

# AN OVERVIEW OF IMPACT FEES IN TEXAS

Short Course on Planning and Zoning  
for Public Officials and Attorneys

Southwestern Legal Foundation,  
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There is no more technical, difficult area of land use law in Texas than municipal impact fees. Nevertheless, in light of recent United States Supreme Court cases, all cities should consider impact fees relative to the development of property and off-site improvements related to specific developments. Before addressing these issues, however, a short explanation of the purpose of impact fees is warranted.

## Capital Improvements, Growth and Impact Fees

Capital improvements, such as sewer lines, lift stations, water or wastewater treatment plants, drainage facilities and roadways, are usually characterized by a high, one-time cost, a useful life exceeding five years, significant land acquisition costs, site preparation, engineering, planning and construction costs and long-term financing options. Most local governments plan for such investments far in advance. Local financing of these public facilities is generally built upon a foundation consisting of three elements: the annual budget, a capital improvements program and long-range facilities/transportation plans. Many local governments also adopt "master plans" for specific public facility systems. Impact fees generally have been welcomed by local governments as a tool in financing facilities and other capital projects. Impact fees shift a portion of the cost of providing capital facilities to serve new growth from the general tax base to the new development generating the demand for the facilities.

"Impact fees, like other forms of development exactions, are imposed as a condition of development approval to mitigate impacts on public facilities and services generated by the development project. The principal use of impact fees, which distinguishes them from traditional subdivision exactions, is the financing of off-site capital facilities to support new growth." Morgan, T. "The Effect of State Legislation on the Law of Impact Fees, With Special Emphasis on Texas Legislation," 18th Annual Institute on Planning, Zoning and Eminent Domain § 7.01 at 7-2 (1988)(hereinafter "Effect of State Legislation"). Further, "[i]mpact fees . . . serve as a substitute for denial of development projects that otherwise would not be served by adequate facilities. In essence, development exactions mitigate adverse impacts of new development on the municipality's ability to provide essential facilities and services." *Id.*, § 7.02[1] at 7-4.

An impact fee is broadly defined as a contribution of land, improvements or money imposed as a condition of development approval to mitigate the impacts of the development project. Such development exactions include mandatory dedications of property for rights-of-way, requirements to construct capital improvements, fees in lieu of dedication or construction, impact fees for public facilities, and fees or charges that are assessed against development projects to mitigate environmental or social impacts. Texas Municipal League Public Policies Briefing Series, "Impact Fees in Texas," § 1.2 at 1-2 (Nov. 1989)(hereinafter "Impact Fees"). The Texas impact fee statute, codified in Chapter 395 of the Local Government Code, defines "impact fee" as "a charge or assessment imposed by a political subdivision against new development in order to generate revenue for funding or recouping the costs of capital improvements or facility expansions<sup>1</sup> necessitated by and attributable to the new development. The term includes amortized charges, lump-sum charges, capital recovery fees, contributions in aid of construction, and any other fee that functions as described by this definition. . . ." Tex.Local Gov't Code § 395.001(4). The statute specifically excludes park dedication or payments in lieu of park land dedication, several different categories of on-site facilities and lot or acreage fees. *Id.*

In certain instances a developer may be entitled to a refund or credit of impact fees. For example, if a developer constructs wastewater facilities in a service area, the developer would not also be required to pay the maximum amount of impact fees for wastewater facilities. To do so would be unfair to the developer since he/she, in essence, would be paying twice for the same capital improvement.<sup>2</sup> The impact fee statute contains three provisions requiring that impact fees be refunded. The first is upon request of an owner "if existing facilities are available and service is denied or the political subdivision has, after collecting the fee when service was not available, failed to commence construction within two years or service is not available within a reasonable period. . . ." Tex.Local Gov't Code § 395.025(a). The second instance entitling a record owner to a refund is when any impact fee is not spent as authorized . . . within 10 years after the date of payment. *Id.*, § 395.025(c). Last, the impact fee statute contains a refund provision requiring comparison of the actual costs of capital improvements identified in the capital improvements plan with estimated costs included in the capital improvement plan. *Id.*, § 395.025(b).<sup>3</sup>

