

# MEMORANDUM

## Talbot County, Maryland Impact Fee/Excise Tax Study and Bill

Provided by the National Association of REALTORS®  
Land Use Consultants

July 12, 2004

### SUMMARY OF REQUEST

Analysis of an Impact Fee/Excise Tax Study prepared by Tischler & Associates, Inc. (the “Study”) and Bill No. 948 (the “Bill”) of the County Council of Talbot County, Maryland (the “County”). Review of revised version of the Study dated June 17, 2004, and a version of the Bill dated June 8, 2004.

*Realtors® are concerned that the County would like to assess the maximum possible amount of impact fees, without conducting any needs assessment and without considering other funding options for new public facilities to serve new development.*

### EXECUTIVE SUMMARY

The Study proposes what appears to be a generally defensible methodology for calculating development impact fees, and the Bill appears to address many of the most critical components of impact fee legislation. However, the Study and Bill raise a number of important issues relating to the interests of Realtors®. In particular, the Study calculates impact fees in a way that tends to increase the amount of those fees and also to shift the burden of increased fees disproportionately to residential development. The Study’s proposed impact fees will be a significant percentage of the cost of the average single family home, and will impact housing affordability in the County. The Study fails to provide credits for certain payments that are properly allocable to new development, and appears to contain arithmetic errors that could affect the amount of the impact fees that are ultimately charged. The Study and Bill rely in part upon national, rather than local, data. The Study makes the unusual proposal of including the costs of preparing the Study itself as one of the costs for which impact fees should be imposed. The Study uses the same discount rate for each type of capital facility for which a credit is calculated. The Bill contains ambiguous language that could result in the wrong party being penalized for the legal costs associated with collecting unpaid impact fees, and does not adequately ensure that refunds will be available to property owners that should be entitled to a refund. Finally, the Bill fails to specify how much time the County has to respond to the appeals of aggrieved property owners.

## KEY COMPONENTS OF IMPACT FEE PROGRAMS

A development impact fee is a cash payment imposed by local authorities upon new development in order to cover the capital costs of infrastructure (i.e., capital facilities), such as water and sewer lines, streets, parks, and schools, necessary to serve the new development. Impact fees are a type of exaction designed to require that each development pay its proportionate share of the cost of providing off-site public services and facilities to meet the demand generated by the new development and its associated impacts. In other words, the purpose of an impact fee is to have new development pay its fair share of the capital facility costs associated with that development. Although the developer often pays the fee initially, the true burden of the impact fee may, depending on market factors, be passed in whole or part onto those who purchase in the development.

### MARYLAND REQUIREMENTS FOR IMPACT FEES

We have not found any reported Maryland decision setting forth a standard for reviewing the constitutional validity of impact fees. However, according to a publication of the Maryland Office of Planning and Maryland Municipal League:

[w]hen courts are asked to evaluate constitutional issues associated with impact fee programs . . . the basic rule articulated by the courts is the rational nexus test. This test requires the following of any impact fee program:

There must be a reasonable connection between the need for additional facilities and the growth resulting from new development.

The fees charged must not exceed a proportionate share of the cost incurred or to be incurred in accommodating the development paying the fee, after crediting that development for other contributions it will make toward the infrastructure cost by other means, such as payment of taxes or donation of land.

There must be a reasonable connection between the expenditure of the fees collected and the benefits received by the development paying the fee.<sup>1</sup>

Although the Maryland Planning Office publication does not reference a source for its articulation of this test, it is in essence the test articulated by the Florida courts and known as the “dual rational nexus test.”<sup>2</sup> Such a test has been followed by the majority of the states in which impact fees are authorized.<sup>3</sup> To the extent that Realtors<sup>®</sup> require advice on the standards

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<sup>1</sup> *Managing Maryland's Growth: Models and Guidelines: Smart Growth: Municipal Implementation* 13, available at [http://www.mdp.state.md.us/smartgrowth/pdf/munic\\_2.PDF](http://www.mdp.state.md.us/smartgrowth/pdf/munic_2.PDF) (2d ed. June 1, 1998).

<sup>2</sup> See e.g. *Hollywood, Inc. v. Broward County*, 431 So.2d 606 (Fla. Dist. Ct. App. 4<sup>th</sup> Dist. 1983).

