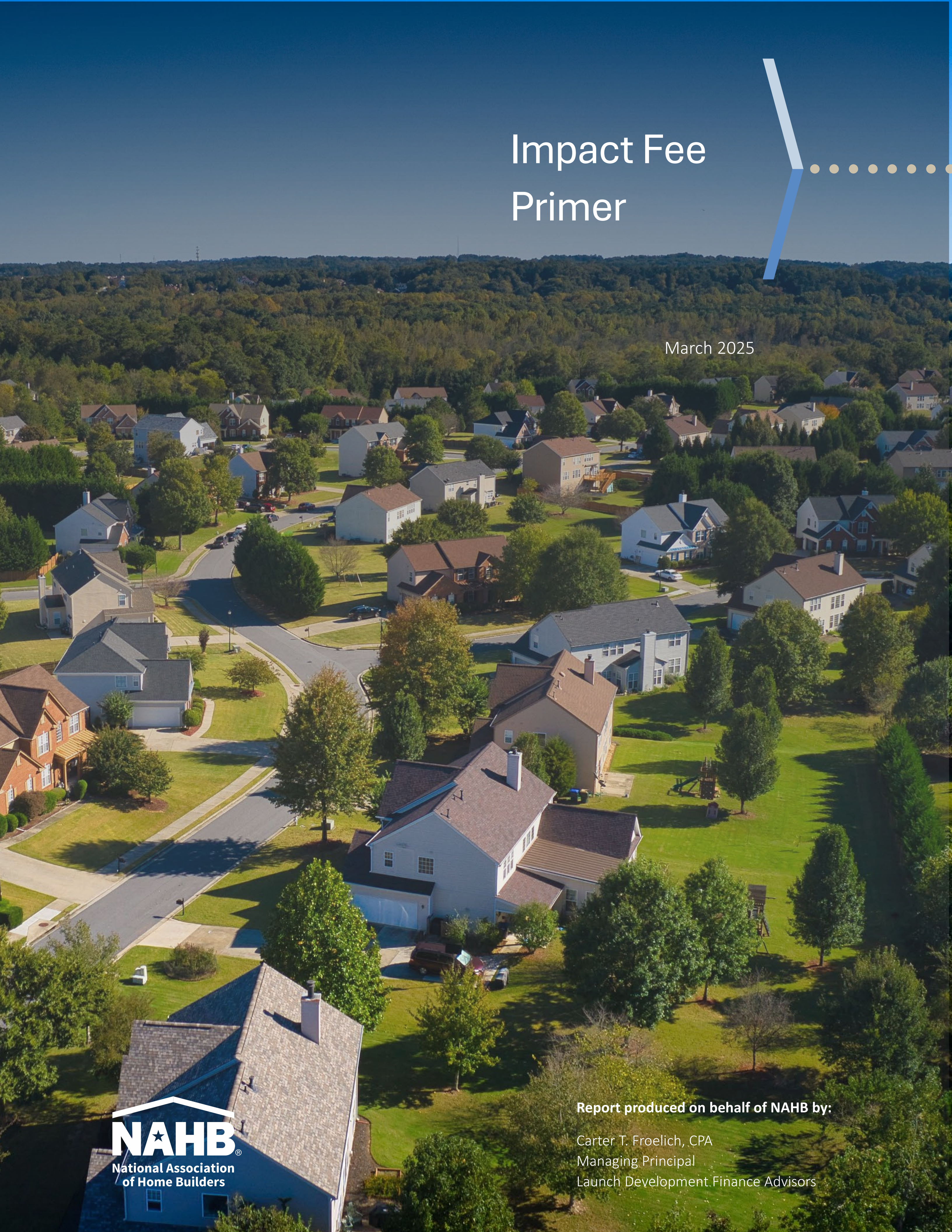

Impact Fee Primer

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Impact Fee Handbook – Handout

Introduction

As local governments increasingly turn to development impact fees as a funding solution for growth-related infrastructure, it is critical for stakeholders in the building and development industry to push back against these fees as a first line of defense. Impact fees, while often positioned as a fair solution to fund infrastructure, can disproportionately shift the burden of growth onto homebuilders, developers, and ultimately homebuyers, if not properly applied. This practice exacerbates housing attainability challenges and adds unnecessary financial strain at a time when affordable housing remains a top national priority. Impact fees should only be considered as a funding mechanism when all other options—including taxes, bonds, and special districts—have been exhausted. Industry members must remain vigilant and advocate for transparent, equitable solutions that reflect the broader economic benefits of new development rather than solely viewing it as a cost burden.