In light of two United States Supreme Court decisions, I believe the use of impact fees to finance off-site capital facilities is far preferable to other methods of obtaining both on-site and off-site improvements impacted by a new development. The first case, *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987), placed local governments on notice that drafting and implementing regulatory conditions in the development approval process that effectuate acquisition of title or interfere with possession can result in a finding that private property has been taken without just compensation. In this case, the Nollans were private beachfront landowners who wanted to replace their dilapidated small bungalow with a larger house. They were granted a permit from the California Coastal Commission with the condition that they grant an easement, by deed, for the public to pass across their beach. The easement required was a lateral one that would pass across a portion of their property. The Coastal Commission's stated rationale for requiring the easement was that the new structure would obscure the view of the ocean, thus burdening the public's right to traverse the beachfront. The Supreme Court ruled in favor of the Nollans, finding that

a condition attached to approval of a single-family development permit, which required the owner to dedicate a portion of his lot to provide the public with lateral access to the beach, violated the guarantee of the Fifth Amendment that private property shall not be taken for public use without just compensation. In so ruling, the Court established a standard of "remoteness," under which development exactions attached as conditions to

development approval must “substantially advance” the asserted and legitimate governmental interest for which they are imposed.

Effect of State Legislation, § 7.03[4][a] at 7-10, *citing Nollan*. The Supreme Court also wrote that it was “inclined to be particularly careful about the adjective [“substantial”] where the actual conveyance of property is made a condition to the lifting of a land-use restriction, since in that context there is heightened risk that the purpose is avoidance of the compensation requirement, rather than the stated police-power objective.” *Nollan*, 483 U.S. at 841.

The second significant Supreme Court case is *Dolan v. City of Tigard*, 512 U.S. 374 (1994). The Tigard, Oregon, city planning commission approved Mrs. Dolan’s application to expand her hardware store and pave her parking lot conditioned upon her compliance with the dedication of land (1) for a public greenway to minimize flooding that would be exacerbated by the increases in impervious surfaces associated with her development and (2) for a pedestrian/bicycle pathway intended to relieve traffic congestion in the city’s central business district. *Id.*, 512 U.S. at 380. She appealed the commission’s denial of her request for variances from these standards to the Land Use Board of Appeals. She alleged that the land dedication requirements were not related to the proposed development, constituted an uncompensated taking of her property for a public use and therefore violated the just compensation clause of the Fifth Amendment to the United States Constitution. The Board found that there was a reasonable relationship between the development and the requirement to dedicate land for a greenway due to the impact that a larger building and increased impervious surfaces would have on runoff into the creek. The Board also found that requiring a pathway was reasonable to mitigate the impact of the increased traffic from the development and to facilitate alternative means of transportation. *Id.*, 512 U.S. at 381-82. On appeal, both the Oregon Court of Appeals and Supreme Court affirmed the Board’s ruling. *Id.*, 512 U.S. at 383.

The United States Supreme Court, however, held that the requirements in fact did constitute an uncompensated taking of property. The Court wrote that, under the well-settled doctrine of “unconstitutional conditions,” a government may not require a person to give up a constitutional right in exchange for a discretionary benefit conferred by the government where the property sought had little or no relationship to the benefit. *Id.*, 512 U.S. at 385. The Court stated that the first question, in evaluating Dolan’s claim, is whether an “essential nexus” exists between a legitimate state interest and the permit condition. If it does, the second question is whether the degree of exaction demanded by the permit condition bears the required relationship to the projected impact of the proposed development. In assessing the second question, the Court instructed that the necessary connection required by the Fifth Amendment is “rough proportionality,” or essentially the “reasonable relationship” test adopted by a majority of state courts. *Id.*, 512 U.S. at 386-91.

In applying this two-step analytical model, the Supreme Court found that although preventing flooding along the creek and reducing traffic congestion in the district were legitimate public purposes, thereby establishing a nexus, the findings upon which the city relied did not show the required reasonable relationship between the flood plain easement and bike path and Dolan’s proposed building. Specifically, the Community Development Code already required Dolan to leave 15% of her property as open space, which would have practically been satisfied by the undeveloped flood plain. The city, however, never stated why a public, as opposed to private, greenway is required in the interest of flood control. Moreover, the city did not meet its burden of establishing, beyond mere conclusory statements, that the additional traffic generated by Dolan’s

development reasonably related to the city's requirement for a dedication of the pathway easement. *Id.*, 512 U.S. at 392-93.

I believe the potential impact of *Dolan* upon local governments across the country is significant. First, most local governments routinely exact donations of land and facilities in conjunction with subdivision plats or other development approvals based on proximity of the land to be developed to existing or planned services and facilities. Typically, as in *Dolan*, the location of the future facilities is designated in master plans or other comprehensive planning documents. These documents, and development regulations that implement those policies, seldom quantify the relationship between the required contribution and the impacts arising from the proposed development of specific tracts and subdivisions. These forms of development exactions contrast markedly with demand-based exactions such as impact fees which necessarily quantify the relationship. Most commentators agree that the *Dolan* decision, in its demand for quantification, likely will encourage the use of fee-based exactions which provide a standard against which land dedications or construction requirements can be measured.

