The John C. Stennis Institute of Government

TECHNICAL BRIEF

Issue: 200-1203 January 2007

DEVELOPMENT IMPACT FEES: CONSIDERATIONS FOR LEGISLATIVE INITIATIVES

BY
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Introduction.

This past June 15, the Mississippi Supreme Court addressed impact fees in the case of *Mayor and Board of Aldermen, City of Ocean Springs, Mississippi vs. Homebuilders Association of Mississippi, Inc.* Impact fees do not have a good track record in Mississippi[1]. However, as tax revenues are outpaced by the need to provide municipal services, the ability of a government entity to exact money from a developer in return for the approval of a project, or ancillary to that approval, will remain a hotly debated area of real estate development law.

Mississippi's municipalities have traditionally used sources of revenue which are available to most municipalities nation-wide: sales and property taxes, grants and bonds. Increasing fiscal pressures are causing local governments in Mississippi and elsewhere to search for ideas to supplement these traditional sources. Two popular concepts of tax supplementations which have seen growth nationally in the last two decades are user fees and impact fees. As the names would suggest, user fees are fees imposed for the use of specific services, while impact fees are generally defined as a one-time charge in order to collect funds for providing infrastructure required by the impact of, for example, a proposed community development such as a subdivision or mall.

The methods by which a municipality can deprive an owner of all or a portion of his land value have changed materially through the history of the Republic. While early case law suggests that *eminent domain* proceedings were the sole way that a citizen could be deprived of his property, developmental impact fees, which began to be applied in local communities in the United States in the early 1980s, pose a modern paradigm of deprivation.

Developmental impact fees were an outgrowth of basic land use regulations viable in almost all localities throughout the nation -- generally referred to as exactions -- where approval of a proposed development could be conditioned upon contributions from the

[1] *See*, for example, *Home Builders Assn. of Ms., Inc., et al. v. City of Madison, MS, et al,* 10 F. Supp. 2d 617 (SD MS 1997).

developer to assist the governmental entity. Traditional land use exactions were in the form of easements for public facilities such as streets to connect the proposed development, or land for parks to serve the proposed development. These remain the most common type of exaction, known in zoning jargon as "inter-developmental dedication." They are easily justified by local government, which is charged with an interest in protecting the health, safety and welfare of the community, and most theorists consider it logical to place the costs of these infrastructures on the people who create and benefit from the improvement – the developer. Being "inter-developmental" they are specifically tied to the development. The park is placed *in* the development, as are the roads which are ultimately dedicated to the local governing authority.

Grafted upon the inter-developmental dedication, the development impact fee is an exaction designed to ensure that developers (and new residents, if passed on through land acquisition costs) pay their proportionate share to finance improvement associated with new development. The rationale associated with the development impact fee is that *but for the development*, the locality would not be required to provide additional municipal services. It is the balancing of interests between the governing authority and the interests of the developer and the long-term resident and the newcomer which engages the contretemps. Who should pay, and why?

A Short History of Impact Fees.

After controversy in a number of states, the 20th century closed with thirty-three of fifty states granting governmental entities authority to impose development impact fees. Impact fee enabling legislation has been passed by legislatures in twenty-nine states. Of these twenty-nine, five restrict the use of the fees exclusively to local road construction. The remainder do not define usage parameters *per se*, so long as it is consistent with the statutory language.

A number of municipalities in the twenty-one states without enabling legislation have also sought to develop impact fee policies through ordinance, relying on home rule authority, or authority derived from general police powers of the municipality. Courts in the states of Kansas, Wyoming, Florida and Ohio have approved a local government's authority to adopt impact fees even in absence of specific enabling legislation. Despite the controversy in Mississippi and other jurisdictions, development impact fees have grown in popularity with municipal leaders across the nation. These local leaders have seized the opportunity to fund community services by to targeting (and taxing) new development.

A principal controversy in the impact fee debate is the question: is the impact fee a *fee* or a *tax*.? Many states, Mississippi included, recognize that the authority to tax must be specifically given to the taxing authority by the legislature.[2] However, a fee may be imposed as a part of the exercise of general police powers of a municipality.