Background

Development impact fees are one-time charges levied by local governments on new development projects. Impact fees began to be widely used in the 1970's and 1980's although the first implementation of impact fees was in Hinsdale, Illinois in 1947 to assist in the financing of a wastewater treatment plant expansion.
The adoption of impact fees was driven by several factors including:

1. Declining Federal and State funding for local governments;
2. Growth related costs of infrastructure and public services;
3. Resistance to use General Fund revenues to fund growth related infrastructure;
4. Utilization of impact fees as a dedicated funding source to service new growth;
5. Use of impact fees as an alternative to raising property taxes on all residents to fund infrastructure to serve new growth.

The legal foundation for impact fees rests on the "rational nexus" test, which requires the jurisdiction to demonstrate that the amount of the impact fee is commensurate and proportional to the demand placed on infrastructure by new growth.

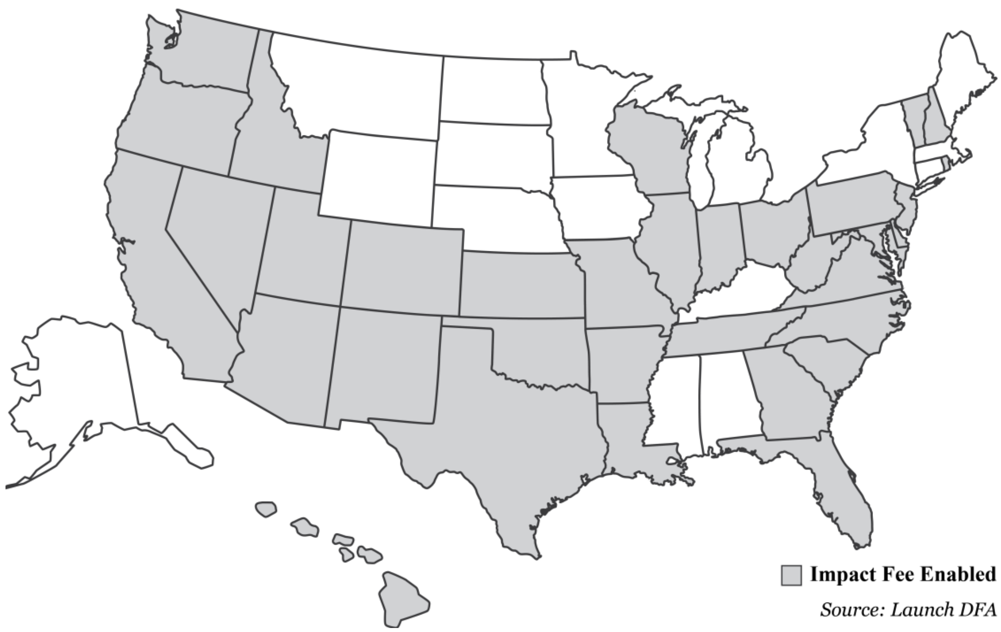
As municipalities continue to face growth pressures and infrastructure demands, development impact fees remain an important tool for local governments to ensure that "growth pays for growth" while maintaining economic interests and fostering sustainable development.

The development and home building industry generally support the use of impact fees to fund growth related infrastructure so long as they are fair, equitable and transparent in their calculation.

What Are Impact Fees and Why Are They Used by Local Governments?

Impact fees are charges levied against new development to generate revenue to fund capital improvements necessitated by new development. The use of impact fees has spread widely throughout the United States. As of 2024, thirty-four (34) states had impact fee enabling statutes, as shown by the map on the following page. In 2015, twenty-nine (29) states had enabling legislation for impact fees representing a seventeen (17) percent increase in states utilizing impact fees.

