Searching for Money in All the Right Places

By Brendan Thompson, P.E., Gary A. Cornell, AICP, and William B. Zieburtz, Jr.

Population growth. Economic development. Local governments routinely struggle to provide infrastructure in response to the demands they create. Several reasons contribute to the challenge, including the inherent difficulty of completing large capital projects, complexity of prioritizing multiple types of projects and difficulty in finding funds to pay for required projects.

Fortunately, there is in some cases a useful tool to help local governments complete projects in a timely fashion – impact fees. They provide up-front revenue to partially offset the cost of required capital projects. Additionally, impact fees can improve equity by recovering a larger portion of the costs of required improvements from new residents or businesses receiving the service. An impact fee program must rest on effective comprehensive planning and detailed infrastructure planning. Local governments invest significant resources to prepare comprehensive and community plans, and to develop infrastructure plans for water, wastewater, transportation and other needs. Impact fees can build on this foundation of understanding, translating these plans into a mechanism through which the costs of additional capacity are offset in part by up-front impact fee payments.

Making growth pay for growth

Impact fees are designed to be paid up-front during the development process to recover a proportionate share of the costs of capital facilities needed to serve new developments. Especially common in the water and wastewater industries, they are becoming increasingly common for other types of capital facilities such as transportation, fire protection, libraries, and parks and recreation.

Capital contribution fees, capital facility fees, system development charges, system buy-in charges and capital recovery fees – all are different names for impact fees. The common thread is that impact fees are calculated to include the cost of providing capacity to serve new development, which "buys-in" to the system through payment of impact fees as an up-front charge.

An appropriate impact fee schedule must be calculated to reflect a rational nexus or connection between the benefit received and the fee paid. For example, a transportation impact fee requires a local government to anticipate the investment in infrastructure required to serve new development, and to develop a fee schedule that reflects only this portion of its total spending on transportation. Similarly, a water utility determines the costs of providing capacity to serve new connections, including the planning, engineering, construction and financing requirements of projects. Once eligible facilities and costs are identified, the capacity provided by each category of facilities must be analyzed to determine the pro rata portion of the facilities' cost attributable to each connection or other unit of development.

Both existing and planned facilities generally can be used in impact fee calculations as long as the net allocation prevents any double-counting and results in no more than a proportionate allocation to each unit of new development. Details vary by state and the particulars of each local government's situation, but the following costs are generally appropriate for inclusion in an impact fee:

- the depreciated value of existing facilities, excluding any facilities no longer in service or scheduled to be removed from service
- the estimated cost of planned facility expansions according to adopted comprehensive or master plans, and
- the financing and interest costs of existing and projected debt related to system improvements.

Multiple disciplines are involved

Impact fees must rest on a solid foundation provided by the results of a number of different technical disciplines examining the situation. The key to a successful impact fee program is a thorough understanding of the demands posed by new development, the impact of anticipated growth on existing facilities, and the new and expanded facilities needed in response to the increase in demand.

Teamwork is a necessity if impact fees are to be a real solution.

Planning → Direction

Engineering → Capital Plan

Financial → Defensible Fees

Effective planning is the first step in preparing an effective impact fee schedule. Local governments must understand current conditions before beginning reasonable discussions of growth. A community's existing character influences the level and types of services needed, as well as influencing the potential direction of growth. Similarly, the aspirations of current community residents help to guide planning for the future, particularly if that vision is different from the current development pattern. Once a current assessment and vision are established, the planning function must reconcile the differences and create a workable plan to bridge the gaps and guide future development. Conflicts in vision and implementation must be resolved

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through effective communication and negotiation. The result is an internally consistent and implementable plan that can serve as a foundation for the analyses to follow.

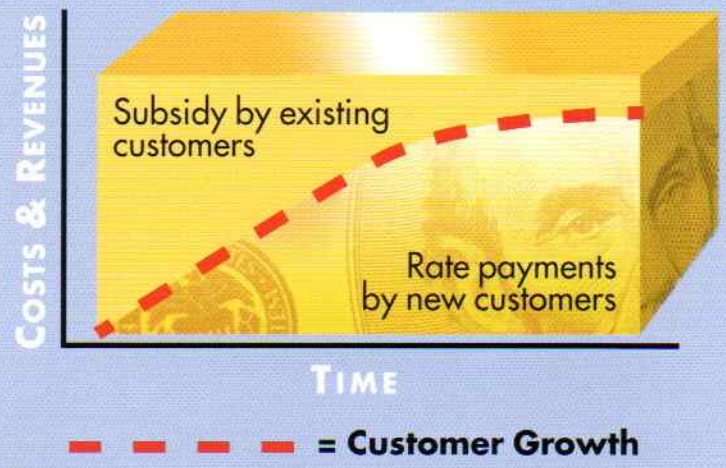
Detailed technical and engineering analyses need to rely on sound planning efforts so the work done in these activities can be free of inconsistencies and provide a reasonable basis for capital planning. Projections of future increases in demands for local government services must reflect an understanding of currently deployed technology and a reasonable utilization of demand factors and other information from outside the local area. Capital improvement plans must be developed utilizing specific expertise in relevant engineering and scientific disciplines. They must also provide a translation of a demand for services into a viable plan for implementing capital projects that ultimately leads to a revenue plan for funding capital expenditures.

Financial analysis builds upon the results of these two prior work efforts and ultimately provides an impact fee study to document and provide a basis for adoption of impact fees. The impact fee study methodically steps through the arithmetic and algebra to quantify the per-unit investment required to support new development for each type of infrastructure. The study quantifies the availability of existing capacity, the extent to which grants or other capital contributions have offset capacity costs, the need for capital spending and its link to new development, and translates these and other factors into an impact fee schedule.