The *Ocean* Springs case turned on this issue (tax vs. fee); thus, the arguments considered by the Court are worthy of consideration. Opponents classify the impact fee as a regressive tax directed toward the potential home-buyer in the proposed development and easily passed on to him or her by the developer through lot pricing. They also argue that the

[2] *Adams v. Kuykendall*, 35 So. 830 (Miss. 1904).

impact fee is a derivative zoning ordinance which allows the city, through impact fee imposition, to manage and control development. There is some merit in the land management argument; longitudinal studies suggest that the imposition of development impact fees does tend to control growth.

Proponents of impact fees argue that the developer, by paying the impact fee, insures that his development pays its fair share of on-site and off-site infrastructure development and re-development, thus reducing the traditional tax burden on all property owners. They also argue that impact fees allow a community with "demand to expand" the ability to do so even if it has otherwise reached the limit of its taxing or bonding authority.

Studies in the last decade of the 20th century on the viability of developmental impact fees reported mixed results. A study from Sarasota County, Florida, in 1992 (Florida was one of the first states to implement impact fees) reported the following results: (1) a generally positive impact on planning; (2) promotion of equity among developments through a well-constructed schedule of variable fees; (3) increased lot values and the cost of home ownership.[3] A late 90's national study connected the use of impact fees with lower levels of capital development, and also noted that the use of impact fees to implement "no-growth" policies was effective.[4] A mid-decade study suggested that impact fees force developers "to consider infrastructure costs" and may "act to align private and public agendas, and eventually lead to more sustainable long-term growth."[5]

Contemplations.

A review of the literature suggests that there are three characteristic components which, when one or more are present, cause governing authorities to consider the use of development impact fees: (1) communities experiencing moderate to rapid growth; (2) communities which are already facing high property taxes; and/or (3) communities where there exists a large capital investment to maintain. The principal policy question is the one of balancing of interests: *Should the cost of the new infrastructure be charged directly to the new residents? Or should it be shared, in terms of increased taxes, among all current residents?*

Remember Proposition 13? In western states, taxpayer revolts, coupled with a need for new facilities to serve new and developing communities, expedited the implementation of development impact fees, which began in Arizona. The Arizona initiative was popular because, by the use of development impact fees, costs necessary to the new development were charged to the new users, while previous residents enjoyed the benefits from construction of the new facilities without paying for them. The premise, then, delivered from Arizona, is that developers should pay the full marginal costs of providing facilities necessary to accommodate growth.

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[3] Nelson, A. C., Frank, J. E. & Nicholas, J. C. (1992). Positive Influence of Impact Fees in Urban Planning and Development. *Journal of Urban Planning*, 118 (2), 59-64.

[4] Clark, W., Evans, J. (1999). Development Impact Fees and the Acquisition of Infrastructure. *Journal of Urban Planning*, Vol. 21, No. 3 (Sept. 1999), 383-407.

[5] Brueckner, Jan, 1997. Infrastructure Financing and Urban Development: the Economics of Impact Fees. *Journal of Public Economics*, 66 (1997), 383-407.

"Model" Legislation: What we can learn from Wisconsin

Arizona's, Florida's and California's legislatures were three of the first to take up the issue of development impact fees, and they are often held up as favored legislation. However, legislative action taken by subsequent states have merit, since they contemplate decisions rendered by various courts, including the United States Supreme Court, subsequent to the initial legislative endeavors. Authorities consider Wisconsin's statute, Wis. Stat. § 66.55 (2), to be one of the more well-drafted. It states, in pertinent part:

> A political subdivision may enact an ordinance under this section that imposes impact fees on developers to pay for the capital costs that are necessary to accommodate land development.

The Wisconsin legislature defined "capital costs" as costs to construct, expand or improve public facilities, which they in turn defined to include highways, sewers, drainage facilities, parks, playgrounds, solid waste and recycling facilities, fire protection, law enforcement, emergency medical facilities and libraries. The Wisconsin law excluded from the definition of public facilities "any property that will be owned by a school district." School districts in many states, however, have sought to charge impact fees on new houses constructed in the school district's geographical contours.[6]

Other aspects of Wisconsin's impact fee statute which demonstrate the drafters' understanding of federal case law on the subject include:

- An ability to impose different impact fees in different geographic zones so long as a rational justification exists for the differing fees;
- An exemption or reduced fee for promoting the development of low cost housing;
- Separation of impact fees from all other local funds;
- Utilization of impact fees only for the capital costs for which the fees were collected;
- A "return option" where fees which are not utilized within a reasonable time for the purposes imposed and collected will be returned to the developer;
- Required public hearings; and
- Required administrative procedure to contest the amount, collection or manner of use of an impact fee by the local collecting authority.