Second, it is common local government practice to formulate conditions that are unique to the development application pending. *Ad hoc* conditions routinely are attached to applications ranging from rezoning proposals to building permits. Often development regulations do not anticipate even the types of conditions that will in fact be imposed. The lack of standards to guide development approval, while always problematic, can be expected to be more so following *Dolan*. The *Dolan* opinion expands *Nollan* so that conditions must be related both to the nature and extent of the proposed development. In the absence of standards and with a newly assigned burden to justify conditions,<sup>4</sup> local governments will have difficulty clearing even the first hurdle - the nexus test.

Third, impact fees directly address the concerns raised in *Dolan* when such fees have been enacted pursuant to proportionality standards established by state statute or constitutional requirements. Impact fees allow local governments to fully mitigate the demands created by new development on public facilities through monetary payments that are quantified for the development at issue. At the same time, traditional subdivision requirements, such as land dedication and facilities construction, can be continued in effect by crediting the value of such improvements against the payment of impact fees.

After *Nollan* and *Dolan*, it is safe to say that impact fees are far more advantageous than traditional development exactions that may arbitrarily vary from one development to another. As stated in *Impact Fees*, the advantages are as follows:

First, impact fees represent an additional source of revenue from which to finance a portion of future capital improvements' needs. Political subdivisions which are responsible for supplying water, sanitary sewer, roads and drainage facilities increasingly are subject to fiscal constraints for funding such improvements to serve new growth. With the disappearance of many federal and state grants, and tax-payer sensitivity to increased taxes and utility rates, local governments must transfer a portion of the costs of capital improvements which serve new development to the ultimate beneficiaries. The more the local government relies upon debt financing to serve its capital improvement needs, the more likely it becomes that service levels in the community will be reduced. By supplementing tax and utility revenues with impact fee revenues, existing revenue sources may be devoted to maintaining service levels and funding capital improvements to correct existing deficiencies or replace existing facilities.

Because impact fees present a means for assuring that community-related facilities will be coordinated with new development, their use promotes economic development by encouraging the location of new employers in the community who value such services.

At the same time, the use of impact fees provides assurance to existing businesses that local taxes and utility rates will remain relatively stable. If the local government must rely upon these sources to finance capital improvements to serve both new and existing development, the community faces steady increases in tax and utility rates attributable to debt financing.

Impact fees also represent a means of attaining certain police power objectives, which are not easily attained through the use of traditional development exactions. Thus, local governments may adjust impact fee rates to meet particular economic development or other police power objectives. Impact fees may be varied among service areas or by type of land use, as long as such differences are reasonably related to a proper police power objective. Through the use of impact fees, the community may encourage the establishment of certain kinds of developments, such as major employers or affordable housing projects.

Finally, impact fees represent a more equitable form of distributing the burdens for financing future capital improvements among various types of development. Traditional development exactions practices, which require the on-site dedication or construction of capital improvements, are based on the location of the property in relation to existing or planned public improvements. As a consequence, developments which equally contribute to the need for additional capital improvements may be assessed widely differing costs under such practices. Generally speaking, the owner of the property which is located on or abutting the site for a future public improvement is required to contribute more than the owner of property which is not so located. This unequal distribution of responsibilities for providing for future capital improvements is avoided through an impact fee program, in which the contribution of a particular development project is in proportion to the demand it creates for additional capital improvements.

Impact Fees, § 3.2 at 15-17.

From a strictly legal standpoint, impact fees provide cities with easily enforceable standards relative to both on- and off-site exactions. If a city had no impact fee ordinance, prior to requiring *any* dedication or exaction, the city would be virtually indefensible without conducting studies regarding the relationship between any dedication or exaction and the impacts of the development. Further, a study would be mandated for each development plan considered by the city and the city would be required to quantify its findings in support of each such exaction or dedication. Consequently, it would be cost-prohibitive to conduct such studies and the potential would be great that the conclusions of any study would be challenged. If a city opted not to conduct studies for each new development, the risk of liability would be exponentially greater with little likelihood the city would prevail. Last, to require a developer to construct a capital improvement pursuant to a city's capital improvements plan and also assess that developer impact fees would violate state law. In the situation where a developer constructed a capital improvement, the developer under state law would be entitled to either a refund or credit because it would be manifestly unfair, and legally indefensible, to "double charge" for the construction of a capital improvement.

