



Extension FactSheet

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Development Impact Fees

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Background

Development impact fees are one-time charges applied to offset the additional public-service costs of new development. They are usually applied at the time a building permit is issued and are dedicated to provision of additional services, such as water and sewer systems, roads, schools, libraries, and parks and recreation facilities, made necessary by the presence of new residents in the area. The funds collected cannot be used for operation, maintenance, repair, alteration, or replacement of existing capital facilities and cannot just be added to general revenue. They are essentially user fees levied in anticipation of use, expanding the capacity of existing services to handle additional demand. The amount of the fee must be clearly linked to the added service cost, not some arbitrary amount.

There are two basic approaches to setting impact fees — the average-cost pricing method that sets a flat connection fee and a marginal-cost pricing system in the form of a three-part tariff. One part of the tariff would be a charge for the costs of the facility used to provide water and sewer services, like a water-treatment plant. The second part is a charge for costs of delivering the new service, such as the costs of connections or extensions. The third part of the tariff is a charge for actual use based on the short-run costs of producing the service. Under this method, the goal of public officials is to determine the location of the central facilities and then charge for their use. The market would then determine “efficient” land-use patterns with appropriate impact fees included.

Policy Considerations

Although impact fees do not alter total service or infrastructure costs, they do affect who pays those costs. Each community must decide whether the cost of new infrastructure is charged directly to the new residents by using impact fees, or shared among all new and current residents through higher taxes. This is a sensitive issue, because current residents can refuse to raise the taxes needed for new facilities serving new residents, lowering the average level of service for all. Or, if the costs are charged to new users, current residents can enjoy any increase in average service benefits from the construction of new facilities without paying for them.

Land Use

The premise on which impact fees are based is that added development should pay the marginal cost of providing added facilities necessary to accommodate growth. Impact fees, then, might offset many of the subsidies of new development that produce a “leapfrog” urban sprawl pattern that allows development to skip over land closer to the urban area. By adopting impact fees, current residents could ease the burden of providing incremental infrastructure by shifting added infrastructure costs onto new residents. Therefore, new residents are essentially buying their way into the community.

Impact fees can help guide development when based on a comprehensive plan and when implemented to allow local governments to finance construction improvements with a schedule that ensures that the improvements are in place to serve new development. Thus, impact fees can encourage growth in some areas by assuring the needed services, while discouraging leap-frog development that would require much higher fees.

Adopting an impact-fee scheme may carry additional costs to the community. Some businesses may choose to locate in a community without impact fees instead of one that has them. Impact fees also require local governments to engage in more professional and sophisticated capital facilities planning, requiring additional administrative staff with the necessary skills. A fee system may reduce the price of undeveloped land because impact fees act as a deterrent to develop open land.

Implementation

Three sets of administrative factors determine success in adopting an impact-fee scheme. First, there must be a need for *fiscal innovation* resulting from rapid population and employment growth and an increasing demand for public facilities. Second, there must be *administrative capacity to innovate*; this means that the governmental unit is able to review, deliberate, and implement an impact-fee scheme. Finally, there must be land-use and facility planning and coordination capacity, because impact fees depend on a comprehensive land-use and capital-improvements program.

Distributional Effects

Impact fees may lead to certain types of inequities as well. Fees will be equitable if the new developments are the same size and kind, but the fees may be considered inequitable if lower-value developments pay impact fees that are a greater proportion of house value than is the case for higher-value developments of comparable community impact. Also, an impact-fee scheme may create problems for low-income households, because it raises housing prices, and, in a competitive market and in the short term, the developer will attempt to pass these costs on to the buyers.

Another question that arises is the relative share of the impact fee paid by the seller and the buyer of a new residence. The answer depends on the elasticities of demand and supply for housing or whatever the development entails. If buyers of new homes are not price-responsive because they strongly prefer that location, they will pay a greater portion of the impact fee. Builders may respond to the increase in cost by increasing the supply of housing outside of the place with the fees. In the short term, both buyers and developers bear part of the burden unless developers offset their share of the fee by reducing lot or dwelling size, quality, and amenities.