<sup>3</sup> Brian W. Blaesser, *Discretionary Land Use Controls: Avoiding Invitations to Abuse of Discretion* 77 (Thomson-West 6<sup>th</sup> ed. 2003). In *Dolan v. City of Tigard*, 512 U.S. 374 (1994), the Supreme Court held that an exaction is unconstitutional under the “takings clause” of the Fifth and Fourteenth Amendments to the U.S. Constitution if it fails to meet a “dual nexus” test. The test has two prongs: reasonable relationship (meaning that an “essential nexus” must exist between the condition imposed and a legitimate state interest) and rough proportionality (meaning that the fee must approximate the amount necessary to alleviate the impacts of the proposed development). *Dolan*

Maryland courts are likely to use to evaluate the validity of a particular impact fee or impact fee program, they should consult with local counsel.

## OTHER IMPORTANT CONSIDERATIONS

Properly designed impact fee programs should take into account the following key considerations:

- **Amount of Fee** — Impact fees should be based on a proportional share of the expected actual costs of capital improvements needed to serve the new development that bears the fee.
- **Use and Expenditure of Fee** — The fees should be expended only for the capital costs for which they have been imposed, and should not be used to address existing capital deficiencies or operating and maintenance costs.
- **Methodology for Calculating Fee** — There should be a defensible study and capital improvements plan explaining the methodology and assumptions used to calculate the fee and justifying the need for and level of the fee.
- **Offsets of Fee** — Impact fees should be offset by the amount of other local fees incurred, or in kind improvements provided by the developer for the same capital needs.
- **Exemptions from Fee** — Any exemptions or exceptions to impact fee requirements should be clearly stated in the development impact fee ordinance.
- **Accounting of Fees** — Impact fee revenues should be segregated from other municipal funds.
- **Refund of Fees** — Impact fee revenues should be refunded to the payer after a reasonable amount of time if not expended for the specified capital costs.

## OVERVIEW OF STUDY

The Study analyzes potential impact fees or excise taxes<sup>4</sup> for six types of public facilities: (1) libraries; (2) parks and recreation; (3) schools; (4) general government; (5) transportation; and (6) community college.<sup>5</sup> Importantly, the Study proposes the maximum supportable impact fee for each type of public facility.<sup>6</sup>

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involved non-monetary exactions that were imposed on an individual and ad hoc basis as part of an administrative decision-making process, rather than exactions imposed pursuant to a legislative enactment. Courts in various jurisdictions are divided as to whether this standard applies to situations beyond the type of ad hoc exactions imposed in *Dolan*. We are not aware of any authority in Maryland addressing this issue in the context of development impact fees.

<sup>4</sup> We have focused on the Study as potential justification for the adoption of impact fees by the County, as proposed in the Bill. The Study states that its methodology could also be used as the basis for imposing excise taxes.

<sup>5</sup> Study at 3.

<sup>6</sup> *Id.*

For most public facilities, two sets of impact fees are calculated for both residential and nonresidential development: one for the Town of Easton and the other for Talbot County.<sup>7</sup> The fees for residential development are calculated per housing unit, and those for nonresidential development are calculated per thousand square feet of floor area.<sup>8</sup>

The Study relies upon three methods for calculating the proposed fees and two methods for providing credits.<sup>9</sup> Under the *incremental expansion method*, impact fees are proposed for the expansion or provision of additional facilities needed to accommodate new development. The fees are based on the current level of service (“LOS”) and on the current cost of providing capital improvements.<sup>10</sup> Impact fees under the *plan-based method* are based on future capital improvements needed to accommodate new development. The *cost recovery method* is applied in certain instances to allocate to new development, is allocated a share of the cost of certain existing facilities based on the useful life and remaining capacity of those facilities. In each case, the proposed impact fee amount also includes a component intended to recover for the County the cost of preparing the Study.<sup>11</sup>

*Revenue credits* are used where necessary to avoid double payment for future principal payments on general obligation debt.<sup>12</sup> For example, because the County financed a portion of the construction costs of the middle and high school with general obligation bonds, a credit is provided on the theory that new residential units that are assessed school impact fees will also contribute to future principal payments on school bonds through property taxes.<sup>13</sup> *Site specific credits* are proposed for situations where developers provide or have provided system improvements that are included in the calculation of impact fees.<sup>14</sup>

Because the County is, according to the consultant that prepared the Study, a tourism and recreation destination, the proposed impact fees are based on seasonal, or peak, population.<sup>15</sup> The consultant estimated peak population based on a three percent vacancy rate.<sup>16</sup>

## ANALYSIS

In our analysis below, we discuss issues raised by the Study and the Bill that could affect important Realtor<sup>®</sup> interests. We also discuss issues generally associated with impact fees that could have significant effects on Realtor<sup>®</sup> interests.