### **The Adoption of an Impact Fee Ordinance in Texas**

The adoption of an impact fee ordinance by a Texas city is a detailed process, the steps of which are outlined in Chapter 395 of the Texas Local Government Code. An overview of that process is discussed below. It should be noted that most cities retain consultants to assist in this process due to the technical nature of the subject matter.

After a city has determined that impact fees are or would be beneficial to the community, a capital improvements advisory committee must be appointed. Tex. Local Gov't Code § 395.058. The city's Planning and Zoning Commission may be appointed as the advisory committee; however, if that is done by the city, at least one member of the advisory committee must be a representative of the real estate, development or building industry. In that case, the industry representative is an ad hoc voting member of the planning and zoning commission when it acts as the advisory committee. *Id.*, § 395.058(b).

The primary purpose of the advisory committee in Texas is to advise and assist in the preparation of the land use assumptions and the capital improvements plan. The advisory committee also has the ongoing responsibility to produce semi-annual reports and assist in the updating of the impact fee program. *Id.*, § 395.058(c).

It is important that the scope of the proposed impact fee ordinance be reviewed and that target facilities be identified. In Texas, those eligible facilities are water supply, treatment and distribution facilities; wastewater collection and treatment facilities; storm water, drainage and flood control facilities; and roadway facilities. *Id.*, § 395.001(A). In determining the scope of the impact fee program, only certain charges and facilities may be included in the impact fee. Those are:

1. construction contract price;
2. surveying and engineering fees;
3. land acquisition costs, including land purchases, court awards and costs, attorney's fees and expert witness fees;
4. fees actually paid or contracted to be paid to engineers and financial consultants preparing or updating the capital improvements plan and who is not an employee of the political subdivision; and
5. interest and other finance costs (if bonds, notes or other obligations are issued to finance the capital improvements or facility expansions).

*Id.*, § 395.012(a) and (b). The Local Government Code provides, however, that certain items may *not* be paid by impact fees. Those items are:

1. projects and related costs of those projects that are not included in the capital improvements plan or facility expansions;
2. repair, operation and maintenance of existing or new capital improvements or facility expansions;
3. upgrading, updating, expanding or replacing existing capital improvements to serve existing development to meet stricter safety, efficiency, environmental or regulatory standards;
4. upgrading, updating, expanding or replacing existing capital improvements to provide better service to existing development;
5. administrative and operating costs of the impact fee program;

6. principal payments and interest or other finance charges on bonds or other indebtedness for projects not in the capital improvements plan; and
7. any roadway designated in the federal or Texas highway system.

*Id.*, §§ 395.013 and 395.001(8). It should be noted that impact fees may be assessed for both residential and non-residential properties.

### **Land Use Assumptions**

After the scope of a proposed impact fee ordinance is determined, the advisory committee must prepare Land Use Assumptions (LUA) and prepare a Capital Improvements Plan (CIP). “Land Use Assumptions” are defined as including a “description of the service area and projections of changes in land uses, densities, and population in the service area over at least a 10-year period.” *Id.*, § 395.001(5). The advisory committee may engage in the following types of review and analysis:

1. **Analyze existing conditions.** This provides base data relating to population, density, zoning classifications and other land use analysis.
2. **Determine service areas.** The boundaries for service areas are contingent upon the specific capital improvement. With the exception of roadway, storm water, drainage and flood control facilities, the service area may be the entire city and the city’s extraterritorial jurisdiction (ETJ). Section 395.001(9) of the Texas Local Government Code provides the following guidance regarding service areas:

*Water and wastewater facilities.* Most cities in Texas have adopted the entire city and the city’s extraterritorial jurisdiction (ETJ) as the service area and thus, impact fees are the same city-wide.

*Roadway facilities.* The service area is limited to an area within the corporate limits (*i.e.*, ETJ cannot be included) not exceeding a distance equal to the average trip length from the new development but in no event more than 3 miles and designated in the Capital Improvements Plan.

*Storm water, drainage and flood control facilities.* The service area is limited to all or part of the land within the corporate limits of the city or its extraterritorial jurisdiction (ETJ) actually served by the storm water, drainage and flood control facilities designated in the Capital Improvements Plan.