The Wisconsin statute seems to have confronted issues raised by case law and handled them masterfully. It recognizes the holding in *Nollan v. California Coastal Commission*, 43 U.S. 625 (1987), a United States Supreme Court decision, that it is critical that an impact fee ordinance bear a "rational relationship" to the need for new facilities to serve the development. In other words, a local entity utilizing impact fees must be prepared to show that the impact fee collected is necessary to meet the increased needs created by the

[6] See, for example, the fight between Owen J. Roberts School District and the Pennsylvania Builders Association.

development. The meaning of this "rational relationship" test established in *Nollan* was enhanced seven years later when the U. S. Court elaborated on in *Dolan v. City of Tigard*, 512 U. S. 374 (1994), adopting a "rough proportionality" test which reiterated and enhanced the nexus between the new facilities and the requirement that fees are utilized for increased needs created by the development. The Court in *Dolan* noted that the proper standard for determining when the exacted condition has the effect of a taking under the Fifth Amendment is the "rough proportionality" test, which places the burden on the city, rather than the property owner challenging the exaction, to make "*some sort of individualized determination* that the required dedication is related *both in nature and extent* to the impact of the proposed development."

Mississippi's Status

The Mississippi Legislature has considered impact fees on several occasions, most notably in the 2000 Regular Session. HB 179 from that session, which died in committee, was, for that period, a piece of thoroughly considered legislation. Currently Mississippi has no enabling legislation authorizing the imposition of impact fees by municipalities or other governmental entities. In Governor Barbour's State of the State speech, January 6, 2006, he requested that the Mississippi Legislature authorize impact fees for local government development and re-development in the wake of Katrina. No action was taken in the 2006 sessions. At least one bill authorizing municipalities to adopt impact fee ordinances has been filed in the 2007 session.

While various municipalities around the state have considered impact fees, the City of Madison tirelessly invoked impact fees and litigated their viability. The ordinances, and the lawsuits that followed, settled nothing definitively. The primary result was a consent decree which established no legal basis from which other municipalities' activities could spring.

Contemporaneous with much of the activity in Madison, the Mayor and Board of Aldermen of the City of Ocean Springs, Mississippi, requested a "Development Impact Fee Report" in 2002. Thereafter, Ocean Springs adopted a comprehensive plan of zoning and municipal development which included an impact fee ordinance which authorized assessment, collection, and expenditure of develop impact fees for various municipal improvements, services, equipment and vehicles. In its comprehensive plan, Ocean Springs defined a development impact fee as:

> [a] fee relating to a capital expenditure or service provided by the City which is imposed on new development as a condition of approval of such development as a pre-requisite to obtaining development approval and which is calculated to defray all or a portion of the costs of capital improvements required to accommodate new land development at city-designated level of service standards and which reasonably benefits the new land development.

Ocean Spring's ordinance required that the fees be paid in addition to any and all other applicable land-use, zoning, planning, adequate public facilities, platting, or other related

fees, requirements, standards and conditions imposed by the City. The local Home Builders Association and the state association, together with various developers, volubly opposed the ordinance and, when it was adopted, filed a Bill of Exceptions appealing its validity. The attack on the ordinance ultimately reached the Mississippi Supreme Court, which issued the afore-referenced opinion in June of 2006.

Relevant findings by the Supreme Court are as follows:

- The Mississippi Legislature has never adopted a statute authorizing developmental impact fees or enabling legislation to authorize a city to adopt and implement impact fees.
- While other states have allowed municipalities to adopt impact fees without enabling legislation but by virtue of home rule authority, but there is no authority in Mississippi's home rule statutes or planning and zoning statutes which supports the use of impact fees.
- The funds raised in Ocean Springs appear to be available for general municipal purposes as a revenue measure.
- Ocean Springs was unable to convince the Court that the fees were for the benefit of new development, rather than the benefit of the city as a whole; the Court reiterated the Circuit Judge's finding that there "is little, if any, assurance that such funds provide a special benefit to the class upon whom the burden is imposed. Simply opening a special account earmarked for particular city services or facilities is insufficient to provide a 'special' benefit to those utilizing the service or facility."
- Impact fees are not *per se illegal* but the authority to implement the fees rests with the Mississippi legislature.