- **Issue:** The Study is narrowly cast at developing a case for the “maximum supportable impact fees” rather than providing County policy makers with support for a range of

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<sup>7</sup> *Id.* at 5.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.* at 3.

<sup>10</sup> Capital improvements are defined in the Bill as “land acquisition, site development, site-related improvements, purchase of equipment, or construction of structures necessary for the expansion or construction of public facilities in the County.” Bill at § 64-8(f).

<sup>11</sup> *See, e.g.*, Study at 11.

<sup>12</sup> *Id.* at 4.

<sup>13</sup> *Id.* at 27.

<sup>14</sup> *Id.* at 5.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* at 5.

**potential impact fee amounts, including lower amounts that might also be justified on public policy grounds.**

The Study states that it has calculated the *maximum supportable impact fees*.<sup>17</sup> From the standpoint of allowing the county to fairly evaluate a range of possible impact fee policies, it would have been better if the Study had been more robust and had calculated a range of impact fees based on specified assumptions. This would better allow the County legislators and the public to weigh the reasonableness and legitimacy of various assumptions, and the policy implications of imposing fees on new development at specified levels. Instead, the Study is narrowly focused on trying to justify a high impact fee for each type of public facility.

For example, in calculating the public school impact fee, the Study uses only two data points for each of the middle school and high school components of the fee. One of those data points is the construction of St. Michaels Middle/High School, which is apparently intended to take place in 2006 and cost \$261 per square foot. By comparison, data is given for Easton Middle School at \$98 per square foot in 2002, and Easton High School, which cost \$48 per square foot in 1999. Even accounting for the difference in the timing<sup>18</sup> and size of the respective projects, it is open to question why the cost of St. Michaels is more than two and one-half times the cost of Easton Middle School, and nearly five and one-half times the cost of Easton High School. Had the Study included more data points—perhaps by reference to average costs in nearby counties—the County would have had the ability to evaluate the legitimacy of the Study’s assumptions, and whether the “true” projected cost of new school projects was closer to one extreme or the other, or was in fact the weighted average the Study indicates.

As another example, in calculating the purchase of open space, the Study relies on three recent purchases for “open space land for recreational use.” Each of the purchases used as reference points involved only a fraction of an acre. Two of the purchases worked out to over \$300,000 per acre, while the third was over \$1.1 million per acre. The Study concludes based on these three purchases that the cost per acre of open space is \$457,238, and the impact fee for parks and recreation was calculated accordingly. Local Realtors® can evaluate whether this per acre price seems justifiable based on their knowledge of local markets. However, we note that the very small size of the parcels suggests that these were special purpose purchases that would not likely be representative of a typical parcel acquired by the County for open space or park purposes.

**Recommendations:** Assuming that the County intends to adopt impact fees of some amount, Realtors® should ask the County to evaluate a range of potential impact fees for different types of facilities, rather than following the Study’s narrow focus on justifying the “maximum supportable” level of impact fees. In considering what level of impact fee to impose, the County should be sensitive to the policy implications of imposing fees on new development, including effects on housing supply and affordability. The County should also be sensitive to the effect of various assumptions, projections, and data sets on the level of impact fees that the Study suggests can be justified. Realtors® should identify to the County and ask for further revision, elaboration or explanation of any assumptions or projections in the Study that appear to be unreasonable, overstated, or insufficiently explained.

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<sup>17</sup> *Id.*

<sup>18</sup> The Study indicates that capital cost data are stated in “current dollars.” *Id.* at 3

- **Issue: The Study seems to place a disproportionate burden of the transportation impact fee on residential development.**

The Study makes selective adjustments in calculating the trip generation rates that are the basis for the transportation portion of the impact fee. Under the Study methodology, trip generation rates are adjusted to avoid double counting a given trip at both the origin and destination points. Hence, the basic trip adjustment factor is 50 percent.<sup>19</sup> Based on various factors and assumptions, the Study adds an additional four percent to the weighting of residential development to account for home to work trips by commuters *leaving* the County for work.<sup>20</sup> As a result, residential development trips are weighted at 54 percent rather than 50 percent. However, the Study fails, without explanation, to make a similar adjustment for commercial development to account for commuters who live in other counties but who *enter* the County in order to work. As a result, the Study appears to impose upon residential development an unjustifiably high portion of any transportation impact fees the County might eventually charge.

