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# Pros and Cons of Paying for Growth With Impact Fees

by

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# PROS AND CONS OF PAYING FOR GROWTH WITH IMPACT FEES

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It has become increasingly common for local governments to impose impact fees as a way of paying for infrastructure and facilities made necessary by new development. In justifying impact fees, it is often argued that it is unfair to ask existing taxpayers to pay for improvements serving new residents, and that new residents should pay for infrastructure and facilities which are especially beneficial to them. However, the equity of shifting costs onto new residents is not nearly so clear in the real world. Existing residents often benefit from improvements necessitated by new development. Moreover, new residents who pay impact fees also pay property taxes, which frequently include the cost of borrowing for capital improvements constructed in previously developed areas.

Proponents argue that impact fees "make developers pay" for the costs their developments impose on communities. This can be a politically popular argument. But the cost of impact fees is rarely paid by developers. In areas with strong property markets, the fee will almost always be passed on to the new occupant in the form of a higher purchase price or increased rent. The second possibility is that the developer, knowing that the fee has to be paid, will pay the landowner *less* for the land. The least likely possibility is that the fee will be paid by the developer. Developers need a certain level of profit for a project to make sense, given the risks involved. If the impact fee cannot be passed back to the landowner, or forward to the purchaser, the developer very likely will not go forward with the project. Most empirical studies to-date have found that the cost of impact fees is passed on to new residents in the form of higher home prices. This finding is not surprising for two reasons. First, as a practical matter, impact fees are usually imposed in communities with strong real estate markets, in which the costs of the fees are most able to be passed on in the form of higher prices. Second, impact fees generally pay for improvements which make new developments more desirable, functionally and/or aesthetically, and therefore *more valuable* in terms of the market price they can command.

Although impact fees have proven highly popular at the local level, there are a number of problems with impact fees which need to be understood.

1) Most of the benefit from impact fees accrues to communities with strong real estate markets which enable them to impose and collect impact fees. Communities which are stagnating or declining will be unable to collect such charges—because developers do not want to develop there in the first place, and will be even less likely to do so if an additional charge is imposed.

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2) Impact fees are imposed and collected almost exclusively by a single local government. However, developments often have impacts on more than one community. For example, a new office park or shopping center may generate a large amount of traffic through nearby communities. In the absence of some mechanism for fee-sharing, the imposition of fees by one community does little to compensate other communities for costs imposed on them.

3) Impact fees imposed on new residential developments have traditionally been assessed on a per unit basis, or on the number of bedrooms, without reference to the cost of the housing unit. As a result, impact fees have worked against the provision of affordable housing, because they have represented a much higher percentage of the cost of a moderate or low priced housing unit than of an expensive housing unit. This shortcoming could be solved by making the fee proportionate to the cost of the housing unit, by reducing the impact fee for housing units which are affordable to average income residents, and/or by eliminating the impact fee altogether for projects which provide low cost housing units.

4) Impact fees *may* be imposed by communities not so much to pay for growth as to discourage new development, and make new development more expensive. Existing property owners often have a powerful incentive to impose impact fees, since increasing the scarcity and cost of new housing makes existing homes and developed properties more valuable.

When impact fees are proposed in any area, they are almost always opposed by developers and real estate interests. But once impact fees have been adopted, those opponents tend to view impact fees in a different light. When public tax revenues are scarce, and when local governments are unable or unwilling to pay for required improvements, most developers recognize the usefulness of impact fees, and that such fees ultimately serve their interests. With impact fees in place, developers can be fairly certain that infrastructure and facilities needed by new development will be provided. Without impact fees to finance those public improvements, many projects which developers want to undertake would not be approved. Also, although impact fees increase the cost of development, the improvements paid for by impact fees make new developments more valuable and saleable. One recent study found that for every $1.00 of impact fees collected, property values rose 85 cents.[2/]

In a state such as Wisconsin, where growth in most communities has been slow to moderate (indeed, some communities have not grown at all), impact fees are not as easily justified as in states where growth has been more explosive. Nevertheless, in some areas in Wisconsin growth has been of sufficient magnitude to justify consideration and use of impact fees. Given the current climate of opposition to property taxation, impact fees are not likely to go away. Indeed, they will become even more important if legislation is enacted at the state level to limit local governments' ability to increase property tax collections.

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2. Arthur C. Nelson, "Planning gain or paying for growth?" Lecture at University of London, Institute for Advanced Legal Studies, London, England, April 27, 1990.