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spotlight

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Raleigh's Flawed Impact Fee

Incomplete Research Means Proposal Is Broken from the Start

SUMMARY: **At a public hearing on April 4 the Raleigh city council will receive public input on a proposed across-the-board 72 percent increase in the city's impact fee schedule (from $682 to $1,172 for single-family homes).[1] Unfortunately, the consultant's report that serves as the basis for an increase is flawed. In fact, Raleigh has collected impact fees for nearly twenty years without ever considering sound economic research. As the word "impact" implies, new housing generates both increased demand for public services and increased tax revenues. Surprisingly, the city council has not demanded that city staff and highly paid consultants produce reports that provide balanced and complete economic analysis. It is not too late; the council should not change the impact fee until proper economic analysis is conducted.**

The positive and negative aspects of growth are debated in many urban areas. Often these debates revolve around increased costs of growth related public services. Some cities charge new home developers so-called impact fees that the city argues pay for public service improvements such as new roads, utilities, and parks. Of course, impact fees, for the most part, are passed on to the homebuyers in higher prices. Raleigh's impact fee has not been raised in ten years and a consultant's report documents potential increases. On April 4 the Raleigh City Council will hold a public hearing on a proposal to increase Raleigh's impact fee. This spotlight examines various methodologies used to evaluate Raleigh's impact fee on new home construction.

What Are Impact Fees, and How Should They Be Justified?

Impact fees are based on the idea that new home construction imposes costs on the public sector.[2] A subdivision of one hundred new homes creates demand for public services such as road extension and widening, new parks and schools. In Raleigh, the current impact fee of $682 is designed to cover the increased costs of roads, parks and open space.[3]

On the other hand, new homes convert land with low property values to higher property values, dramatically increasing property tax revenues. For example, if farmland is converted to a subdivision of one hundred homes, that land is moving from producing very low property tax revenues to land that is

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producing a relatively high level of property tax revenues.

Impact fees are justified only if the growth created cost of public services is greater than the increase in property tax revenues. In other words, when one home is built, the cost of the public services created by that new home must be greater than the revenues created by the building and occupancy of that home. Thus the impact fee is the difference between these amounts. If the added costs of the public services for one house are $5,000 and the added revenues created are $4,000, the difference and therefore the impact fee is $1,000. On the other hand, if the added costs are $4,000 and the added revenues are $5,000 no impact fee is justified.[4]

When the city of Raleigh first imposed its $667 impact fee in 1987, it did so without justifying it based on comprehensive economic research.

If an impact fee is justified, the fee must not be greater than the difference, nor used for any other purpose than to cover the public service costs directly associated with the new home. If the public costs are less than the amount of tax revenues generated or if they are the same, no impact fee is justified.

How Did Raleigh Determine Its Impact Fee?

Raleigh established its first impact fee of $667 per new dwelling in 1987.[5] It was limited by the state authorizing statute to improving roads and providing open space and park facilities.[6] This amount was based on the 1987 impact fee report prepared by City of Raleigh staff.[7] The city's report was derived from a "Working Paper" written by Michael Stegman and Thomas Snyder of UNC's Department of City and Regional Planning.[8] The city's report used an "improvement-driven" methodology to calculate a fee of $292 for the projected cost of freeways, arterial roads, and thoroughfares growth for a ten-year period (1986-1996).[9] A "comparable" methodology was used to determine the fee of $375 for purchasing open space acreage needed to maintain the city's existing level of open space.[10] The thoroughfare fee was applied to all new construction, alterations or expansions, and changes of use. The open space fee is charged only to new residential construction.[11] Added together, the council established the impact fee of $667. The city council raised this fee by $15 to $682 in 1995.[12]

The city's 1987 report did not analyze or estimate any of the tax revenues generated by building and occupancy of new homes. The city's report and the UNC working paper both recommended that the impact fee should be less than the full cost of infrastructure because the new residents would also pay taxes and fees "to finance public infrastructure for established residents."[13] Thus, those reports recommend setting the impact fee at less than full cost to avoid new residents paying twice for the same infrastructure. Despite these references to taxes paid by the new residents, those reports fail to calculate the amount of these taxes or compare them to the public service costs. Therefore, when the city of Raleigh first imposed its $667 impact fee in 1987, it did so without justifying it based on comprehensive economic research.

The Duncan report totally fails to consider the increase in tax revenues generated by the new home construction and ownership.