**Recommendations:** Realtors<sup>®</sup> should ask the County to explain why trip generation rates have been adjusted in a way that favors nonresidential development at the expense of residential development.

- **Issue: The Study places a disproportionate share of the community college and the general government impact fees on residential development by failing to allocate certain costs to nonresidential development.**

The Study neglects to allocate some portion of the costs of the impact fees for the local community college to nonresidential development. The Study asserts that new residents will be the main beneficiaries from improvements at Chesapeake Community College (the “College”), and thus proposes to apply impact fees for this purpose only to new residential development.<sup>21</sup>

Community colleges are widely considered to be critical components to local and regional economic development. The United States Department of Education reports that community colleges are the nation’s largest provider of occupational skills training.<sup>22</sup> As such, it is disingenuous to assert that improvements to community colleges will primarily benefit new residents. According to its website, the College provides significant workforce training opportunities for regional businesses.<sup>23</sup> The College’s Office of Continuing Education & Workforce Training states that it “specializes in meeting the training needs of employers throughout the region . . . .”<sup>24</sup> The College boasts that it will work with businesses “to design, develop and deliver the training [they] need to meet [their] productivity and continuous improvement goals.”<sup>25</sup>

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<sup>19</sup> *Id.* at 36.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.* at 44.

<sup>22</sup> See *The Role of Community Colleges in Workforce and Economic Development*, U.S. Department of Education Office of Vocational and Adult Education, at <http://www.ed.gov/about/offices/list/ovae/pi/cclo/workforc.html> (last viewed July 6, 2004).

<sup>23</sup> See *Continuing Education & Workforce Training*, Chesapeake Community College at [http://www.chesapeake.edu/continuing\\_ed/default.asp](http://www.chesapeake.edu/continuing_ed/default.asp) (last viewed July 6, 2004).

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

The Study also fails to allocate some portion of the costs of the impact fees for certain general government facilities to nonresidential development. In particular, the Study explicitly states that “[t]he Health Department is allocated fully to residential demand since residents are the beneficiaries of services provided at that facility.”<sup>26</sup> According to the County’s own website, however, the Talbot County Health Department (“the “Health Department”) and its Office of Environmental Health (the “Office”) conducts a host of activities that directly benefit nonresidential uses. For example, the Office’s food control program conducts plan review and pre-opening inspections of new facilities; issues an annual food service operating license for all facilities; conducts regular inspections of existing facilities; maintains records and inspections of temporary or special food events; and investigates all complaints and suspected food borne illnesses and the collection of food samples<sup>27</sup>. The Office also licenses septic contractors and haulers, and conducts various other activities related to on-site sewage disposal that presumably benefit nonresidential development.<sup>28</sup>

In addition, the Study fails to allocate any portion of the costs of parks and recreation facilities to nonresidential development. It stands to reason, however, that the Study should also have allocated some portion of the costs of impact fees for parks and recreation facilities to nonresidential development. It seems likely, for example, that the County’s community center, community parks, and golf course are probably used by local businesses for various functions. To the extent that this is true, the Study unfairly shifts the burden of impact fees to residential development.

**Recommendations:** Realtors<sup>®</sup> should ask the County to justify the exclusion of nonresidential development from the impact fees proposed for various types of facilities, and should urge the County to allocate a reasonable share of such fees to the nonresidential development that will ultimately benefit from services provided at facilities such as the College.

- **Issue:** The County is considering an amendment to the Bill that would define affordable housing and add affordable housing to the list of exemptions from impact fees.

An amendment to the Bill would create a limited exemption from impact fees for certain affordable housing. An affordable housing exemption would only be allowed if the applicant proposes to build no more than 40 non-exempt homes for the entire project. Such an amendment helps to alleviate the effect of the impact fees on housing affordability for the County’s lowest income residents. However, depending on whether and how the amount of the impact fee is adjusted to account for the exempted development, it also could have the effect of causing other development to subsidize the provision of facilities for the exempted development. For example, unless the exempt development’s share of development impact on capital facilities is offset out of general revenues or borrowing, the level of impact fees imposed on other new development may have to be raised to make up for the shortfall caused by the exemption.

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<sup>26</sup> Study at 32.

<sup>27</sup> Talbot County Health Department, Office of Environmental Health, Food Control Program, at <http://talbothealth.org/html/chfood.html> (last visited July 8, 2004).

