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How Development Impact Fees Can Finance Essential Public Facilities in Growing Local Economies

Gregory S. Burge, University of Oklahoma

Cities and their surrounding suburbs play a critical role in promoting economic growth. Innovative citizens and entrepreneurs are the drivers, but public infrastructure also matters. Without schools, roads, parks, community centers, utilities, and public safety systems, economic growth and quality of life are quickly compromised.

Prior to the 1970s, the maintenance and expansion of these valuable public services was financed almost exclusively with property taxes. But after California voters passed Proposition 13 in 1978, local tax assessments were dramatically reduced – first in California and then in many other states. As they lost flexibility to raise revenues through the property tax, local communities searched for alternative approaches. Development impact fees have emerged as one of the most innovative and economically efficient ways to finance infrastructure expansions, so a close look at how they work and their advantages and disadvantages is in order.

How Impact Fees Work

First implemented in South Florida in the late 1970s, contemporary impact fees are one-time levies, predetermined through a formula adopted by a local government unit and assessed on property developers during the permitting process. Impact fees shift the extra cost for new municipal infrastructure facilities – such as sewers, lighting, roads, and so forth – away from existing residents who pay property taxes and toward developers and the new residents and businesses that will locate in the freshly developed projects. Legal standards require revenues from impact fee programs to be used for infrastructure systems serving the development projects they are attached to. For example, school impact fees could be used to add a new wing onto an existing school, but they could not be used to pay teacher salaries.

Over recent decades, impact fees have become very popular with local governments. Most medium to large-sized communities experiencing population growth use some version of this approach. Roughly 30 states have enacted legislation allowing impact fee programs, and they are protected by legal precedents in a handful of other states, including Florida.

The Effects of Impact Fees

Impact fees have been fairly characterized as a growth-friendly form of local land-use management. Research indicates they may systematically reduce the negative impact on building new homes that can happen due to the sole use of traditional forms of regulation such as large lot zoning, permit caps, and growth boundaries. What is more, with impact fee programs in place, local politicians and planning departments can accurately claim that new development within their jurisdiction is "paying its own way."

For projects such as affordable housing programs to create more apartments or small starter homes, impact fees can help to parry opposition from politically influential groups – such as wealthy suburbanites who may not want such developments located near-by, even when the community as a whole would benefit. Impact fees do not remove all of the concerns Not-In-My-Backyard protesters may have, but empirical evidence suggests that existing stakeholders become less intensely opposed to new developments when it is understood that impact fees will generate revenues for supportive infrastructure without further burdening existing owners.

The exact effects of impact fees on affordable housing are complex. Research has consistently shown they boost housing prices within the implementing communities. More specifically, however, these fees have been found to increase the supply of small starter homes and apartment complexes in exclusive suburban areas, while simultaneously reducing the supply of new large and expensive homes. How to view this trade-off is debatable, but impact fees do seem to broaden social access to desirable high-income residential areas.

Other interesting effects of impact fees have also been found in research projects I have conducted with colleagues:

- Impact fees can mitigate urban sprawl if implemented in a zone-based form, where fees are highest near the urban fringe and lower in interior urban areas that already have sufficient infrastructure facilities. In other words, zone-based impact fees may provide city planners with a beneficial alternative to purely regulatory efforts to curb urban sprawl, such as the setting of fixed growth boundaries.

- School impact fees levied on undeveloped land shift the tax burden toward residential interests and away from commercial interests, making commercial growth more attractive. Overall, the exact design of impact fees matters greatly. A well-balanced program will neither slow nor increase job growth, but an imbalanced program could do either.

The Questions Communities Should Ask

Impact fees can be valuable, but communities should ponder basic issues before using them.

- Is the community growing? Costly to design impact fees are not very useful where there is little demand for new construction. If growth should continue, impact fees can help to manage it.

- Is the community ready for clashes between tax winners and losers? Impact fees remove the subsidy that established residents cover when higher property taxes fund added infrastructure. But the shift can unleash battles between residents and developers.

- Does the community need more affordable housing – and if so, should the new costs be paid by existing home owners or by developers (even if they pass the fee costs to buyers or renters)?

- Is the goal to improve service levels to new areas or shift the cost of paying for limited services everywhere? Businesses and homeowners may want both lower taxes and more or better public services, but fiscal realities force trade-offs. Impact fees are one more revenue-raising tool to put in the mix, but choices still need to be made in the democratic political process.

Read more in Gregory S. Burge and Keith Ihlanfeldt, "Promoting Sustainable Land Development Patterns through Impact Fee Programs." *Cityscape* 15, no. 1 (2013) and "The Effects of Impact Fees on Multifamily Housing Construction." *Journal of Regional Science* 46, no. 1 (2006).