Figure 1: States with Impact Fee Enabling Acts



The increasing use of impact fees can be attributed to:

- Diminishing local government fiscal resources due to a decrease in federal and state funding, legal constraints, and public resistance to increases in taxes;
- Pressure to avoid decline in public service levels as population grows, and a demand to extend public service areas to urban expansion areas;
- Increased costs to provide public services;
- Demand for repairs and maintenance to existing infrastructure;
- Public pressure for growth to pay its own way.

Typically, impact fees are:

- Levied at the time of building permit issuance or subdivision approval;
- Dedicated to a specific public use, such as a transportation, sewer, water, public safety, and parks and recreational facilities; and

- Calculated on the basis of the number of residents or bedrooms in a dwelling, the square footage of a building, the linear footage of the front property line, or as a flat fee per unit or building lot.

Benefits of Development Impact Fees

Development impact fees can be beneficial for a community as they allow local governments to respond to increased service level demands from growth without adding an additional property tax burden to existing taxpayers. This enables local governments to focus existing property taxes on operations and deferred capital maintenance and repairs. The current sentiment in the United States related to property taxes is largely negative, with many Americans feeling overburdened by rising property tax rates and questioning the value they receive in return. As a result, using impact fees paid by "new residents" is a way by which "growth can pay for growth" without increasing property taxes on the wider community.

Challenges with Development Impact Fees

Local governments are attracted to impact fees because of their potential to generate revenue at a lower political cost than some other measures such as increased property taxes and general obligation bond elections.

The use of impact fees shift the financial burden for growth-related infrastructure away from the general public to a narrow segment of the public - homebuilders and new homebuyers. Aside from basic issues of fairness and equity, the use of impact fees raises legal, economic, technical, administrative, policy, and financial concerns for interested parties.

Decision makers may fail to recognize the broad range of benefits associated with new development, such as increased property tax and sales tax revenues along with other economic contributions by new households. In addition, they may overlook the economic implications of impact fees on housing affordability and economic development.

Where impact fees are utilized, the dollar amount per home has grown substantially over the years. Based on recent surveys conducted by Duncan Associates, a single-family detached house with 3 bedrooms in California required impact fees of approximately $22,154 in 2012; increasing to $37,471 in 2019, representing a 69% increase over the seven-year period[1]. In comparison, the average impact fee being charged by jurisdictions in the United States as of 2019 was $13,627[2].

Who Ultimately Pays an Impact Fee?

Because developers and home builders provide the capital outlay for impact fees, it may be said that they pay the impact fees. However, similar to any tax or other costs imposed on businesses, the ultimate burden of payment will, to varying degrees, be passed to new home buyers in the form of higher home prices. The following table shows a breakdown of the costs involved in determining the sale price, not including the addition of impact fees.

Figure 2: Sale Price Breakdown for an Average Single Family Home in 2024

Average Lot Size:	8,400 sq. ft.
Average Finished Area:	2,411 sq. ft.

Description		**Share of Price**
Finished Lot Cost (including financing cost) (1) (3)	$ 74,416	15.0%
Total Construction Cost (1) (2)	$ 325,988	65.8%
Financing Cost (1) (2)	$ 12,466	2.5%
Overhead and General Expenses (1) (3)	$ 14,544	2.9%
Marketing Cost (1)	$ 5,402	1.1%
Sales commission (2) (3)	$ 19,115	3.9%
Profit (1) (3)	$ 43,819	8.8%
Total	**$ 495,750**	**100.0%**

Footnotes

(1) National Association of Home Builders. Special Study: Cost of Constructing a Home 2022. February 2023. https://www.nahb.org/-/media/NAHB/news-and-economics/docs/housing-economics-plus/special-studies/2023/special-study-cost-of-constructing-a-home-2022-february-2023.pdf.

(2) NewSilver. "Construction Loan Rates." Accessed December 2024. https://newsilver.com/construction-loan/construction-loan-rates/.

(3) Builder Online. "Rates and Inflation Top Builder Concerns for 2024." Accessed December 2024. https://www.builderonline.com/data-analysis/rates-and-inflation-top-builder-concerns-for-2024_c.