<sup>28</sup> Talbot County Health Department, Office of Environmental Health, On-Site Sewage Disposal System Program, at <http://talbothealth.org/html/ehdisposal.html> (last visited July 8, 2004).

Under one version of the amendment, the exemption would terminate if the property is sold for more than \$140,000 or if the unit is improved so that it no longer satisfies the criteria for affordable housing. If that version of the amendment were passed, it appears that it could result in an affordable housing exemption being terminated retroactively—if an exempt unit ceases at some point to qualify as affordable housing—whether because of changes made to the property or its ownership, or simply as a result of inflation over time. The unit would then be subject to development impact fees at that time.

**Recommendations:** Realtors<sup>®</sup> should ask the County to clarify its objectives with respect to the proposed amendment. In particular, Realtors<sup>®</sup> should ensure that the County intends to offset the effects of the exemption with its general revenues rather than through future increases in the amount of impact fees imposed on non-exempt development. Realtors<sup>®</sup> should also note that the version of the amendment providing for retroactive payment of the impact fee upon the appreciation of the property seems unfair and could have the unintended effect of creating a disincentive for housing maintenance and investment.

- **Issue: The Study fails to provide credits for certain payments properly allocable to new development.**

The Study appropriately offsets with credits a portion of the calculated cost of the proposed impact fees. However, it is not clear that the Study includes credits for all payments that might be attributable to a particular dwelling unit. For example, property taxes paid for vacant land where no services have ever been received are not credited. Landowners who have paid property taxes over the years on their vacant land holdings will have contributed to the capital costs for public facilities previously constructed using County tax money, even though the land generated no demand for those facilities while it was vacant. To the extent that the impact fee seeks cost recovery for these expenses, such as for the recreational pools, and the elementary schools and community college buildings, it is arguable that the portion of prior tax payments that went to pay for those capital facilities should be credited against any impact fee imposed on housing later developed on the vacant land.

**Recommendation:** Realtors<sup>®</sup> should ask the County to provide a credit against impact fees in an amount sufficient to offset the amount of tax payments made while the land was vacant that were used to pay for facilities that are to be funded through impact fees premised on a cost recovery approach.

- **Issue: The Study appears to contain arithmetic errors that could affect the amount of the impact fees ultimately charged.**

In several places, the Study contains either simple arithmetic errors, or rounding errors. While it is possible that these errors could have some small effect on the amount of the impact fees assessed by the County, the errors are perhaps more significant for what they suggest about the level of care that went into preparing the Study. For example, the Study appears to contain an erroneous calculation of price per acre of open space. According to the Study, recent open space

acquisitions of .68 acres at a cost of \$310,000 results in a price per acre of \$457,238.<sup>29</sup> In fact, the total price per acre based on those figures is \$455,882.<sup>30</sup>

The Study also states that the total capital cost per student is \$12,380 for middle schools, and \$11,834 for high schools.<sup>31</sup> Based on the Study's own figures, we calculate the total capital cost per student as actually \$12,355 for middle schools,<sup>32</sup> and \$11,851 for high schools.<sup>33</sup>

In addition, the Study appears to erroneously calculate cash flow for various capital facilities. For example, the Study appears to misstate both the annual surplus or deficit and the cumulative surplus or deficit for libraries,<sup>34</sup> parks and recreation facilities,<sup>35</sup> public schools,<sup>36</sup> and transportation.<sup>37</sup> The Study likewise misstates the cumulative surplus or deficit for general government<sup>38</sup> and community college facilities.<sup>39</sup>

**Comments and Recommendations:** Some of the discrepancies described above may be due to rounding errors, while others are apparently simple mathematical mistakes. To the extent that the discrepancies are due to rounding, then Realtors<sup>®</sup> should rely upon the accuracy of those figures, as rounded. However, we note at least one place where the Study specifically noted that figures were "rounded,"<sup>40</sup> suggesting that the discrepancies noted above either were not based on rounding, or that the Study failed to clearly indicate where numbers had been rounded and where they had not been. Moreover, it appears that at least some of the discrepancies noted above are simple mathematical mistakes that have survived the various drafts of this Study. This suggests a level of sloppiness in preparing the Study that calls into question the Study's accuracy in other respects, including the various assumptions and hidden calculations that form the basis for the level of impact fees ultimately recommended. As one leading treatise on impact fees has noted, "[e]xperience has shown that if a citizen sitting in a public hearing with a hand calculator is unable to arrive at the same numbers shown in the methodology, great confusion can result. This confusion can be magnified out of all proportion to the few cents often at issue."<sup>41</sup>

▪ **Issue: The Study relies upon national, rather than local, data.**

In calculating impact fees for local government facilities, the Study relies upon multipliers for the number of employees per 1,000 square feet of floor area that are derived from nationwide averages published by the Institute of Transportation Engineers and the Urban Land Institute.<sup>42</sup> By using national, rather than local data, the Study may or may not accurately calculate fees by

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<sup>29</sup> Study at 15.

