POLICY BRIEF

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The Effects of Impact Fees on Housing and Land Markets

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An increasing number of local communities in the United States have sought alternatives to the property tax as a means of financing capital improvements or other expenditures. Prominent among these are development impact fees, which are one-time levies assessed on property developers ostensibly for the provision by the local government of infrastructure services (such as roads, schools, and parks) for the additional population that is caused by the development. Florida is among those states that have taken a lead in the adoption of impact fees. In a recent survey of Florida's counties conducted by the DeVoe Moore Center, of the 42 (out of 67) counties that responded, 25 (or 59%) impose impact fees on new development. The most popular types of fees are those earmarked for transportation facilities (96% of all counties that impose fees use this type), parks and recreation (64%), and schools (48%).

The principal source of the growing popularity of impact fees is that traditional property tax financing of the public capital services (or infrastructure) required by new residential development increases the tax burdens of existing homeowners. Homeowners perceive these higher taxes as unfair because they enjoy few benefits from the new infrastructure that is built for the residents of new subdivisions located far away on the fringes of their metropolitan area. Impact fees are seen as a way to shift the costs of new infrastructure to where they belong; namely, to buyers of new housing who directly benefit from the new infrastructure. Presumably, new home buyers will pay for this infrastructure because the fees that are assessed on developers will simply be added to the prices they charge for their new homes.

Recent theoretical advances in the public finance literature have questioned the prevailing opinion that impact fees levied on developers are passed on to new home buyers. The "New View" theory of impact fee incidence argues that if developers attempt to raise their new house prices to cover the impact fees they must pay, people will respond by purchasing their new home in other jurisdictions that do not have impact fees or have lower impact fees. Alternatively, new residents can avoid paying impact fees by purchasing existing rather than new housing. Because home buyers are mobile (across jurisdictions and between new and existing homes), the conclusion of the new view is that impact fees will not be borne by buyers of new housing.

Who then bears the financial burden of the impact fees imposed on new development? According to the New View, the answer to this question hinges upon the property tax savings that new homeowners expect to enjoy as the result of shifting the financing of new infrastructure from property taxes to impact fees. The greater the property tax savings that homeowners expect, the more they will be willing to pay for housing (both new and existing) within the jurisdiction. If the increase in house prices that results from these property tax savings equals or exceeds the fees that developers must pay, there is no financial burden on any party that results from the imposition of the fees: developers continue to make a competitive rate of return; buyers of new housing pay a higher price, but are compensated by the property tax savings they will enjoy in the future; and existing homeowners enjoy a capital gain when they sell their homes. However, if the expected property tax savings from the adoption of impact fees are relatively small, the increase in the price of housing within the jurisdiction will be less than the fees assessed on developers. Because developers, like homebuyers, are mobile, they must earn at least a competitive rate of return in order to continue building homes within the jurisdiction. Hence, the New View predicts that developers will be willing to pay less for land within those jurisdictions where the increase in the price of housing (i.e., the savings in property taxes) is less than the increase in fees.

An Empirical Test of the New View Theory of Impact Fees

To investigate the predictions of the New View, an empirical study was conducted of the effects that impact fees imposed by Dade County, Florida have had on the prices of new homes, existing homes, and vacant residential land. The first impact fee adopted by Dade County was in 1989 and was earmarked for road construction. Since then the total amount of fees has grown as fees for parks, education, fire protection, and police protection were added and existing fees were increased. Today, for the new home with the mean amount of square feet of living area (all of the fees are flat fees except the education fee which is based on square footage), total fees equal $5,239 within Dade County.

To study the effects that impact fees have on housing and land prices, a two-stage methodology was utilized. In the first stage, monthly indices of the price of constant–quality new and existing housing and undeveloped residential land were constructed using property sales data obtained from the Dade County Property Appraiser for the years 1985 – 2000. In the second stage an econometric model was estimated that related intertemporal changes in these indices to changes in impact fees and an extensive set of control variables.

The results show that an additional $1.00 of impact fees increase the price of both new and existing housing by about $1.60 and reduces the price of vacant land by about $1.00. The results from the estimation of another econometric model show that the present value of the property tax savings caused by an additional $1.00 of impact fees equals $1.20. As predicted by the New View, there is therefore a correspondence between the effects of impact fees on housing prices and their effects on the property tax savings of individual homeowners. The results are also consistent with the New View in that the price of new and existing housing is found to increase by the same amount. This is expected since both the owners of new and existing homes enjoy the same millage rate reduction from the imposition of impact fees.

While the effects of impact fees on housing prices are consistent with the New View theory of impact fees, the finding that land values decline would appear to contradict this theory. Why should developers pay less for land if the impact fees that they pay can be fully recovered in the price they charge for new homes? There would seem to be no reason for fees to be shifted backward to landowners. However, developers' bids for land are based upon the profits they expect to earn sometime in the future when their new homes are offered to the market. Considerable time may pass between the purchase of the land and the payment of impact fees. As is generally the case, in Florida impact fees are assessed at the time building permits are issued. Local land use regulations often add long delays to the development process. For example, before building permits can be issued, subdivision permits must be obtained, re-zoning of existing parcels from agricultural use may be necessary, and environmental impact statements must be filed. Given the steady increase in impact fees within Dade County since their inception, developers may expect that because of these regulatory delays the fees that will affect them will be higher than those currently in place. There may also be considerable uncertainty over the impact these higher fees may have on housing prices. The results suggest that developers' uncertainty over impact fees cause them to lower the price they are willing to pay for land.

Policy Implications

The compelling logic of the New View theory of impact fees along with the empirical support provided for Dade County strongly suggests that common beliefs regarding the effects of impact fees are probably wrong. Impact fees are not really like excise taxes on cigarettes or beer that are simply shifted forward to the final consumer in the form of a higher price. The effects of impact fees are more complicated and depend on the savings in property taxes expected by home buyers and the expectations that developers have regarding future fees. Fees will have a neutral effect on new homebuyers and a positive effect on existing homeowners, but may have a negative effect on the owners of undeveloped land. These positive and negative effects should be carefully weighted by jurisdictions before they impose impact fees on new development.

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