fees are not utilized, local taxpayers are likely to end up subsidizing development. This subsidy is currently quite substantial, amounting to about \$83,000 for each new house built in the state.⁶ Reducing or eliminating this subsidy can help create a more-efficient housing market that reflects the true cost of home construction.

Recommended References on Impact Fees

- ***Impact Fees: Growth Paying for Growth***, Columbia Policy Update, Columbia Public Interest Policy Institute, Bellevue, Washington, August 1998.
- ***Impact Fees: A Selected Bibliography (1985 to Present)***, by Jeff Cain and Amanda Cain, Columbia Public Interest Policy Institute, Bellevue, WA, 1999.
- ***Paying for Growth's Impacts: A Guide to Impact Fees***, State of Washington Department of Community Development, Growth Management Division, January 1992.
- ***Practitioner's Guide to Development Impact Fees***, by James C. Nicholas, APA Planners Press, 1991 (<http://www.planning.org/bookstore/default.asp>)



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Endnotes and References

1. ***The Cost of Growth in Washington***, by Eben Fodor, Columbia Public Interest Policy Institute, October 2000.
2. Association of Washington Cities, ***2000 Tax and User Fee Survey***, Part II, Released November 2000.
3. This kind of flexibility is specifically authorized by state law in RCW 82.02.060(2) where it states that impact fees, “*May provide an exemption for low-income housing, and other development activities with broad public purposes, from these impact fees, provided that the impact fees for such development activity shall be paid from public funds other than impact fee accounts.*”
4. See article by Joseph D. Lee, “Sudden Impact: The Effect of Dolan v. City of Tigard on Impact Fees in Washington,” which was used as a reference for this section.
5. The main enabling statutes for impact fees in Washington can be found in the Revised Code of Washington, Sections 82.02.050 through 82.02.100.
6. Ibid #1.