<sup>30</sup>  $\$310,000 / .68 = \$455,882$ .

<sup>31</sup> Study at 29.

<sup>32</sup>  $130 \times \$132 \times 72\% = \$12,355$ .

<sup>33</sup>  $177 \times \$93 \times 72\% = \$11,851$ .

<sup>34</sup> Memorandum to County Manager R. Andrew Hollis, dated January 16, 2004, at 2.

<sup>35</sup> *Id.* at 3.

<sup>36</sup> *Id.* at 4.

<sup>37</sup> *Id.* at 7.

<sup>38</sup> *Id.* at 5.

<sup>39</sup> *Id.* at 7.

<sup>40</sup> Study at 14 (noting that improvement costs per acre is a rounded figure).

<sup>41</sup> James C. Nicholas, Arthur C. Nelson & Julian C. Juergensmeyer, *A Practitioner's Guide to Development Impact Fees* 95 (Planners Press 1991).

<sup>42</sup> Study at 33.

type of nonresidential development for the County's government facilities. National data on the number of employees per 1,000 square feet of floor area for nonresidential development may well differ from similar data collected in the County or in the State of Maryland, and might accordingly overstate or understate the proportion of impact fee for government facilities that should be attributed to various nonresidential uses in Talbot County. National ITE data is also used to calculate the transportation impact fees, and the same issue applies. The impact fee consultant presumably used national data because it was quicker and easier to do so than to research or develop more specific local data.

**Recommendations:** Realtors<sup>®</sup> should ask the County whether there was an effort made to identify or develop more specific local data rather than rely on national data. To the extent that reliable local data is available, the County should be asked to justify its reliance on national data sets.

▪ **Issue: The Study proposes to finance the consulting fee with impact fee revenues.**

The Study proposes to incorporate the consulting cost into the impact fee for each type of public facility, while providing no substantive explanation of how the consulting cost was calculated. In total, the Study proposes to allocate to each single family residential dwelling a total of \$134 to reimburse the county for the cost of the Study. The Study does not provide the overall consulting charge. Moreover, the Study does not explain how the consultant cost was allocated across each type of public facility, other than to say that the charge was calculated based on projected growth in the County's population over the next five years.<sup>43</sup>

The Study's conspicuous absence of detail on consulting charges makes it difficult, if not impossible, to evaluate the amount of the consulting fee that could be allocated for each type of public facility. We are unable to determine, for example, whether it is fair for the Study to include \$113 per student, and not some other amount, for the impact fee associated with each type of public school (elementary, middle, and high).

We also question whether it is appropriate for the Study to shift the entire burden of the consulting cost to new development, when the County as a whole—including existing residents and businesses—is affected by the results. To the extent that the Study proposes to shift the entire burden of the consulting charges to new development, the Study provides an inequitable subsidy to the County's existing residents.

This element of the proposed impact fee is an unusual one in our experience. Of the several jurisdictions in which we have reviewed impact fee studies and methodologies as part of the Land Use Initiative, this is the only one we recall in which we have identified this approach to the recovery of consulting fees.

**Recommendations:** Realtors<sup>®</sup> should question the County as to the nature and amount of the consulting fee and whether it is appropriate that the fee be incorporated into the calculation of impact fees for capital facilities. Realtors<sup>®</sup> should question in particular whether it is appropriate for new development to bear the entire burden of the consulting cost, and should ask the County to explain the basis for excluding existing County residents from sharing this burden. Realtors<sup>®</sup>

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<sup>43</sup> See *id.* at 11.

should also ask the County to clarify how consultant costs were allocated across the various types of public facilities evaluated.