3. **Project ten-year growth patterns.** Projection of ten-year growth patterns involves a review of all available land use data, including zoning classifications, density calculations, anticipated growth, population trends, economic issues, including employment projections, and the various land use matters often contained in comprehensive plans.
4. **Ultimate (or “built out”) growth projections.** The same type of data required for the ten-year growth projections also is utilized in determining the ultimate or “built out” projections for each service area. This is often based on the holding capacity of the ultimate land area of the city using proposed future land uses to determine anticipated land use types and densities and ultimate populations. Again, a city’s comprehensive plan may be the best source of much of this information.

If there is no comprehensive plan or other projections of growth and land uses, then a city must develop a basis and methodology for land use and population projections within the Land Use Assumptions. The Land Use Assumptions (LUA) will serve as a basis for the preparation of the Capital Improvements Plan (CIP) over a ten-year period as well as a basis for the generation of the number of “service units” to be served. A city must be able to show that costs within the Capital Improvements Plan that are eligible for impact fee funding indeed are attributable to new growth and are derived from the Land Use Assumptions.

After the Land Use Assumptions have been established (usually with the advice and assistance of the advisory committee, as contemplated by Section 395.058(c)(1) of the Texas Local Government Code), a public hearing must be held to consider those Land Use Assumptions “within the designated service area that will be used to develop the capital improvements plan.” *Id.*, § 395.042. There are very specific notice and publication requirements for the public hearing (*see id.*, §§ 395.043 and 395.044) and approval of the Land Use Assumptions is required before an impact fee ordinance can be adopted. Although the statute allows a consolidated hearing on the Land Use Assumptions and the Capital Improvements Plan (*see id.*, § 395.0515), that rarely is advisable since changes in the Land Use Assumptions will often necessitate modifications to the Capital Improvements Plan.

### **The Capital Improvements Plan**

After the adoption of the Land Use Assumptions, the Capital Improvements Plan (CIP) may be prepared. The statute sets out certain requirements for the Capital Improvements Plan. It must:

1. be prepared by a qualified professional (registered professional engineer);
2. describe existing capital improvements within the service area and the costs to upgrade, update, improve, expand or replace the improvements to meet existing needs and usage and stricter safety, efficiency, environmental or regulatory standards;
3. analyze the total capacity and current levels of usage and commitments for usage of capacity of the existing capital improvements;
4. describe each type of facility expansions or capital improvements (water, wastewater, storm water, roadway, etc.) and associated costs for improvements of each necessitated by and attributable to new development within each service area based on the approved Land Use Assumptions;
5. determine by service unit the consumption, generation, discharge or use of a facility or capital improvement relative to various types of land use (residential, commercial and industrial);
6. determine the total number of projected service units;
7. project the demand for capital improvements or facility expansions required by new service units over the next ten-year period; and
8. determine and calculate the maximum impact fee that can be charged for each service unit for each type of facility or improvement.

*Id.*, §§ 395.014 and 395.015. It should be noted that the Capital Improvements Plan prepared pursuant to Chapter 395 of the Texas Local Government Code is very different from a city's traditional capital improvements plan. The traditional capital improvements plan usually identifies many projects (including repairs or enhancements of existing facilities) that are to be undertaken during a shorter period of time. Consequently, some cities may have two types of capital improvements plans, a Chapter 395 Capital Improvements Plan and a traditional capital improvements/projects plan. The Chapter 395 Capital Improvements Plan requires a city to define an appropriate level of service. This level will vary depending upon the nature of the targeted capital facility. Selection of a service level represents an indirect commitment by the city to both correct existing deficiencies and to deliver services in accordance with projected need. Although all facilities expected to serve growth in the ten-year period are not required to be included in the Capital Improvements Plan, there should be an attempt to include all that are appropriate. The Plan should not attempt to under-estimate or over-estimate the facilities that will be required to serve growth over the next ten-year period. See Kahn & Sefko, "Impact Fees and Exactions," *A Guide to Urban Planning in Texas Communities* (American Planning Association, Texas Chapter) at 11-9.

Like Land Use Assumptions, after completion of the Capital Improvements Plan, a public hearing is necessary. The notice and hearing requirements the Capital Improvements Plan are contained in Section 395.049 of the Texas Local Government Code. Specifically, an impact fee ordinance must be adopted within thirty (30) days of the hearing on the Capital Improvements Plan and impact fees. *Id.*, § 395.051(a). Any impact fee ordinance adopted as a consequence of the Land Use Assumptions and Capital Improvements Plan should contain the following elements:

1. administration of impact fees;
2. time of assessment of the impact fees;
3. time of collection of the impact fees;
4. make provision for offsets and credits of impact fees;
5. schedule of maximum fees and actual fees to be collected;
6. accounting system for funds collected; and
7. refund provisions.

