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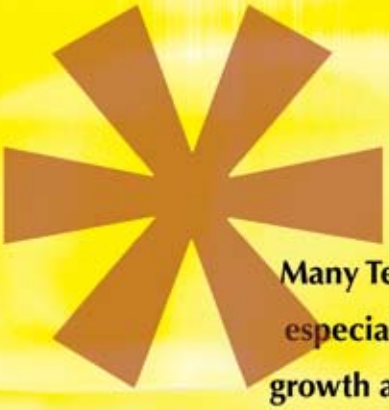


Many Texas communities, especially those in high-growth areas, are assessing impact fees to finance infrastructure construction. Only eligible state-authorized political subdivisions can do this, and those that do must create local impact fee ordinances as described in Chapter 395 of the Texas Local Government Code.

IMPACT FEES

Crunching the Numbers

By James P. Gaines

In the last issue of *Tierra Grande,* the ordinance creation process was examined in detail (see "Impact Fees: Paying for Progress," *Tierra Grande,* July 2007).

Impact Fee Studies

Once the Capital Improvements Plan (CIP) is adopted, the impact fee amount must be calculated, presented and reviewed for final approval and enactment of the ordinance. Typically, this part of the process includes an impact fee study that details the data, assumptions, measures and methodology used to compute the maximum fee amount. By statute, land use and service demand projections must include:

- forecasted new development by individual land uses for at least ten years within a defined service area;
- the ratio of service units per land-use category; and
- projections of service demand by land-use service units.

Identifying eligible costs for impact fee funding within the comprehensive CIP is critical to the fee calculation. A comprehensive CIP may be created to satisfy capital facility needs based on long-term land-use assumptions (LUA), to improve existing facilities for existing users or to meet legally mandated upgrades for safety or environmental purposes.

Impact fees, however, are limited in time, purpose and geography. Chapter 395 of the Texas Government Code specifies the formula and outlines the computational process to derive the maximum allowable impact fee.

Service Areas

Impact fees are assessed within specifically defined service areas, which are generally limited to the corporate boundaries of the political jurisdiction. If water-wastewater services or flood control and drainage services are provided in areas of the jurisdiction's extraterritorial jurisdiction, those areas may be included in the service area. The service area for water-wastewater capital facilities may include the entire geographic area served by the water-wastewater system.

The service area for roadway improvements is limited to "an area within the corporate boundaries of the political subdivision and shall not exceed six miles" (Section 395.001[9]). The law is not clear as to whether the six-mile limit refers to an area encompassing six square miles, a six-mile radius, six miles square or something else. Impact fee study analysts typically apply the six-mile limit as the maximum useable trip length to compute road demand from new development, but a six-mile trip length is not actually an "area."

Municipalities located in less-populated counties are subject to a special provision. A municipality with a population of 105,000 or less that constitutes more than three-fourths of the county's population and has not adopted impact fees may allow

landowners adjoining the current construction of a capital improvement for sewer, waterline, drainage or roadway facilities to connect to the capital improvement if certain conditions are met.

Service areas are important for a number of reasons. The existing capacity of public facilities may be uneven across a jurisdiction. Some areas within a city may have existing capacity to serve additional development, while other areas may not. Physical characteristics, land-use densities and road systems may vary from one service area to another, greatly affecting the cost of needed capital facilities. The law mandates that impact fees can fund only capital costs that arise from new development within a service area.

A systemwide service area definition may require a different method of impact fee calculation. New development should not be asked to pay more than its pro rata fair share for total system improvements. Therefore, if new facilities constructed with impact fee revenues improve the system for all users, impact fee calculations should account for the fact that the majority of system users are existing residents.

Because in any year new development represents a fraction of total development, new development should pay only a fraction of new capital facilities' costs. This approach is difficult to quantify.

Land-Use Assumptions

The land-use assumptions (LUA) include the economic, land-use, demographic, service level and capital facilities data to project future development, service needs and costs. By law, the LUA must cover at least ten years, but sometimes longer-term data are applied for extended planning. The assumptions establish the empirical foundation for the decision to impose an impact fee by identifying future demand relative to existing capacity.

The LUA include projections of new development by individual land-use categories as well as projections for road and water services demand. The population and LUA warrant detailed examination because the amount of an impact fee depends directly on the number of persons, dwelling units and nonresidential land uses that will share responsibility for capital costs.

Common areas of concern and review include such details as household size and age, densities, undevelopable land (parks and flood zones, for example) and changes in technology and physical limits on development (wetlands, rivers, topography). Nonresidential LUA are equally important to ensure that residential growth does not pay a disproportionate share of the costs of required facilities. The amount and timing of nonresidential development may play a significant role in new service demand and costs.