The price of the home to the buyer may increase by more than the impact fee amount. This is because each time total construction costs increase, such as increasing the price of permits or impact fees, other costs such as financing costs, sales commissions, and return metrics increase as well. The size of these additional charges to the buyers depends both on the type of fee/cost increase and when it is imposed in the development process. NAHB estimates that the add-on charges range from 0 percent if a fee is imposed directly on buyers to 40 percent if cost is incurred when applying for site development approval (see Figure 3). Pursuant to NAHB's research, for every one dollar ($1) increase in fees when acquiring a building permit, the final selling price of a new home rises by approximately $1.20. For example, if fees increase by $1,000, the price of a new home is estimated to increase by $1,200.

Figure 3: Impact Fee Effect on Sale Price

Description	Length of Time (Months)
Permit to Start [1] [2]	1.1
Start to Construction Completion [1] [2]	8.3
Construction Completion to Home Sale [1]	4.8
Total	**14.2**

Building Costs/Fees	Add-On Charges
Imposed directly on buyer	0.0%
During construction [1] [2]	17.5%
At start of construction [1]	18.0%
When building permit acquired [3]	20.0%
During development [1]	40.0%
When applying for site development approval [1]	40.0%

Footnotes

(1) AZ Big Media. "Residential Construction: Here's the Time from Permit to Completion." Accessed December 2024. https://azbigmedia.com/real-estate/residential-real-estate/residential-construction-heres-the-time-from-permit-to-completion/.

(2) Statista. "Time Needed to Construct Residential Buildings in the United States as of 2021, by Building Type." Accessed December 2024. https://www.statista.com/statistics/909951/us-construction-of-residential-buildings-average-time/.

(3) NAHB. https://www.nahb.org/-/media/NAHB/advocacy/docs/industry-issues/land-use-101/infrastructure/impact-fee-handbook.pdf?ref=freopps-oppblog&utm_source=chatgpt.com

Implications of Higher House Prices

When an impact fee is passed to the buyer, what are the implications? Obviously, one is an adverse effect on housing affordability. Households that no longer qualify for a mortgage following the price increase are referred to as being "priced out" of the market for the home.

Applying this approach to the U.S. as a whole reveals that in 2024 - utilizing typical assumptions about the mortgage, down payment, property taxes and property insurance - a $1,000 impact fee increases the price of a median-priced new home by approximately $1,200 and prices out about 106,031 [3] households, as shown in the table on the following page.

Figure 4: US Households Priced Out of the Market by Impact Fees – 2024

Description	Mortgage Rate (1)	Home Price (1)	Monthly Mortgage Payment (2)	Taxes and Insurance (3)	Minimum Income Needed (4)	Number of Households Unable to Afford the Median Price (5)	Percentage of Households Unable to Afford the Median Price (5)
Without Fee	6.5%	$ 495,750	$ 2,820	$ 994	$ 163,479	103,870,000	79.9%
With Fee	6.5%	$ 496,950	$ 2,827	$ 997	$ 163,875	103,976,031	80.0%
Difference	**-**	**$ 1,200**	**$ 7**	**$ 3**	**$ 396**	**106,031**	**0.1%**

Footnotes

(1) National Association of Home Builders. "Households Priced Out by Higher House Prices and Interest Rates." Housing's Economic Impact, accessed December 10, 2024. https://www.nahb.org/news-and-economics/housing-economics/housings-economic-impact/households-priced-out-by-higher-house-prices-and-interest-rates.

(2) Mortgage calculations assume a 10% downpayment, over a 30 year fixed rate term.

(3) Assumptions for Property Tax, Private Mortgage Insurance, and Home Insurance use 1.25%, 73 Basis Points, and .5% respectively.

(4) A Household Qualifies for a Mortgage if Mortgage Payments, Taxes and Insurance are 28% of Income.

(5) Per US Census Bureau's report on Household Income Distribution

In 2019, the average impact fee was $13,627. With an approximate 20.3% rise in construction costs, as indicated by the Engineer New Record Cost Index (11,281 in 2019 to 13,571 in 2024), the average impact fee for 2024 is estimated to be $16,394 ($13,627 x 1.203), representing an increase of $2,767 ($16,394 - $13,627). This increase in impact fees is estimated to increase average home prices by $3,320 ($2,767 x 1.20), pricing approximately 1,456,000 households out of the home-buying market, as shown in the table below.