Pursuant to Section 395.016 of the Texas Local Government Code, impact fees may be assessed at any of the following "trigger" times: recordation of plats, issuance of building permits, connection to the water or sewer system, issuance of a building permit or issuance of a certificate of occupancy.

### **Post-Adoption Requirements**

According to the state impact fee statute, cities have an ongoing requirement to semi-annually review the progress of the Capital Improvements Plan and report any perceived inequities in implementing the Plan or imposing the impact fee. The advisory committee undertakes this function and must report its findings to the governing body. Tex. Local Gov't Code § 395.058(c)(4). Every three years a city must review and update its Land Use Assumptions and Capital Improvements Plan. *Id.*, § 395.052.

## **The 1999 Legislative Session and H.B. 2045**

House Bill No. 2045, sponsored by Representative Brimer of Arlington, is presently being considered in the Texas Legislature. At the time this paper was prepared, it had been approved by the House of Representatives and was on the Senate calendar. While it is impossible to predict its future, H.B. 2045, if passed by both houses and signed by the governor, will amend Chapter 395 in several substantial ways. A copy of the bill is attached to this paper and its major highlights are as follows:

1. Roadway impact fees could be collected for the political subdivision's share of costs for roadways and associated improvements for federal and state highways.
2. For roadway facilities, service areas will be increased from three to six miles.
3. In the Capital Improvements Plan, developers and landowners would receive credits (a) for the portion of tax revenue generated by new service units identified in the Land Use Assumptions for the payment of construction costs for the government's construction projects and (b) for the portion of the monthly water and wastewater service charges received from new service units identified in the Land Use Assumptions that is used for the payment of construction costs for water and wastewater infrastructure to serve new development.
4. A government annually must certify to the Attorney General that it complies with Chapter 395 of the Texas Local Government Code and if a government fails to do so, it is liable to the state for a civil penalty in an amount equal to ten percent (10%) of the impact fees erroneously charged.

### **Myths About Impact Fees**

Although I would like to claim credit for the following, Professor Arthur C. Nelson of Georgia Tech published the following myths about impact fees in *Exactions, Impact Fees and Dedications: Shaping Land-Use Development and Funding Infrastructure in the Dolan Era* (American Bar Association, State and Local Government Law Section 1995) at pages 93-96. I have slightly modified this portion of Professor Nelson's article for this paper.

Many impact fee myths so distort the truth as to ignore that the purpose of impact fees is to actually *improve* the climate for developers. These myths concern effects on housing and development prices, affordable housing, economic development, border effects, and administration.

#### **Myth 1: Impact Fees Will Be Passed On To Homebuyers**

Developers usually argue that impact fees will simply be passed on to the homebuyer. This implies that impact fees will raise the price of housing. If this were true, developers would not oppose impact fee policy since it would cost them nothing. Also, if this were true, developers are not now charging as much as the market will bear and are therefore leaving money on the table.

In fact, developers have it part right. Depending on market dynamics, the impact fee will actually be paid by the landowner, land developers, builder, or homebuyer. There are two kinds of markets: competitive and noncompetitive. In competitive markets, housing prices are set at the maximum the market will bear across all housing segments. In

these markets, it is very difficult to pass impact fees forward to the buyers of new homes. Except for a transitional period, impact fees will be mostly, if not entirely, paid by the seller of the land--whether that is the seller of raw land or the seller of finished lots. This is because, according to classic economic theory, the urban land market will force landowners to absorb the fees in the form of lower sales prices. Indeed, by viewing impact fees as a form of tax, classic economic theory requires that the fees be internalized in land prices. From a public policy perspective, this is a desirable outcome because it leads to more efficient use of land and its resources, thereby maximizing social benefits while maximizing social costs.

The situation is different in noncompetitive markets. Rising costs can indeed be passed on to homebuyers, especially in the short term. Such markets may be characterized by the affluent San Francisco Bay Area communities of the 1980s, and smaller, isolated communities where buyers have no locational alternatives, such as the affluent mountain communities of Colorado. However, such a market situation is irrelevant to impact policy consideration. Generally speaking, noncompetitiveness is a product of supply constraints. Ironically, impact fees finance the very facilities that expand the supply of buildable land. In effect, impact fees help make noncompetitive markets less noncompetitive.