The 2006 Duncan & Associates impact fee report, which is currently being considered by the city council, notes that the current single-family fee of $682 could be raised to a maximum of $3,404.[14] The Duncan research uses a modified "consumption based" methodology for both roads and open space. This method allows a shift from the current flat rate per dwelling unit to a rate calculated based on size and location of the new housing. Improvements in technology and experience allow more accurate calculations of public service costs. While the public cost side may be more accurate, the Duncan report totally fails to consider the increase in tax revenues generated by the new home construction and ownership. While all three reports conform to the minimum requirements of state statute, they do not go beyond the statutory minimum and provide the city council with a comprehensive economic analysis. Therefore, all three reports that the city has used to justify its impact fees failed to consider the increase in tax revenues created by the new homes construction. Thus the city is in the position of imposing an impact fee to pay for infrastructure and reaping large increases in property taxes that could be used for infrastructure, but are used for other purposes. The double taxation mentioned in the UNC working paper and quoted in the city's staff report and the Duncan report is reality.

Does a Comprehensive Impact Fee Study Exist?

During the last 20 years Raleigh has imposed an impact fee on its new homebuyers without proper analytical research. On April 4, Raleigh's City Council will hold a public hearing on its proposal to increase the impact fee by 72 percent.[15]

On the other hand, the city council could consider an economic study that assesses both the public service costs and the increased tax revenues. Professor Michael Walden, the William Neal Reynolds Distinguished Professor of Economics at North Carolina State University wrote a 2005 report that calculates the total economic impact of constructing 100 new single-family homes and 100 multi-family housing units in the Triangle.[16] Professor Walden calculated the public service costs and the tax revenue created during the construction phase and the occupancy phase for these 200 housing units. He calculated public costs not just for roads and open space, but for schools, police and fire protection, solid waste disposal and water and sewer services. Professor Walden also calculated the multiple sources of tax revenues created by these 200 housing units including property taxes, local sales taxes, utility excise taxes, inspection and permit fees, and motor vehicle taxes. These costs and revenues are for local city and county government in the Triangle and not limited to Raleigh.

> **Walden's study indicates that new home construction more than pays for itself and no impact fee is justified.**

Walden found that, with some minor technical caveats, local city and county tax revenues out-paced the public costs by nearly $77, 000 per year over a ten year period. In addition, building these homes also produced $64.7 million in new economic activity and almost 600 new jobs.[17] In other words, Professor Walden's study indicates that new home construction more than pays for itself and no impact fee is justified. While the Walden report is not directly applicable to Raleigh because it does not separate city and county costs and revenues, its methodology is a model that Raleigh should use to determine whether or not an impact fee is justified.

Conclusion

The explanation for Raleigh's nearly twenty-year failure to accurately assess the total impact of new housing is not found in the consultant or city staff reports. The answer is more likely found in politics. In the past, city council members have pandered to a vocal minority that has demanded that the council "do something about growth" and have ignored less vocal homebuyers, especially low-income homebuyers who have been priced out of their opportunity for home ownership. Instead, the city council and staff have hired consultants who ignore simple economic logic and produce documents that provide "politically correct" recommendations.

Now, years later, the basic idea behind an impact fee has been forgotten. The city council, the city staff, and the media all discuss the impact fee in the context of whether the fee covers the "costs" of roads and open space, ignoring the fact that the very definition of *impact* means that new housing produces public costs and increased tax revenues. It is unfortunate that the city is engaged in a one-sided discussion where only public service costs are discussed and increased revenues are ignored.

If city officials are to provide equitable treatment to all citizens, both new and old, the city needs to halt the discussion of changes to the impact fee until comprehensive economic research of both growth related increases in public costs and revenues is conducted.

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Notes

1. Motion passed at the City Council meeting, March 21, 2006
2. Raleigh's impact fee for roads charges not only single-family homes but multi-family homes and commercial development. For simplification this report will discuss only single-family homes.
3. Duncan and Associates, "Facility Fee Study," February 2006, p.3, http://www.raleighnc.gov/publications/Public_Affairs/Facility_Fee_Study.pdf
4. Of course, this is an oversimplification. Proper calculations would take into account the present value of the added revenue over time and present value of the added costs over time and apply appropriate discount rates.

5. Duncan, p. 8, based on the open-space fee from Zone 2.
6. Duncan, p. 6.
7. City of Raleigh, “Implementation Report on Facility Fees of the City of Raleigh,” May 1987.
8. Michael Stegman and Thomas Snyder, “Establishing Facility Fees in Raleigh: Issues and Alternatives,” University of North Carolina at Chapel Hill, Department of City and Regional Planning.
9. Duncan, pp. 7 and 48. The $307 figure on p. 48 includes the $15 added in 1995.
10. Duncan, pp. 7 and 63.
11. Duncan, p. 11.
12. Duncan, p. 8.
13. Quoted in City report, p. 14; also, the statute limits the impact fee to no more than 50 percent of the total infrastructure costs.
14. Duncan, p. 3.
15. Motion passed at City Council meeting on March 21, 2006.
16. Michael Walden, “Economic Impacts of Construction of Owner Occupied Residential Housing in the Triangle, North Carolina,” January 2005.
17. Walden, p. 3