This last finding places the future of impact fees in Mississippi in the hands of the Legislature.

Considerations for Legislative Initiative.

If the legislature chooses to consider development impact fees in the 2007 session, it should measure draft legislation with criteria established by the United States Supreme Court. Impact development fees create a type of taking under the 5th Amendment to the United States Constitution, applied to the states by the 14th Amendment. As case law has established, there are three relevant constitutional tests which an impact fee statute must "pass" or conform to in order for the taking to be constitutionally sound. These tests are

- substantive due process
- equal protection, and
- takings.

Substantive due process requires that a local government have the authority to assess, collect and spend impact fees for a particular purpose and do so in a lawful way. Equal protection requires that the fees be applicable to all parties on the same basis. As an example, all new development that imposes an impact must be assessed the same kinds of fees, although the fees may vary by the magnitude of the impact on the community. A variety of takings tests have been applied to impact fees, depending on the jurisdiction.

Under one test, there must be a reasonable connection between the fee charged to the developer and the needs generated by the development. Known as the "reasonable relationship test", it developed out of California exaction practices and has been applied also by Illinois and Rhode Island courts. A second test is the "specifically and uniquely attributable test" which requires that the fee charged to a developer be directly and uniquely attributable to that development. Finally, the "rational nexus test" demands proportionality between the amount charged to the developer and the nature and type of facilities demanded by and generated for the development. Clearly, a recognition of relationship between the fee and the needs generated by the development should be drafted into any legislation.

Burdening Local Government

One thing is for sure: if the Legislature determines to adopt enabling development impact fee legislation, a significant burden will inure to the governmental entity that seeks to utilize it. While the prospect of the development impact fee may appear glamorous, it will require rigorous attention by the adopting governmental entity. The requirements of any sustainable legislation will require the governmental entity to engage in more professional and sophisticated capital facilities planning, which mandates the assistance of additional (and generally more sophisticated) administrative staff with the skills necessary to keep records appropriate to the measures, and consulting assistance on development of local ordinances, regulations and applicable policy which may result. In short, an impact fee scheme is more complicated and expensive to implement than general budgetary measures or planning and zoning policy. So even if the apparatus is made available, the burden is on the local government to handle the apparatus in a manner which will enable it to prove, for example, what the Mississippi Supreme Court said that Ocean Springs could not: that the funds assessed were being used to provide a special benefit to the class upon whom the burden was imposed.

Conclusion.

The decision to allow local governments to choose to utilize development impact fees as a method to finance an expanding infrastructure is a question for the Legislature. Should the Legislature determine to adopt enabling legislation on the subject, the question then becomes whether the Legislature, in addition to enabling legislation, will adopt additional criterion-based language or whether the Legislature will leave the criterion development to local governments *via* ordinance. Alternatively, the Legislature might consider establishing some criteria but allowing each local government a hand in further shaping its own impact fee design. Whatever entity becomes the ultimate designer, there is ample case law providing guidance. The designer must consider due process, equal protection and takings in articulating the standards for impact fees. With takings as the most fluid and controversial aspect of the development impact fee, special care should be exercised to ensure that the taking is rationally related to the development and does not overreach. And fundamentally, the ultimate fee collector – the locality – must be able to demonstrate viably that the fees were utilized for the stated purpose which, of course, must not deviate from legislative intent, be it from statute or ordinance.

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Quarles remains active in bar work, and currently chairs the Women in the Profession Committee, a standing committee of the Mississippi Bar. She also serves as co-chair of the Mississippi Supreme Court's "Gender Fairness Implementation Study Committee" and acts as the Chief Operating Officer of the Workers' Compensation Section of the Mississippi Bar. She is a fellow of the Mississippi Bar Foundation, a recipient of the Mississippi Bar's Distinguished Service Award, a member of the Mississippi School for Math and Science Foundation Board and a member of the MUW Alumni Board. Quarles was recently honored by the American Bar Association's Administrative Law and Regulatory Practice Section, receiving the Mary C. Lawton Award for lasting contributions to the Mississippi Workers' Compensation Commission in the areas of alternative dispute resolution and access for Hispanic workers.

In 2004, Quarles was named one of Mississippi's 50 Leading Business Women by the Mississippi Business Journal; the Journal recognized her service to the State as a Commissioner as well as entrepreneurial skills developed in her property management business in Starkville, Spruill Property Management, LLC

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