Builders and developers are becoming quite adept at forcing landowners to pay the fee. One to two years before impact fees were adopted by Atlanta metropolitan area local governments, for example, developers were routinely inserting a new paragraph in their land purchase option agreements requiring landowners to reduce their sales prices by the impact fees charged. Indeed, it is the inefficient or unprofessional builder and developer who do not require the seller to internalize such fees. While impact fees may adversely affect developers and builders who have excess inventory acquired previously at high prices, inventory accumulation usually includes a risk factor that helps account for future uncertainties of both government and markets.

Based on economic logic and builder/developer behavior, it is unlikely that all impact fees will be passed forward to homebuyers. Indeed, in competitive markets and after a transition period, impact fees will be passed backward to the owners of vacant land.

#### Myth 2: Impact Fees Are Bad For Low- And Moderate-Income Housing

Some will argue that impact fees will be bad for the production of low- and moderate-income housing. This is true if the fees result in reducing land prices to nearly zero. However, impact fees probably do more to facilitate the production of such housing than inhibit such production. Consider that housing prices rise if demand exceeds supply. What causes supply to fall below demand? Inadequate infrastructure. What is the purpose of impact fees? To provide infrastructure commensurate with demand. In effect, impact fees enable local government to increase the supply of buildable land to more closely match demand. If supply meets demand, prices will not rise.

There are thus two dynamics at work to keep low- and moderate-income housing prices competitive. First, impact fees will result in lowering land prices to offset the fee. Second, impact fees will increase the supply of buildable land, thereby also dampening price effects. Indeed, careful economic analysis of impact fees applied to competitive housing markets suggests that they will actually improve the opportunities for low- and moderate-income housing. Nevertheless, there can be some problems associated with impact fees on low- and moderate-income housing.

#### Myth 3: Impact Fees Will Have Border Effects

This argument asserts that if a developer is choosing between two parcels of land on which to build, where the first parcel is inside a city that charges impact fees and the second is in another where impact fees are not charged, the developer will choose the second parcel. The trouble is that the owner of the first parcel does not make a sale. The owner must lower the land price to offset the fee in order to make a sale.

#### Myth 4: Impact Fees Are Bad For Economic Development

Related to Myth 3 is the argument that because impact fees raise the price of doing business, they frustrate economic development. However, just the reverse is true. First, remember that impact fees will be offset by reduced land prices and by enabling the community to more easily expand the supply of buildable land relative to demand. Now, consider what economic development *really* looks for: skilled labor, access to markets, and land with adequate infrastructure. Competitiveness for economic development will be stimulated by the new or expanded infrastructure paid in part by impact fees.

#### Myth 5: Impact Fees Are Too High

This argument relates that the only good impact fee is no impact fee, and any impact fee is too high. First of all, impact fees merely reflect the real cost to provide the very infrastructure to new development that development needs. Second, impact fees rarely exceed one quarter of the total cost of new facilities needed to accommodate new development; the larger share of that cost is paid from intergovernmental sources and existing tax structures. Third, impact fees (other than utility connection fees) usually run less than 5 percent of the total sales price of a new home, which is less than the customary 6 or 7 percent charged by real estate professionals.

#### Myth 6: Impact Fees Are Difficult And Costly To Administer

At 1 to 5 percent of total receipts, impact fees are the most efficient method of exaction. For example, researchers at the Georgia Institute of Technology recently found that government costs associated with case-by-case, negotiated exactions are four times higher than impact fee administration costs. Moreover, considering that developers incur far greater costs associated with case-by-case negotiations than local government, but there are no such costs where impact fees are involved, the developer savings can be considerable.

#### Myth 7: Impact Fees Are Just One More Bureaucracy Developers Have To Contend With

Since developers pay fees based on a published fee schedule, gone are many of the time-consuming, unpredictable, usually unfair horse trading between developers and local government for improvements. The result is several important efficiencies that accrue to developers. These include predictability of decision-making processes, certainty of infrastructure provision, streamlined decision processes, and more precise information for financial analysis purposes.

### **Impact Fees: Questions and Answers**

#### **1. Can only cities impose impact fees?**

No. According to Section 395.001(7) of the Texas Local Government Code, the following political subdivisions may impose impact fees: (1) municipalities, (2) districts or

authorities created pursuant to Article III, Section 52 (conservation and water districts and county road districts) or Article XVI, Section 59 (conservation and reclamation districts) of the Texas Constitution, and (3) certain counties, as described in Section 395.079 of the Texas Local Government Code.