Service Units

A key measure generated from the LUA is the projected total new service units created by new development. This number is the denominator in the equation to compute the maximum impact fee. A service unit is a standard measure of service use or demand per land-use category. The number of service units for each land-use category equals the projected development units for each land use times the demand or usage factor for each land-use type. By formula, this is represented as:

$$\text{Service Unit}_{\text{land use}} = \text{Development Units}_{\text{land use}} \times \text{Use or Demand Factor}_{\text{land use}}$$

For residential uses, a development unit usually corresponds to a projected single-family or multifamily unit. For commercial and industrial properties, a development unit is typically expressed per 1,000 square feet of new development or some other standard measure (number of beds in a hospital, for example). Total development units derive directly from the projected development within the area over the period considered.

The service demand factor per development unit per land-use category requires more extensive analysis. While impact fee studies attempt to estimate the future demand per service unit objectively, analysts are forced to make critical assumptions, to derive estimates based on other data or to extrapolate historical trends. The factors applied derive from technical engineering studies using standardized data from local, state or national research organizations or are based on direct local studies and data collection.

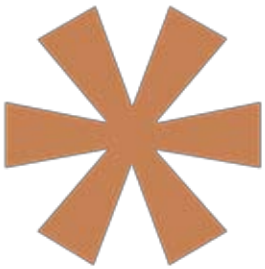
For example, water-wastewater use may be measured in thousands of gallons of water per day per residential development unit or per water meter size for commercial or industrial properties. Roadway demand may be measured as average daily or peak-hour vehicle-miles per development unit, which is a function of the number of trips generated and the length of each trip.

Capital Improvements Plan and Eligible Capital Costs

Most jurisdictions that assess impact fees attempt to attribute as much of the CIP as possible to new development, as is required for inclusion in computing an impact fee. Ideally, the basis for allocating future capital costs is well identified and explained in professional, comprehensive master plans and in the CIP. The comprehensive CIP should segment eligible costs for impact fee funding. Eligible capital costs for each capital project or program are identified in terms of:

- *Geographical coverage* — only costs for providing services within the defined service area are eligible.
- *Purpose* — only costs necessitated by and attributable to projected new development are eligible.
- *Timing* — only costs incurred or planned during the ten-year CIP horizon are eligible, and only the portion of longer-term costs that meets the projected needs during the ten-year period is eligible.
- *Existing capacity* — costs to remedy an existing capacity deficiency cannot be included in the impact fee computation because the deficiency is not a function of projected new development. If excess existing capacity is more than sufficient to serve projected service needs over the next ten years, the need for an impact fee could be questioned.

  For example, if current road capacity includes an excess of 80,000 vehicle-miles and development during the next ten years is projected to add 40,000 vehicle-miles of demand, are any additional facilities attributable to new development? Similarly, if existing excess capacity is not greater than projected need from new development, should there be some offset to the projected capital costs for whatever excess capacity does exist?
- *Future capacity* — costs to provide service capacity beyond the ten-year projected need are not eligible for inclusion in the impact fee calculation. For example, if a city decides to install a 16-inch water main pipe in anticipation of long-term demand, even though projected need would be satisfied with a 12-inch pipe, the additional cost for the superadequate, larger pipe should not be included in computing the impact fee. Otherwise, the land uses developed during the next ten years would pay for the future demand beyond what the law allows.
- *Cost estimates* — the actual cost estimates for each project or program listed must be reviewed and evaluated for accuracy, thoroughness, scope and appropriateness.
  - *Legally permissible costs* — Chapter 395 lists capital costs eligible for impact fee funding. Costs that may be included are limited to:
    - construction contract price;
    - surveying and engineering fees;
    - land acquisition costs, including land purchases, court awards and costs, attorneys' fees, and expert witness fees;
    - fees paid or contracted to be paid to an independent qualified engineer or financial consultant preparing or updating the capital improvements plan who is not an employee of the political subdivision; and
    - interest charges and other finance costs only if the impact fees are used to pay principal and interest on bonds, notes or other obligations issued by or on behalf of the political subdivision to finance the capital improvements or facility expansions identified in the CIP (Section 395.012).
  - *Impermissible costs* — Costs that may not be funded by impact fees are:
    - construction, acquisition or expansion of public facilities or assets other than capital improvements or facility expansions identified in the CIP;
    - repair, operation or maintenance of existing or new capital improvements or facility expansions;
    - upgrading, updating, expanding or replacing existing capital improvements for existing development to meet stricter safety, efficiency, environmental or regulatory standards;
    - upgrading, updating, expanding or replacing existing capital improvements to provide better service to existing developments;
    - administrative and operating costs of the political subdivision; and
    - principal payments and interest or other finance charges on bonds or indebtedness other than those allowed in Section 395.012 (Section 395.013).
- *Existing and future service levels* — the quantitative service level applied to new development should be the same as existing service levels unless differences are fully explained and supported. If a community is trying to elevate its service level everywhere, only the equivalent existing service level for new development is fundable by impact fees; general service enhancements should be funded from other revenues. Service levels should be addressed explicitly in the CIP and not left to speculation.