Figure 5: US Households Priced Out of the Market by Average Impact Fee in 2024

Description	Mortgage Rate (1)	Home Price (1) (6)	Monthly Mortgage Payment (2)	Taxes and Insurance (3)	Minimum Income Needed (4)	Number of Households Unable to Afford the Median Price (5)	Percentage of Households Unable to Afford the Median Price (5)
Without Fee	6.5%	$ 495,750	$ 2,820	$ 994	$ 163,479	102,414,000	78.8%
With Fee	6.5%	$ 499,070	$ 2,839	$ 1,001	$ 164,574	103,870,000	79.9%
Difference	**-**	**$ 3,320**	**$ 19**	**$ 7**	**$ 1,095**	**1,456,000**	**1.1%**

Footnotes

(1) National Association of Home Builders. "Households Priced Out by Higher House Prices and Interest Rates." Housing's Economic Impact, accessed December 10, 2024. https://www.nahb.org/news-and-economics/housing-economics/housings-economic-impact/households-priced-out-by-higher-house-prices-and-interest-rates.

(2) Mortgage calculations assume a 10% downpayment, over a 30 year fixed rate term.

(3) Assumptions for Property Tax, Private Mortgage Insurance, and Home Insurance use 1.25%, 73 Basis Points, and .5% respectively.

(4) A Household Qualifies for a Mortgage if Mortgage Payments, Taxes and Insurance are 28% of Income.

(5) Per US Census Bureau's report on Household Income Distribution

(6) Difference shows the average Impact Fee in 2024, inflated from 2019 based on ENR Construction Cost Index.

Alternatives to Development Impact Fees

With public financing methods available to local governments, the entire community contributes towards the new capital facilities. Under private financing methods, including the use of impact fees, the cost of providing new capital facilities is borne by new growth which is considered the underlying cause of the need for new capital improvements.

Impact fees are viewed by many local communities as an inevitable solution to finance infrastructure due to the declining availability of state, federal, and local general fund revenues. There are, however, viable alternatives to impact fees that may, in some cases, offer a more fair, equitable, expedient, or politically viable mechanism to address a community's infrastructure deficits.

Alternatives to impact fees include:

1. *Taxes* - Including property taxes, sales taxes, and personal income taxes.
2. *General Obligation Bonds* – Typically, the traditional way of funding public improvements.
3. *Revenue Bonds* – An additional traditional way of funding public improvement through a dedicated revenue stream (e.g., a percentage of property and/or sales tax revenues).
4. *User Fees* – Fees charged to user charges for use of public utilities (e.g., water/sewer monthly charges).
5. *Local Improvement Districts* – Special assessment liens are placed on the area benefiting from public improvements.
6. *Tax Increment Financing* – Captures the tax increment resulting from increased property tax assessed valuation as the result of new development activities.
7. *Exactions* – Requirement that developers construct infrastructure or dedicate land for specific public purposes.
8. *Special Service Districts* – Autonomous units of government to provide a narrow list of public services.
9. *Special Taxing Districts* – Separate political subdivisions created to finance specific public improvements that directly or indirectly benefit the landowners within the taxing district (e.g., CFD, CDD, MUD, etc.).

Common Mistakes Local Governments Make When Assessing Impact Fees

Impact fees must be proportional to the actual cost of providing capital facilities. Making these calculations is neither simple nor straightforward. Common mistakes which we have seen include:

1. Growth paying for non-growth-related public improvements (e.g., performing arts centers, town lakes, etc.).
2. Construction cost estimates provided by unqualified municipal staff (e.g., a fire chief preparing cost estimates for a fire station).
3. The failure to use service areas to determine levels of service.
4. Not utilizing the appropriate levels-of-service to and to estimate infrastructure costs and the impact fees necessary to provide capital facilities at existing service levels.
5. Requiring new growth to fund levels of service that are in excess of existing service levels.
6. Challenges with the proportionality of the impact fees versus benefits received.
7. Inaccurate school enrollment projections leading to misestimates of required facilities.
8. Lack of transparency in the impact fee calculation process.
9. Math, logic, and/or reference errors.

[1] Mullen, Clancy, *National Impact Fee Survey: 2012 & 2024*, Duncan Associates
[2] Mullen, Clancy, *National Impact Fee Survey: 2019*, Duncan Associates.
[3] *Impact Fee Handbook: 2016,* NAHB.