**2. Can a city charge an impact fee outside its corporate limits and ETJ?**

Yes, but only if it has contracted to provide capital improvements to such an area. It cannot collect a roadway impact fee, however. See Tex. Local Gov't Code § 395.011(c).

**3. If a city wishes to impose an impact fee, can it do so on its own without following all of the requirements of Chapter 395?**

No. According to Section 395.011(a) of the Texas Local Government Code, unless specifically authorized by state law or Chapter 395, no governmental entity or political subdivision may enact or impose an impact fee.

**4. If a landowner cannot pay an impact fee, can a city enter into an agreement providing for the time and method of paying the fee?**

Yes. Section 395.018 of the Texas Local Government Code specifically provides that a political subdivision may “may enter into an agreement with the owner of a tract of land for which the plat has been recorded providing for the time and method of payment of the impact fees.”

**5. If a city has assessed impact fees, but those fees have not yet been paid, can the city subsequently increase the fees?**

No. According to Section 395.017 of the Texas Local Government Code, “[a]fter assessment of the impact fees attributable to the new development or execution of an agreement for payment of impact fees, additional impact fees or increases in fees may not be assessed against the tract for any reason unless the number of service units to be developed on the tract increases.”

**6. May a city, for example, require that a school district pay impact fees?**

Yes. Section 395.022 provides that other governmental entities may pay impact fees imposed under Chapter 395.

**7. Does Chapter 395 of the Texas Local Government Code prohibit moratoriums?**

Yes and no. Section 395.076 of the Texas Local Government Code specifically prohibits a city or other covered governmental entity from placing a moratorium “on new development for the purpose of awaiting the completion of all or any part of the process necessary to develop, adopt, or update the impact fee.” Moratoriums for non-impact fee matters (e.g., moratorium on zoning applications while a zoning ordinance is being reviewed and amended) are permissible.

**8. How long does a developer have to challenge the imposition of an impact fee?**

Ninety days. According to Section 395.077 of the Texas Local Government Code, a suit to contest an impact fee “must be filed within 90 days after the adoption of the ordinance, order, or resolution establishing the impact fee.” Venue lies in the county in which the major part of the land is located and a successful litigant is entitled to recover reasonable attorney’s fees and court costs.

### **9. Can impact fees be assessed for park land?**

No. Section 395.001(4) of the Texas Local Government Code specifically excludes impact fees for a dedication of park land or payment in lieu of dedication to serve park needs.

### **10. Are pro rata agreements for water and sewer lines valid if a city has adopted an impact fee ordinance?**

Yes. Section 395.001(4)(C) of the Texas Local Government Code provides that “lot or acreage fees to be placed in trust funds for the purpose of reimbursing developers for oversizing or constructing water or sewer mains or lines” are not included in the definition of “impact fees.”

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1 The terms “capital improvement” and “facility expansion” are terms of art. A “capital improvement” is limited to only one of four types of public facilities with a life expectancy of three or more years. “These are (1) ‘water supply, treatment and distribution facilities’; (2) ‘wastewater collection and treatment facilities’; (3) ‘storm water, drainage, and flood control facilities’; or ‘roadway facilities.’” Impact Fees, § 2.1 at 5-6. “Facility expansion” refers to the “expansion of the capacity of an existing facility of one of these types of capital improvements.” *Id.*, § 2.1 at 6.

2 The impact fee statute provides that “an owner may not be required to construct or dedicate facilities and to pay impact fees for those facilities.” Tex. Local Gov’t Code § 395.001(4). A “credit” is “a reduction in the amount of the impact fee reflecting previous monetary contributions identified in the capital improvements plan for impact fees” and an “offset” refers to “a reduction in the amount of an impact reflecting the value of land dedicated by a developer for a capital improvement designated in the capital improvements plan for impact fees, or the value of such improvement constructed by a developer pursuant to the political subdivision’s land use regulations or requirements.” Impact Fees, § 11.3 at 102-03.

3 One commentator has described this third refund provision as “virtually unworkable.” See Impact Fees, § 10.5 at 94.

4 In *Dolan*, the Supreme Court, although stating that precise mathematical calculation is not required, placed the burden of proof upon cities to make some sort of individualized determination that a city-imposed dedication is related both in nature and extent to the impact of the proposed development. *Id.*, 512 U.S. at 389-91. Thus, any exaction must bear a reasonable relationship to the needs created by the development and the burden of proof rests with the city to establish and quantify such needs.