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Credits

Texas law requires the local jurisdiction to give a credit for future taxes and service revenues from projected new development before computing the maximum amount of an impact fee. The future taxes and revenues may be calculated or, alternatively, the jurisdiction may apply a 50 percent deduction. Most jurisdictions opt for the 50 percent credit, as future taxes and revenues are difficult to project with accuracy and open to debate.

Additional credits may be given for off-site improvements paid for by the developer (for example, road construction or upgrades, or main water lines brought to the property by the developer). The impact fee may be adjusted if a new development results in fewer service units than was originally estimated.

Credits may apply if land use changes. For example, if the use is changed from residential to commercial, the increased traffic may necessitate a change in fee calculation. However, the impact fees would not be based on the total number of trips generated by the commercial use, but on the net increase in trips. The residential trips that were taken off the roads by the change in land use would be the basis for a credit.

Sometimes projected land-use development changes from an intense use to a less intense use with a subsequent reduction in impact on public infrastructure. Some argue that if developers must pay a fee for actions that increase the impact on infrastructure, they should receive a credit or some compensation (a reverse impact fee?) from the government when they take action that reduces infrastructure impacts. Local governments may resist making cash payments in such cases, but transferable impact fee credits are certainly an option.

Maximum Allowable Impact Fee

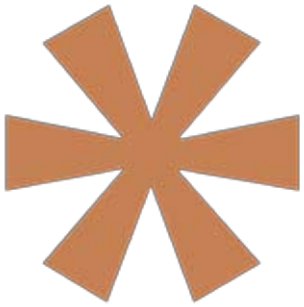
The maximum allowable impact fee equals the eligible capital infrastructure costs identified in the CIP less the credit for future taxes and service revenues divided by the total number of projected new service units. By formula, the maximum impact fee =

$$\frac{\text{[eligible CIP costs – credit for future taxes and service fees]}}{\text{projected new service units}}$$

Local jurisdictions may elect to impose fees less than the maximum allowable fee.

Unlike other tax revenues, which are deposited in a general fund to be spent with broad discretion, impact fees must be separately accounted for and spent only for the specific purposes for which they are collected, and as detailed in the CIP. They cannot be transferred to other accounts or spent for any other purposes. All accrued interest must be applied to the account and can only be spent for the same purposes as the impact fee. State law requires that the records be open for public review and inspection.

Proper computation of an impact fee relies on each number, assumption, estimate, data source and method applied in the impact fee study. Often numbers or other data will be presented in tables with little or no explanation of how they were derived, what they were based on, when they were prepared or other limitations. Data attributed to studies performed by other government agencies or other research organizations may be presented as factual and appropriate with little justification, explanation or verification.



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All data and assumptions should be critically examined in terms of their:

- *Timeliness* — the most current data available should be employed.
- *Accuracy* — data must be accurate and precise for reliable results.
- *Applicability* — data must reflect local circumstances and conditions. Data from another city, county or state may not represent local reality.
- *Relevance* — data should be directly associated with either the demand for or the supply of local infrastructure services.
- *Source* — only established, reliable sources of data should be allowed. Unconfirmed, unidentified or unreliable sources will render any data invalid.
- *Completeness* — data should present a complete portrayal of current or expected conditions, relationships or demand.
- *Objectiveness* — data should be unbiased, impartial and independent in representing current or future conditions.

The Bottom Line

When it comes to reviewing proposed impact fee ordinances, the devil is indeed in the details, as the old adage says. The LUA, the projected types and rate of new development, the CIP, the projected service units and demand per service unit as well as individual capital improvement costs and the other variables affecting the fee are highly technical, complex and difficult to quantify accurately.

The law requires that professional engineers and consultants be used to prepare the estimates. But projecting future growth and costs is not an exact science. The estimates should be carefully reviewed before final acceptance, and developers, builders and the public should get involved in the process as early as possible.

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THE TAKEAWAY

Texas law governing impact fees is complicated. The variables used to compute the maximum allowable impact fee are complex and difficult to quantify accurately. Municipalities, developers, builders and the public need to educate themselves on what the law requires and allows, and everyone should get involved in the process as early as possible.

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