Legislative requirements vary

The legislative environment for up-front capital recovery charges for capacity varies by state. There is no enabling legislation granting specific authority to impose impact fees in many states, while in others the legislature provides rules and procedures required for implementation. Georgia and South Carolina are examples of states with legislation. Georgia adopted the Development

Existing Customers Subsidize Future Customers If There Are No Impact Fees



New facilities must be constructed in advance of the receipt of rate payments or tax revenues from new customers. Existing residents subsidize growth in communities without impact fees.

Impact Fee Act so that "municipalities and counties which have adopted a comprehensive plan containing a capital improvements element are authorized to impose by ordinance development impact fees as a condition of development approval" (Official Code of Georgia Annotated (OCGA), Sec. 36-71-1 et seq).

The legislative intent of the bill was to ensure the availability of adequate public facilities, to establish minimum standards for impact fee ordinances and to require that new development pay a proportionate share of the cost of new public facilities. This is a common intent, and the language is very similar to legislation adopted in several other states. The law contains numerous procedural requirements, including creation of an advisory committee, constraints on capital assets that can be included in an impact fee, requirement of an ordinance, public notice and other adoption procedures, and a reliance on and consistency with an adopted comprehensive plan.

In other states, such as Tennessee, the legislative authorization is very general or no legislation grants

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specific authorization to impose impact fees. Local governments in such states routinely adopt fees for water and sewer systems as an extension of the same authority under which user charges are implemented and enforced. Impact fees are less common for other non-utility functions in the absence of enabling legislation. Interestingly, the patterns required for calculation of an appropriate and defendable impact fee are similar in states with legislation and states without.

How impact fees work

- Impact fees allow an equitable sharing of development-related costs among developers, without regard to their individual skill at negotiations with local governments.
- Impact fees provide up-front financial contributions for capital needs in a more timely fashion than user charges or future tax payments.
- Impact fees reduce the proportion of growth-related costs that must be borne by existing residents and businesses.

The most important of these benefits to local governments may be the third, as equity is a foundational criterion in local government finance and management. Because capital facilities are most efficiently constructed in relatively large increments, the costs for new or expanded facilities can significantly impact the annual revenue requirements of a community. While the costs are incurred in advance of development, the rate and tax revenues associated with new or expanded facilities typically only accrue gradually, as new development proceeds over time. This discontinuity can result in existing residents subsidizing future residents if impact fees are not used.

Benefit versus cost decision

Local governments can weigh the benefits and costs of an impact fee program to determine whether a new or expanded program would be worthwhile. The key benefits of an impact fee program are the dollar amount of anticipated proceeds, the increase in equity in the sharing of capital costs and the increased stability of user charges or tax rates. Primary costs are the dollar cost of implementation, the dollar cost of increased record-keeping and the potential increase in administrative duties to maintain the program. The increase in costs related to record-keeping is of note as it is important to document receipt and expenditure of impact fee proceeds more comprehensively than is necessary with other sources of funds.

The financial benefit of an impact fee program is enhanced by the fact that proceeds are received much sooner than revenues could be generated from rate or tax payments from new development. In a rapidly growing community, an impact fee program can make the difference between being able to provide necessary facilities and having to interrupt the development process to wait for funds to become available. In this way, impact fees can be very supportive of development, not the impediment that is commonly assumed.

Points to consider

Local government officials and managers contemplating an impact fee program should remember:

- Impact fees can in many cases pay for themselves and help reduce the costs of growth borne by existing residents and businesses.

- Only an appropriate share of growth-related costs can be recovered through impact fees. There should be an equitable and reasonable relationship between the fee imposed and the benefit received by the payor.
- Care must be exercised in establishing levels of service and service areas. Establishing a target level of service is tantamount to making a commitment to achieving that target. Similarly, be aware of the reporting and record-keeping requirements associated with the adoption of multiple service areas.
- The revenue stream from impact fees is substantially less stable and predictable than those from most other sources of funds available to local governments. Prudent financial planning and conservative budgeting are important to creating a successful impact fee program.
- Budget for the increase in operating costs that will accompany the new capital facilities being partially funded through impact fees. Meeting the needs of growth and development will impact the operating budget and capital budget.
- Build community support by forming an outside advisory committee even if it is not required by your state. Seek out individuals who are committed to civic responsibility, with more than a narrow self-interest in growth and growth management.
- Using impact fee proceeds to correct existing deficiencies is not an allowable use of these funds. Proceeds from up-front charges for capacity may only be used to provide capacity for new growth.

Impact fees and other up-front charges for capacity are not a perfect fit for every city, county or authority because of differing capital needs, growth pressures, and political or geographical constraints. But local governments that fail to look at the advantages of some form of impact fee as a financing tool could potentially face rate and tax increases that are higher than necessary. Impact fees help growth pay for growth. In many instances, implementing these charges can help stabilize user charges and tax rates. ■

New Fees Help

Ratepayers of the City of Georgetown, South Carolina, will have to pick up less of the cost of growth now that the City has adopted an impact fee program. The impact fee study implemented by JJG allows new development to "buy-in" to the available capacity in the City's water and sewer systems.

"The impact fee program will help us fairly recover the costs of serving new customers," says Lane Mixon, the City's water utilities manager. The City has relied on tap fees to cover the costs of making new connections, but has not previously charged for capacity in its existing systems. "It is something we have needed to do for a long, long time," explains Mixon.

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