- **Issue: The Study uses the same discount rate for each type of capital facility for which it calculates a credit.**

The Study calculates as a credit an amount intended to offset the contributions the new development will make out of future tax payments toward the County's future principal payments on existing general obligation bonds that were issued to pay for facilities that are the subject of an impact fee. Whenever it does so, the Study relies upon a 5 percent discount rate. In other words, to account for the time value of money, annual principal payments for certain capital facilities are discounted using the net present value formula based on what the Study claims is the going interest rate for the bonds.<sup>44</sup> While we do not question the Study's calculation of credits using the net present value formula, we are not familiar with the County and with whether the interest rate on the bonds issued to account for the specified facilities is always 5 percent.

***Recommendation:*** Realtors<sup>®</sup> should use their knowledge of the County's borrowing to determine whether the Study has used the correct discount rates for the capital facilities for which a credit is calculated.

- **Issue: The Study does not provide credits for interest payments on the bond amounts.**

The Study states that it applies a credit only for future principal payments on outstanding general obligation bonds and not for future interest payments on such debt "because interest costs are not added to the impact fees." However to the extent an impact fee is paid in year one, there is no need for the County to borrow that amount in future years, and so we question the basis for having the impact fee payer cover the principal *or* the interest on borrowing for the same public facility through its taxes.

***Recommendation:*** Realtors<sup>®</sup> should ask the County to explain why impact fee payers are not credited for the interest on general obligation borrowing that will be covered by their future tax payments, to the extent that the impact fee is intended to cover the same capital facility for which the borrowing was authorized.

- **Issue: The Bill authorizes an annual adjustment that is based upon national data.**

The Bill would authorize an annual adjustment to account for inflation, which would be based on the most recent 20-city annual national average data from the Engineering News Record Construction Cost Index.<sup>45</sup> By relying upon national average data from a 20 city index, the County could impose higher impact fees even when there is little or no inflation in the County.

***Recommendation:*** Realtors<sup>®</sup> should ask the County to justify its reliance upon national data as a basis for charging higher impact fees, rather than local data which would presumably be more pertinent to the actual increase in local costs.

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<sup>44</sup> See, e.g. Study at 9-10.

<sup>45</sup> Bill at § 64-13(b).

- **Issue: The Bill could penalize the wrong person in the event an impact fee is not paid.**

The Bill would allow the County Attorney to file suit in the event a development impact fee is not paid as required, and would expressly place the responsibility for the costs of any such suit on “the person who fails to pay.”<sup>46</sup> The Bill’s present language is ambiguous, and raises questions about who could and should be held responsible for the costs of any legal proceedings to recover unpaid impact fees.

***Recommendation:*** Realtors<sup>®</sup> should ask the County to revise the Bill to clarify that the responsibility of the cost of any suit to recover unpaid impact fees should be placed upon the person that owns the property at the time the unpaid fee is assessed.

- **Issue: The Bill does not adequately ensure that refunds will be available to property owners that should be entitled to a refund.**

The Bill states that property owners who have paid an impact fee that the County has failed to use or appropriate “may apply for a refund” of such fees.<sup>47</sup> Moreover, the Bill would exact a 2 percent administrative fee, or up to \$500, on the amount of any refund granted, even where the County’s failure to use impact fee revenues is the result of circumstances beyond the impact fee-paying landowner’s control.<sup>48</sup> The Bill does not say how much time the County has to process refund applications.

***Recommendations:*** Realtors<sup>®</sup> should ask the County to revise the Bill so that it states that upon application such property owners “shall be entitled to a refund.” Realtors<sup>®</sup> should also ask the County to revise the Bill so that the refunds of such property owners are not reduced by an administrative fee to defray County expenses when the County’s own actions or decisions are the cause of the fee not being used. Realtors<sup>®</sup> should ask the County to include within the Bill language that specifies the precise amount of time the County has to process refund applications, and to ensure that such time is minimal.

- **Issue: The Bill fails to specify how much time the County has to respond to appeals.**

The Bill allows aggrieved persons to appeal final decisions of the County to the County Board of Appeals,<sup>49</sup> but does not specify how much time the County Board of Appeals has to respond to such appeals or even whether the appealing party would be entitled to such basic due process rights as the opportunity to be heard.

***Recommendations:*** Realtors<sup>®</sup> should ask the County to include within the Bill language specifying the precise amount of time the County Board of Appeals has to respond to any appeal. Realtors<sup>®</sup> should also ask the County to include language that expressly states the rights of the party appealing a final decision of the County relating to development impact fees.

## GENERAL COMMENTS ON IMPACT FEES

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<sup>46</sup> *Id.* at § 64-14(c).

<sup>47</sup> *Id.* at § 64-20(b).