Legal Considerations

Constitutional Tests

An impact fee must meet three constitutional tests.

- First, the fees must meet a substantive *due-process* test, where the local government has the authority to assess, collect, and spend impact fees for a determined public facility. General home-rule authority by which municipalities may govern themselves without specific authorization from the state legislature seems to include the power to enact impact fees. The manner of assessment, collection, and expenditure must clearly qualify the payment as a fee and not a tax. The fee must *substantially advance* a legitimate state or local interest, and the fee must be roughly proportional to the added service cost.

- Second is the *equal protection* test — the fees must be applied to all parties on the same basis. All new development that imposes an impact must be assessed the same kind of fees, although fees may vary by the magnitude of impacts and must be rationally related to the public purpose. Courts have considered whether imposing a fee on new but not pre-existing residences violates the equal protection clause of the 14th Amendment to the U.S. Constitution. The general conclusion has been that municipalities have a legitimate governmental purpose in classifying properties for levying fees, and impact fees have been upheld.

- Finally, the *takings* test must assure that the local objective is sufficiently close to the method chosen to accomplish that objective and that property is not *taken* without just compensation.

Nexus Tests

Three nexus tests of impact fees have emerged from the court record on impact fees to meet the constitutional issues.

- The *reasonable relationship* test is based on California exaction practices and requires that there is a reasonable con-

nection between the fee charged to the developer and the needs generated by that development.

- The *specifically and uniquely attributable* test requires that the fee charged to the developer is attributable to that development.

- The *rational nexus* test states that there must be a proportionality between the amount charged to the developer and the type and amount of facilities demand generated by the development and that there be a reasonable connection between the use of the fees and the benefits produced for the new development.

State Legislation

Several states have enacted legislation affecting the ability of public agencies to levy impact fees. The use of impact fees has expanded since 1985 to about 20 states by 2000. This legislation ranges from very specific, comprehensive, and restrictive, as is the case in Texas and Illinois, to very brief and general, as in New Jersey or Indiana.

The Ohio Situation

Meck and Pearlman, in their annual update of Ohio Planning and Zoning Law, provide an excellent review of important cases on impact fees. The information presented here draws heavily on their work. As of 2003, Ohio has no specific enabling legislation for local development impact fees. Several recent court cases address the constitutionality of utility tap-in fees or recreational excise taxes imposed by Ohio municipalities under their general home-rule authority. The cases focus on the authority to impose such fees and the *reasonableness* of the fee, that is, the relationship between the fee charged and the actual cost of providing the service in question.

One of the first Ohio cases was the 1967 dispute between Englewood Hills, Inc., and the Village of Englewood. A Montgomery County appeals court ruled in that case that Ohio municipalities may levy tap-in charges for water and sanitary-sewer services if the fees are “fair and reasonable and bear a substantial relationship to the cost involved in providing the service.” There was sufficient engineering evidence that the fees in question bore a direct relationship to the per-unit cost of providing the service, based on marginal cost as defined above.

The Ohio Supreme Court confirmed a municipality’s authority to impose sewer tap-in or connection fees in *Amherst Builders Association vs. the City of Amherst*. The Court noted that the connection fee must bear “a reasonable relationship to the entire cost of providing service to those new users.” The fees must not be available for general services, only for the sewer system. Fees may be based on replacement cost, less depreciation, or on estimated sewer flowage from various users.

Another example of municipalities exercising their home rule power is in *Towne Properties vs. the City of Fairfield, Ohio*, in which the Ohio Supreme Court affirmed a municipality’s authority to impose an excise tax on new homes in the city to generate funds for needed public recreation facilities. The Court held that municipalities might adopt a local charge on new development, absent an express or implied prohibition by the state legislature.