<sup>48</sup> *Id.* at § 64-20(d).

<sup>49</sup> *Id.* at § 64-22.

Below we provide some additional comments on impact fees generally, to provide Realtors<sup>®</sup> with some additional perspective on and policy arguments concerning the County's proposal.

- **Development Costs**

One of the main and most enduring criticisms of impact fees is that they can have adverse effects on the market for housing and on profit margins for developers. The burden of impact fees must be borne by developers or homebuyers or, more likely, both developers and homebuyers in a relative proportion that depends on market factors. The party that ultimately bears the burden of impact fees will depend on many factors, including local elasticities of supply and demand. As a practical matter, growth and desirability in a given real estate market tend to introduce a degree of inelasticity (i.e., lack of responsiveness to changes in price) in the demand for housing, especially for new construction. Thus, where demand is relatively inelastic, costs may more easily be shifted to consumers. On the other hand, if impact fees are imposed in distressed, non-growing, or less desirable areas, it is more likely that builders and developers will be unable to recover their increased costs and will have to absorb the fees as lower profits. If impact fees act as a disincentive for developers to develop new housing in that jurisdiction, the effects may spill over to the local economy, affecting both its attractiveness to new investment and its ability to grow. In this way, impact fees have the potential to cause negative socioeconomic effects.

- **Housing Affordability**

To the extent that impact fees are passed through to the purchasers of new homes, housing affordability will be affected and low-income buyers may be priced out of the market. Studies have shown that in practice impact fees do increase the cost of new housing. According to one study:

[I]mpact fees are significantly increasing the costs of new housing in the eight Chicago suburbs studied. Many of those increased costs—which municipal officials often claim are paid by developers—are (to varying degrees) being passed on to homebuyers. Impact fees may have a disproportionately negative effect on low- and middle-income families seeking to become suburban homeowners: not only do the fees represent a higher percentage of the sale cost of a lower-priced home than a higher-priced home, but they also may encourage developers to build higher-priced houses, thus pricing lower-income families out of suburban neighborhoods.<sup>50</sup>

When the cost of new construction rises, existing homes become increasingly preferred and their price is bid up until relative equilibrium is restored. Thus, impact fees have a direct negative effect on housing affordability, and that effect may be exacerbated by creating a tendency in developers to shift the type of housing they produce to a more “upscale” product where there is a market for such a product. At some point, impact fees may become so high that the most affordable housing development becomes infeasible or unprofitable, while higher-end housing developments remain profitable.

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<sup>50</sup> Brett M. Baden, et al., *Effects of Impact Fees on the Suburban Chicago Housing Market 3* (1999), available at Heartland Institute Policy Study No. 93 at <http://www.heartland.org/studies/baden-ps.pdf>.

According to MAR data for 2003, the *median* value of a single family house in Talbot County in 2003 was \$246,750.<sup>51</sup> The proposed \$5,153 impact fee for single family detached housing in Talbot County outside Easton would amount to a 2.1 percent increase in that median price. Talbot County's median single family house price in 2003 was the fourth highest of all Maryland counties, and its 2003 *average* house price of \$432,994 was the highest of any county in Maryland.<sup>52</sup>

Some jurisdictions provide an exemption from impact fees for housing that qualifies as "affordable," although this also raises issues of fairness and uniform treatment of new residents. We noted above some concerns about the proposed amendment to the Bill intended to address "affordable" housing.

#### ▪ **Land Development Patterns**

Because impact fees increase development costs, they can affect where and how land is developed. For example, all else being equal, if impact fees are imposed in one jurisdiction but not in contiguous or neighboring jurisdictions, one would expect the jurisdiction without impact fees to experience more development. And if higher impact fees are imposed in one jurisdiction than another, all else equal, developers will tend to favor the jurisdiction with the lower fees.

**Recommendations:** Realtors<sup>®</sup> should ask whether Talbot County has undertaken any study of what effect the proposed impact fees will have on housing affordability, housing quality, and housing mix in the jurisdiction and should encourage County officials to evaluate these effects as part of the process of deciding whether to impose an impact fee and at what level any such fee should be set.

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<sup>51</sup> Maryland Association of Realtors<sup>®</sup>, Housing Statistics: 2003 Year End, at [http://www.mdrealtor.org/consumer\\_housingstats\\_yearend\\_2003.asp](http://www.mdrealtor.org/consumer_housingstats_yearend_2003.asp) (last viewed July 12, 2004).

<sup>52</sup> *Id.*