When a local government attempts to impose fees higher than the added service cost, a court would hold the fees invalid. For example, in a 1977 case (*State ex. Rel. Waterbury Development Co. v. Witten*), the Ohio Supreme Court affirmed a Lucas County appeals court in striking down a water tap-in charge required before a building permit could be issued as having no relationship to the present or future cost of providing water. The county fee had included a substantial overhead charge to cover an existing water system.

In 1993, the city of Beavercreek in Greene County, Ohio, established an impact fee on new land developments within an area of the city defined as an impact-fee district. The purpose of the fee was to provide for the new streets, roads, and related traffic facilities associated with the new development. The fee was paid with application for a zoning permit or final residential plat approval concerning the land to be developed in the special impact-fee district. Funds collected from the developers of the land within the district would go into a special trust fund for providing traffic-system improvements necessitated by new development. No funds could be used for periodic maintenance. The impact fee ordinance was intended to shift an appropriate share of the cost of new roads and streets onto the new development.

Because the ordinance segregated impact-fee monies into a separate fund, it limited expenditure of those funds to constructing the roads needed to serve new development. The Court found that the ordinance was based on sound land-use planning, passed the dual nexus test linking the fee to demonstrated need and appropriate level, and did not constitute a regulatory taking. The trial court declared the Beavercreek ordinance to be a constitutional exercise of home-rule authority.

But the Greene County Court of Appeals reversed in favor of the plaintiffs, Homebuilders Association of Dayton and the Miami Valley.

The appeals court concluded that the impact fees should be characterized as a tax. One reason, said the court, was because the city financed the defense of the ordinance out of the fees themselves, although typically defending litigation against challenges is a general city responsibility, not something unique to a particular ordinance. "Using the fees in an adversarial context to support litigation costs, while not absolutely prohibited, makes the ordinance operate more like a tax than a fee." The Court ruled against the city, because of the absence of a matching fund to augment impact fees collected.

The Ohio Supreme Court received this case in November 1999 and issued its finding in June 2000, reversing the Appeals Court decision and upholding the Beavercreek ordinance. The city had made an extraordinary effort to limit the fee to developments necessitating new transportation expenditures. A deduction was made for "pass through" existing traffic, and specific exemptions were granted. The court was persuaded that the impact fee was indeed a fee and not a tax, and that a matching fund was not required to remain a constitutionally valid action under home-rule authority.

Absence of a uniform enabling structure for impact fees in Ohio means that each municipality that tries this approach to dealing with local development cost must be prepared for a legal test on its own merits. Legitimacy of these ordinances will be decided

on a case-by-case basis. Having a state-wide enabling law with appropriate guidelines and tests is still a preferable option for Ohio. And little about the Beavercreek experience is directly transferable to townships or counties that lack the home-rule status of a municipality. The Beavercreek experience has been long and costly for the community. It took three years to develop the ordinance and another five years to defend it in court.

As of November, 2003, about 40 Ohio municipalities use impact fees for purposes discussed above. All of these are in rapidly growing areas, mostly in the central and southwestern parts of the state. Several other communities are considering impact fees.

Conclusions

Development impact fees acknowledge that new development frequently creates infrastructure costs greater than the revenue generated for the municipality providing the service.

Development impact fees may raise the cost of development and could affect location decisions by residents or businesses. Impact fees can add some economic rationality to the development pattern by internalizing more of the cost of new development. If these location decisions tend to drive development away to places without fees, the community may prefer higher user fees or other ways to pay for local services.

Policy experience with impact fees is highly diverse and inconsistent from state to state. Some states have statewide enabling statutes dealing specifically with local impact fees. In other states, authority is given to certain municipalities. In others, by far the more numerous, impact-fee policy has evolved through court-tested specific efforts by municipalities or other jurisdictions to generate funds they need to provide needed and demanded services. In Ohio, municipalities and home-rule counties and townships have acknowledged authority to develop an impact-fee structure, subject to constitutional tests of equal protection and due process. Valid fees must be related to the demanded cost of required new services and must be used for those services only.

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